

ECONOMICS FORUM 2019



Foreign Direct Investment, the Pitfalls, Risks, and how to Mitigate the Risks

By

EurIng Prof. Colin Roberts

Natural Resource Geo-strategy Pty Ltd
Centre for International Dispute Resolution
WASM: Minerals, Energy and Chemical Engineering - Curtin University

23rd July 2019

© Colin Roberts

PERTH ISLAMABAD BRISBANE KAMPALA NOUAKCHOTT SOFIA HARGEISA EDINBURGH BELFAST LONDON

DISCLAIMER

- Any comments made by the Presenter/Author are the opinion of the Presenter/Author. They are not necessarily the opinion of the World Bank, MIGA or any Government, Institution or Corporation to which the Presenter/Author has association.

Who am I? and what do I do?

- **Petro-strategist & Resource Geo-strategist:**
 - International Commercial & Investment Arbitrator; Civil & Commercial Mediator; Adjudicator & Expert Determiner.
 - Resources & Energy Lawyer (Lawyer's Lawyer); Chartered Mining & Petroleum Engineer; Chartered Resources Scientist.
 - Resources Policy Adviser; Risk Mitigant.
 - Academic
 - Associates in Brisbane, Perth, Islamabad, Nouakchott, Sofia, Hargeisa, Belfast, Kampala, Edinburgh, London
- **Dedicated to:** the promotion of foreign direct investment (FDI) into developing countries to support economic growth, leading to the reduction of poverty and subsequently the reduction of conflict.
 - 25% of group time is undertaken *pro bono publico*

What is Geo-strategy?

- Geo-strategy, a subfield of geopolitics, is a type of foreign policy guided principally by geographical factors as they inform, constrain or affect political planning.
- As with all strategies, geo-strategy is concerned with matching means to ends – in this case, a country's resources (whether they are limited or extensive) with its geopolitical objectives (which can be local, regional or global).
- As a Natural Resource Geo-strategist, Colin Roberts gives Governments the ability to optimize their natural assets and gives International Corporations the ability to optimize their foreign direct investments.
 - This is done by matching a country's natural resources with its geopolitical objectives, while managing - or mitigating - sovereign risk to the investor. Successful negotiations need a technical knowledge of the resource industry, paired with knowledge of resource policy, economics and the International Law with jurisdiction over the particular international transactions.

Dedicated To:

- Foreign Direct Investor and Sovereign State Geo-strategic Advice
- Mitigation of Political Risk through
 - Conflict Management
 - International Dispute Resolution
 - Sovereign State Policy Advice
- Specializing in:
 - Energy
 - Oil & Gas
 - Mineral Resources & Projects
 - Major Infrastructure

Current Project (~US\$ 400 million) Solar Salt & Food Production-Somaliland



Foreign Direct Investment

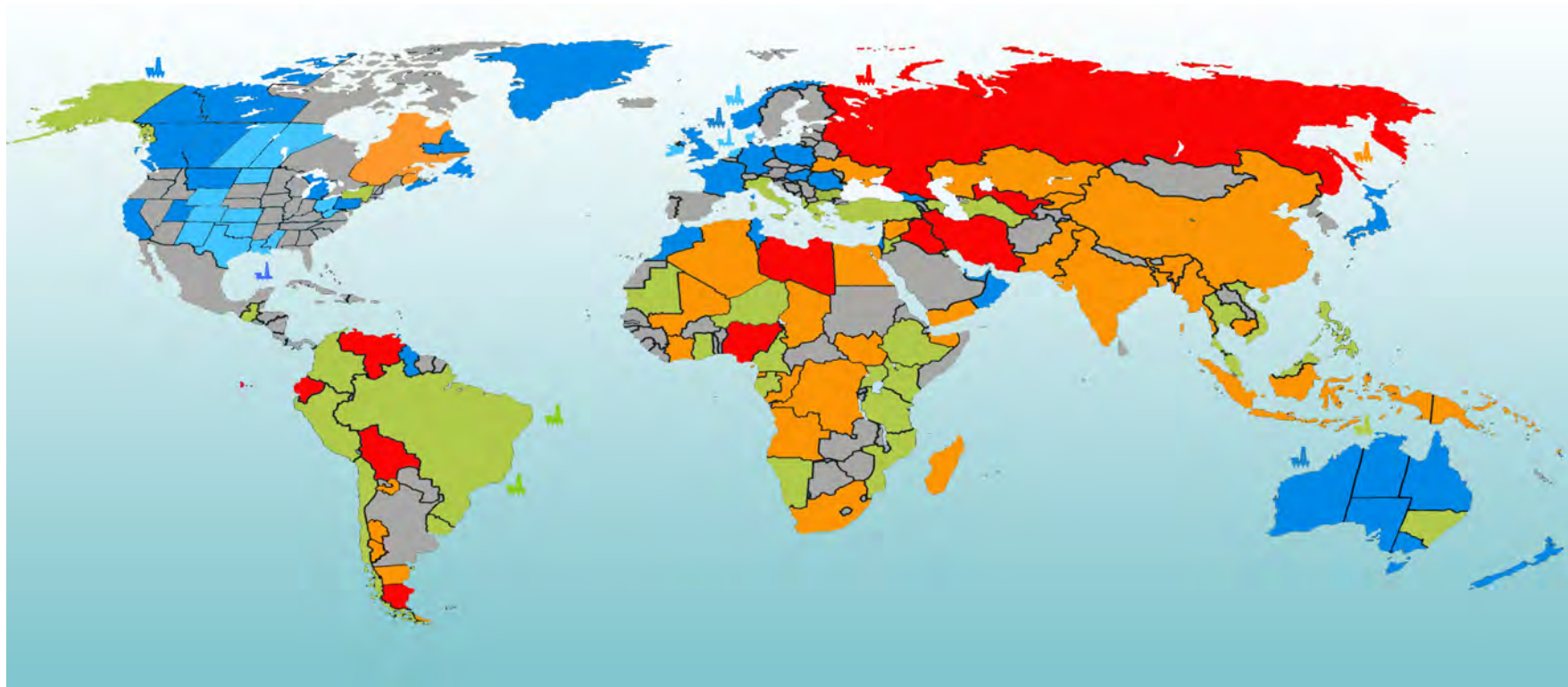
- UNCTAD reports that FDI will reach \$1.8 T, in 2016.
- SOEs make up 11%, even though only 1% of TNCs.
- Developed Asia is the largest FDI recipient. (\$400B+ in/\$300B+ out)

What Does The Foreign Investor Want?

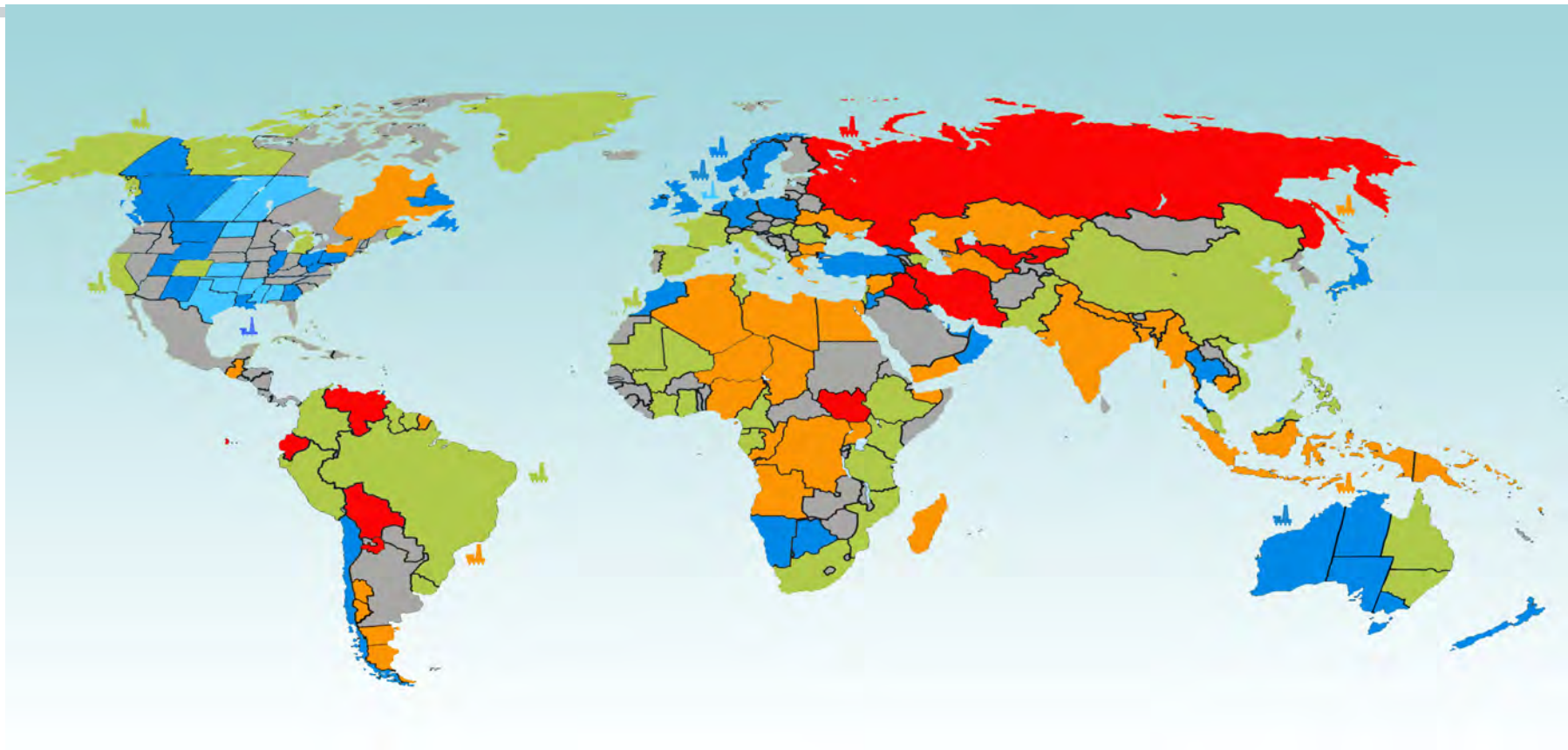
Fraser Institute Petroleum Survey

Ranking Exploration Stage	Exploitation Stage	Decision Criteria
1	N/a	Geological Potential for target product
N/a	3	Measure of profitability
2	1	Security of tenure
3	2	Ability to repatriate profits
4	9	Consistency and constancy of petroleum policies
5	7	Company has management control
6	11	Petroleum ownership
7	6	Realistic forex regulations
8	4	Stability of exploration and exploitation terms
9	5	Ability to pre-determine tax liability
10	8	Ability to pre-determine environmental obligations
11	10	Stability of fiscal regime
12	12	Ability to raise external financing
13	16	Long-term national stability
14	17	Establish petroleum titles system
15	N/a	Ability to apply geol assessment techniques
16	13	Method and level of tax levies
17	15	Import-export policies
18	18	Majority equity ownership held by company
19	21	Right to transfer ownership
20	20	Internal (armed) conflicts
21	14	Permitted external accounts
22	19	Modern petroleum legislation

World Risk Map: Fraser Institute Petroleum Survey (1)



World Risk Map: Fraser Institute Petroleum Survey (2)



What Risk? - This?



What Risk? (2)

- Poor governance
- Expropriation
- Creeping Expropriation
 - Tax Increases
 - Licence Cancellations
 - Security (War, Terrorism, Civil Disturbance, Sabotage, Kidnapping)
 - Govt Obligations (Repatriation of Profits, Currency Inconvertibility, Licensing)

What Risk? (3)

- What are the risks to a Foreign Direct Investor?
 - War & Terrorism
 - Forcing shutdown or closure of operations
 - Economic
 - Exchange Transfer
 - Restriction or prohibition of the repatriation of dividends or currency
 - Strike, Riot, Civil Commotion
 - Disruption or sabotage of foreign operations
 - Sovereign Non-payment (PSC/PSA)

What Risk? (4)

- Logistics & Supply Chain
 - Customs and infrastructure
- Health
- Legal & Regulatory
 - Cancellation, restriction or breaching of the terms of agreement
 - Increase of taxes, changing of licensing rules
- Political
 - Expropriation and confiscation
 - Resource Nationalism & Vox Populi
 - Restriction and prevention of export
 - Governance (e.g. taxation) & Corruption
 - Change of government through insurrection or the ballot box

Resource Nationalism: What is it?

- "the tendency of people and governments to assert control over natural resources located on their territory."
- We are all resource nationalists in some way, and like our developing counterparts, don't want to sell-off the family farm.
 - Australian Government: MRRT,
 - US block CNOOC acquisition of UNOCAL,
 - Costello rejects Shell bid for Woodside,
 - Baird urged to abort Ausgrid sale after Treasurer blocks both bidders on national security grounds
 - Canadian blocking of proposed acquisition of Potash Corp by BHP Billiton.....

Resource Nationalism: Is it new?

- This is not a new phenomenon. Remember the nationalization of mines in Zambia by Kenneth Kaunda (KK) in 1969. A disastrous experiment that devastated Zambia's copper industry for 30 years.
- However, today there is a new trend emerging throughout the prospective developing world (DRC, Zimbabwe, Zambia, Ghana, Guinea, Mali, Cote d'Ivoire, Kenya, Mongolia, Mozambique, South Africa, Argentina, Bolivia, Venezuela, even Australia, Canada and US).

Resource Nationalism: The Forms

- Imposition/increasing of royalties or taxes;
- Mandated beneficiation/export levies;
- Retaining state or national ownership of resources;
- Expropriation;
- Downstream Processing;
- NOC v IOC.

Resource Nationalism Recent History



“They are ours, they are Argentine”

Risk Mitigation

- How can we mitigate the risks?
 - Anticipate
 - Research the Host State
 - Economist Intelligence Unit
 - Speak to other investors
 - Check for BITs and MITs
 - UN, WTO, World Bank, Judicial & Arbitral Precedent
 - Check for regional treaties or specific trade treaties and investment laws
 - Energy Charter Treaty, CHAFTA, NAFTA, ASEAN, Colonia (Argentina, Brazil, Paraguay, Uruguay), Cartagena (Colombia, Mexico, Venezuela) etc..

Risk Mitigation Using International Law

- A BIT (Bilateral Investment Treaty) is an investment treaty between two states, which provides:
 - Greater protection than customary international law.
 - Apply regardless of whether there is a contractual relationship
 - Obviate the need for diplomatic protection.
 - Almost 3500 BITs currently in force (Australia has 21 BITs in force)
 - [Argentina, Chile, China, Czech Republic, **Egypt**, Hong Kong, Hungary, India, Indonesia, Lao PDR, Lithuania, Mexico, Pakistan, PNG, Peru, Philippines, Poland, Romania, Sri Lanka, Uruguay, Vietnam]. 7 FTAs and 7 under negotiation.
- Give legal rights to private parties against foreign States.

Risk Mitigation Using International Law

- BIT Continued:
 - Provide a mechanism for private parties to enforce rights directly against a State.
 - Limit political risk.
 - Ensure enforcement outside the host State.
- Australians consider “Treaty Shopping”.

Risk Mitigation Using International Law

- What protection does a treaty offer through International Law?
 - Freedom from expropriation or nationalization without proper compensation
 - Most treaties promise fair compensation. Expropriation is not just the direct taking of property, but also the more indirect ways of reducing the investment value through actions of the State and its organs - e.g. the denial of an operating license and “Creeping-Expropriation”).
 - **Can a State legally expropriate or Nationalize?**

Risk Mitigation Using International Law

- **YES IT CAN**
- Charter of Economic Rights and Duties of States, GA/Res/3281 (XXIX), UN GAOR, 29th Sess., Supp. No 31 (1974) 50.
- “Each State has the right:
To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.”

What is the Basis of Quantum of Compensation

- Investment made to-date?
- Opportunity Cost?
- Is Interest to be paid? Compound or Simple?

International Treaty

- What protection does a treaty offer through International Law?
 - Fair and equitable treatment
 - The promise to compensate if an investment is damaged as a result of an action, or failure of action of a Host State.
 - Right to repatriate investment and returns
 - Host State undertakes that an investor can convert both the capital value and the return from an investment into a currency other than that of the Host State.
 - Compensation for losses due to war or riot
 - “Most favored nation (MFN)”
 - Protection against breach of legal obligation

Risk Mitigation Using International Law

- What protection does a clause offer through International Law?
 - Stabilization (Umbrella Clause for Equilibrium/Re-negotiation)
 - The right to have a case heard in a neutral venue under a neutral jurisdiction
 - Doctrine of Separability

Mitigation of Risk

Checklist #1

- What is the least we should do? (Love and Cherish?)
 - Research; Research; Research
 - UN, World Bank, EIU, WTO, Judicial & Arbitral Precedent, Anecdotal
 - Can I trust and Do I want to do business with these people?
 - Evaluate the Host State's Laws
 - Petroleum & Mining, Investment, Constitution

Checklist (2)

- Is the State a signatory to an International Treaty?
 - Bilateral Investment Treaty (BIT)
 - Multilateral Investment Treaty (MIT)
 - NY Convention
 - Washington Convention
 - Dispute Resolution Clause
 - WTO
 - ECT
 - NAFTA, ASEAN etc.

Checklist (3)

- Choose law applicable to the conduct of the contract
- Your own law – do you really think it will work?
- Choose Lex Arbitri

Checklist (4)

- Include Stabilization Clause (or try to) which provides for:
 - the stabilisation of the fiscal regime for the duration of the project, or at least for such a period as to protect the integrity of the investor's financial model for the project; and
 - an express reservation of rights in the event the parties need to renegotiate any provision of the agreement.

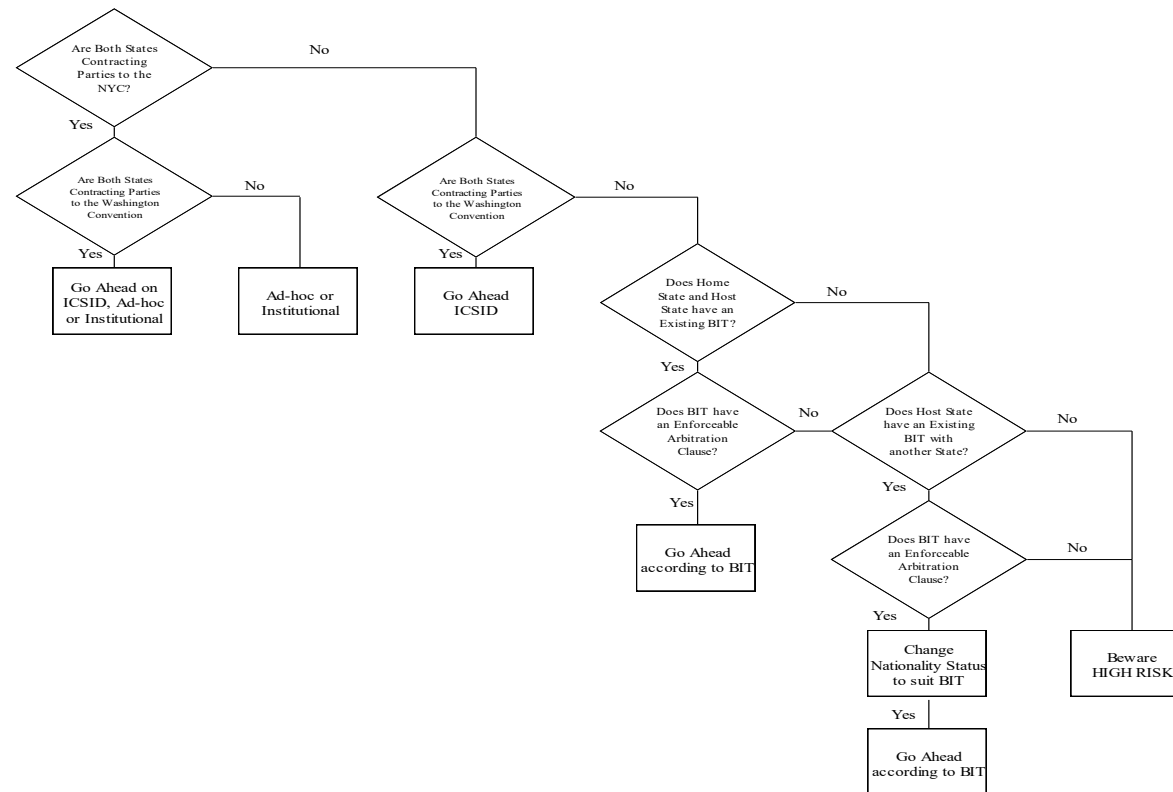
Checklist (5)

- Meet ALL regulatory requirements
- Keep duplications of all documentation in the investor's Home State.
- Secure Political Risk Insurance
 - Available commercially or from the World Bank (MIGA – Multilateral Investment Guarantee Agency)

Checklist (6)

- Beware of and avoid corrupt activities
 - US FCPA (1977)
 - AUSTRALIA: Criminal Code (Bribery of Foreign Public Officials) Bill 1999
 - ENGLAND & WALES: Bribery Act 2010
 - OECD
 - “It is a criminal offence for any person intentionally to offer or give any monetary or other advantage to a foreign public official in order to obtain or retain business or otherwise gain an improper advantage in the conduct of international business.”

Checklist (7)



Risk Mitigation Using International Law

- So. What happens when the Host State or your foreign commercial partner breaks the rules?

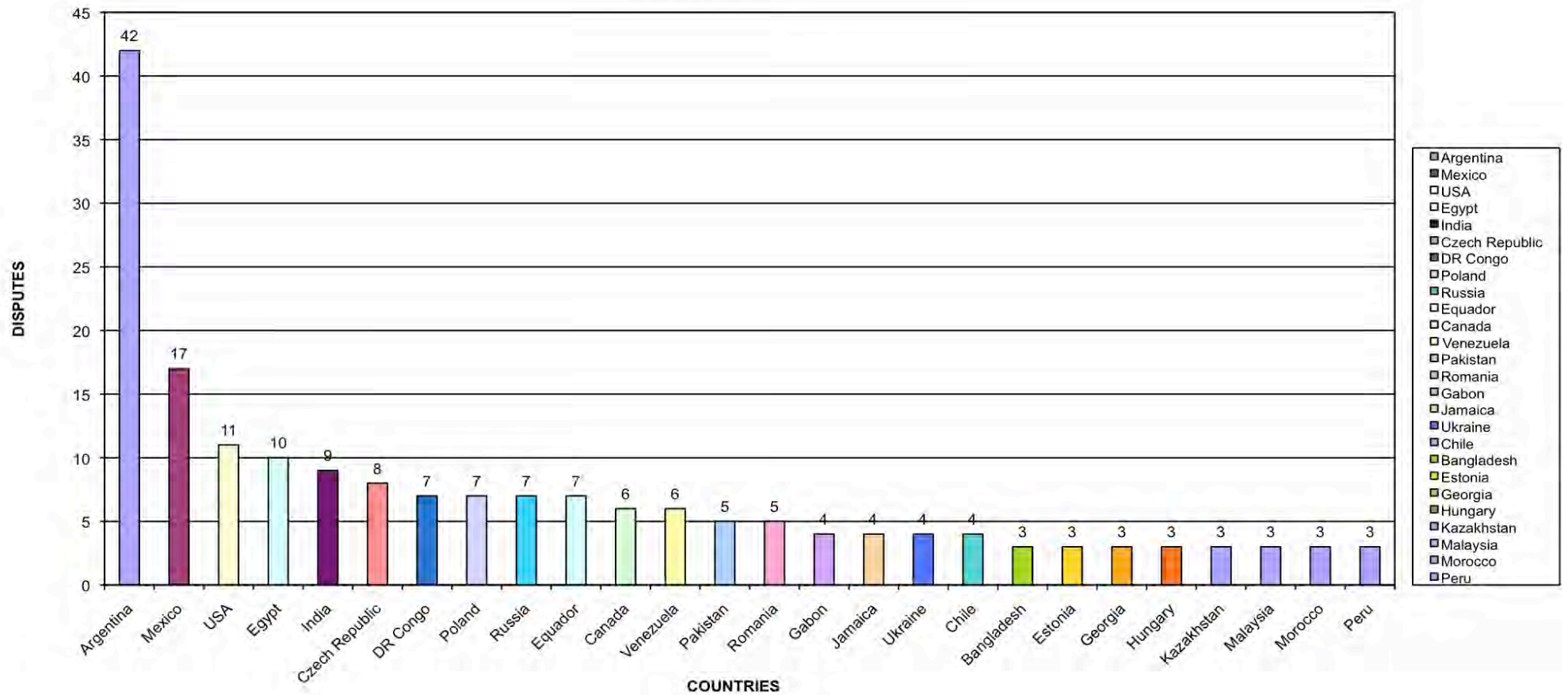
If It Happens, Is It Too Late?

- Normally, Yes. Many FDIs have nothing like an agreement with a host State.
- Does Australia have a BIT with the Host State?
- Has the Host State ratified and entered into force, a MIT?
- “Reasonable Expectations” Mmmmmmmmm!
- “Legitimate Expectations” Better
- Are you Insured?

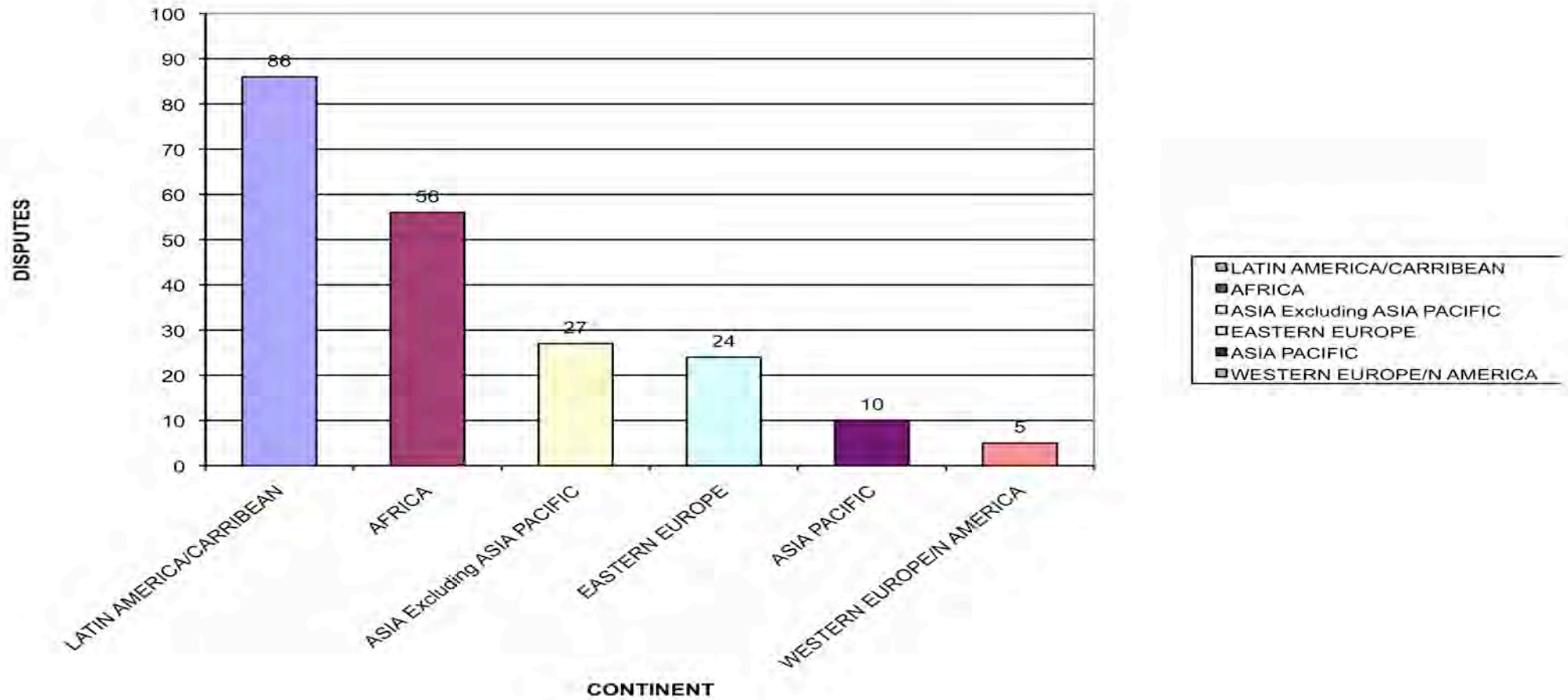
Multilateral Investment Guarantee Agency (MIGA) – The World Bank Group

- Insures Against:
 - Currency Inconvertibility and Transfer Restriction
 - Expropriation (Award not paid)
 - War, Terrorism and Civil Disturbance
 - Breach of Contract
 - Non-honoring of Sovereign Financial Obligations
- 15 to 20 years
- 90 to 95% of Investment (\$220MM + partners)
- Country limit of \$720MM (negotiable)

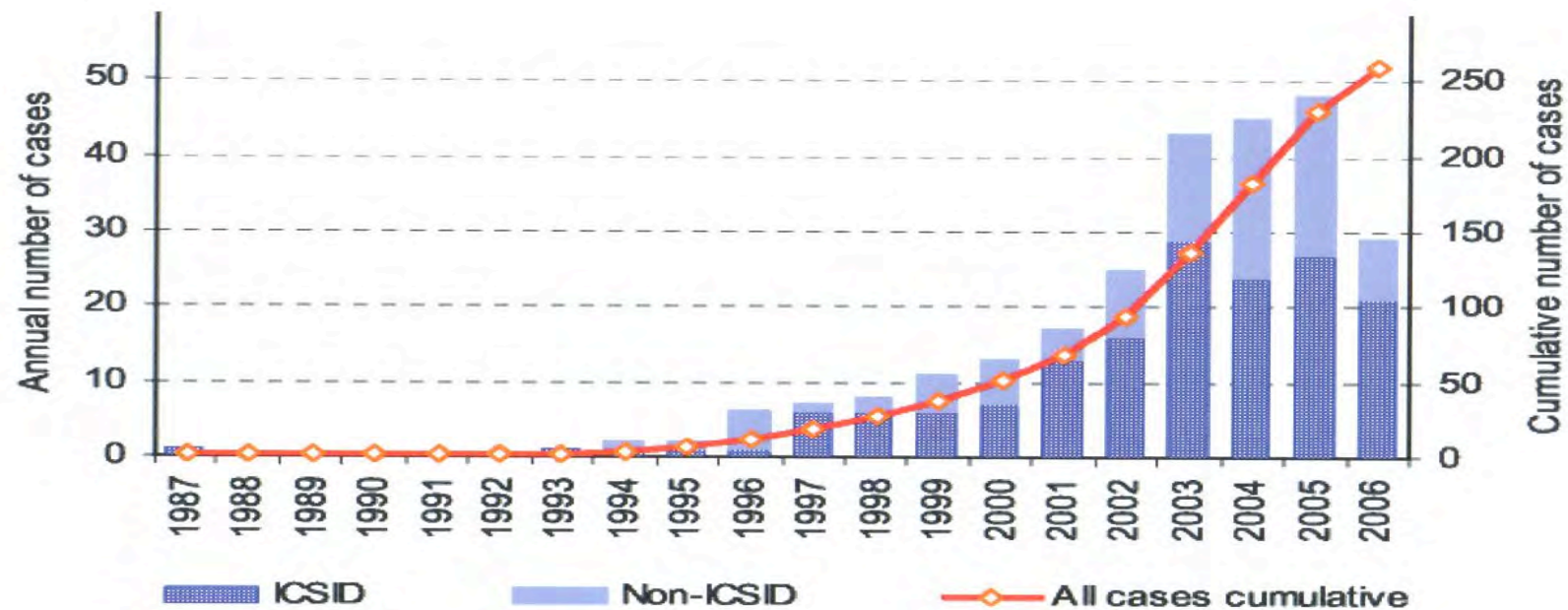
STATE DISPUTE FREQUENCY TOP 26 GLOBALLY



DISPUTE FREQUENCY CONTINENTAL REGION

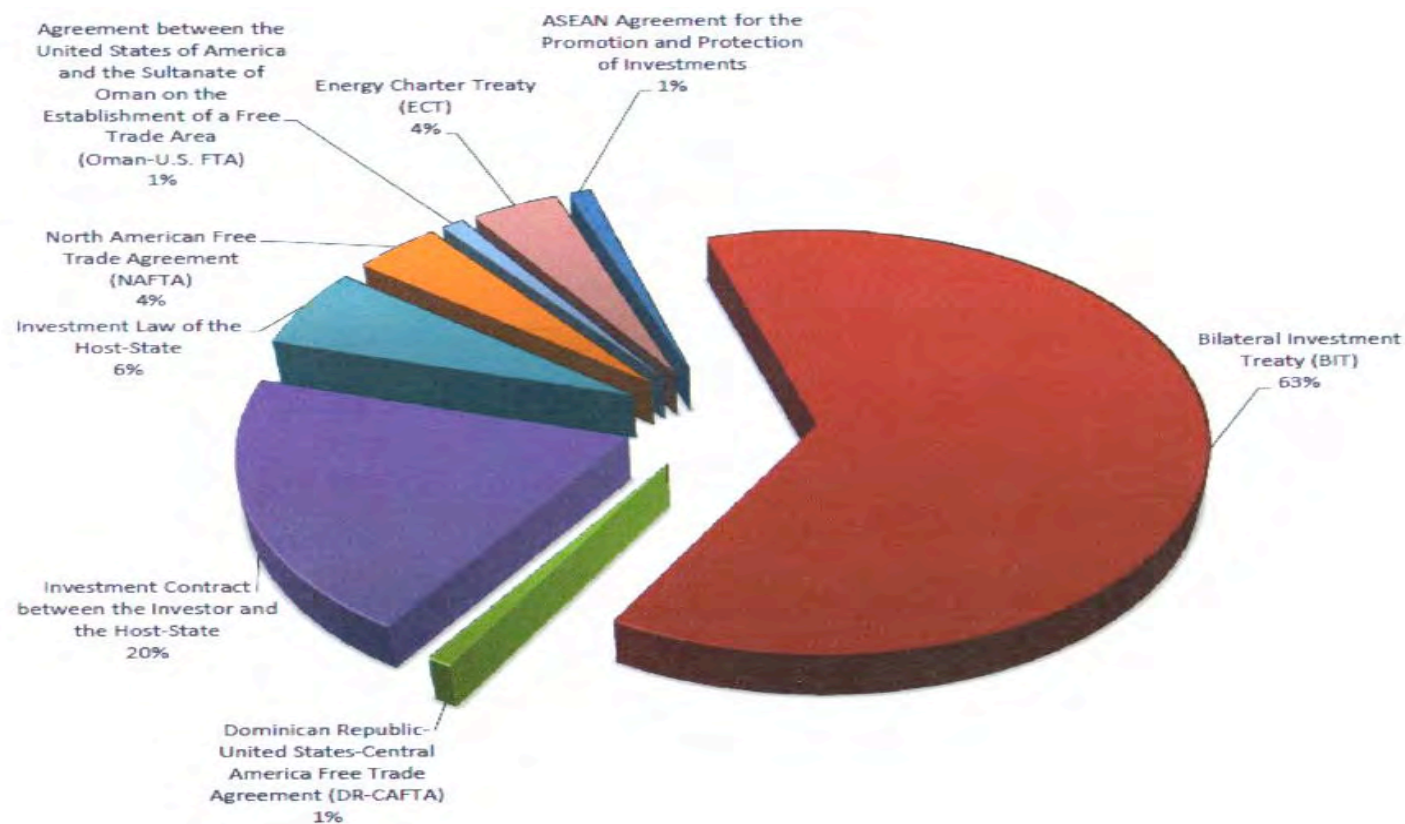


Growth Of Investment Arbitrations

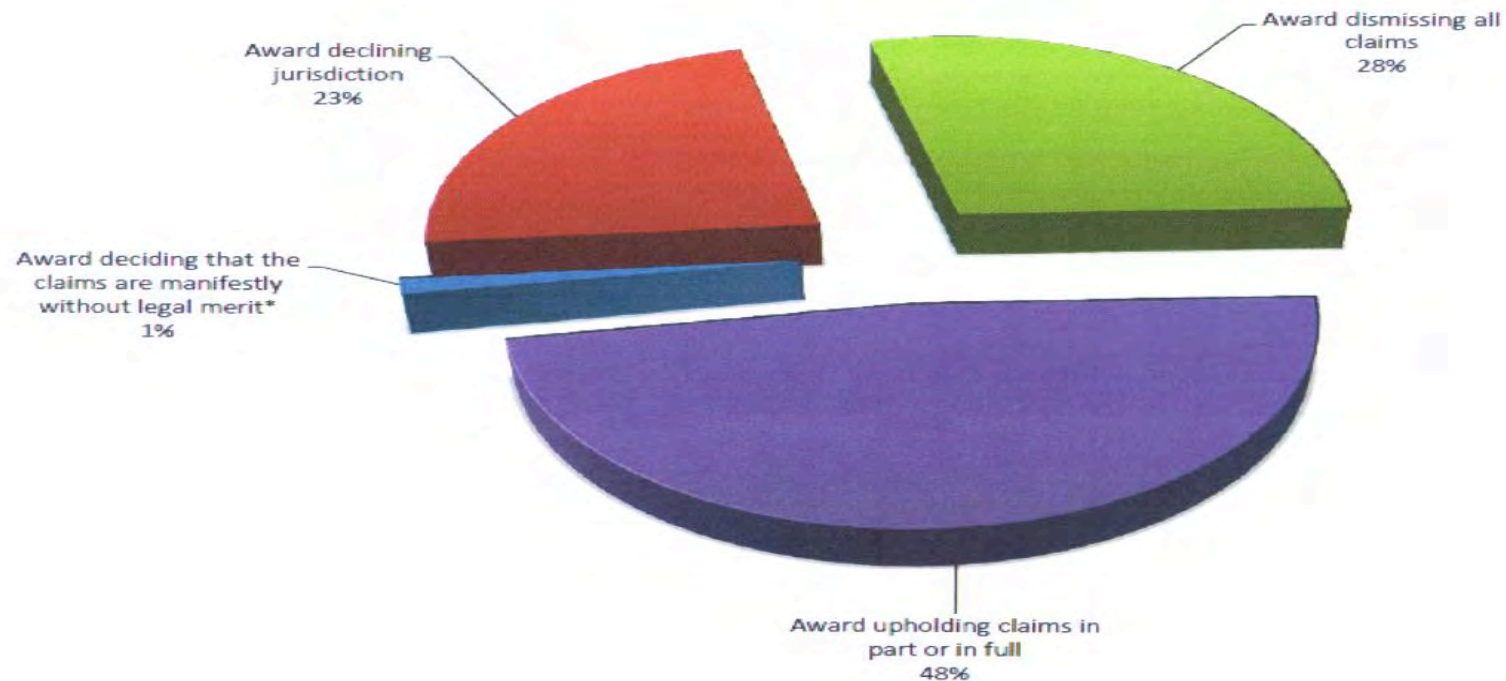


Source: UNCTAD

Basis of Consent Invoked To Establish ICSID Jurisdiction



ICSID Arbitration Outcomes (Who Wins?)



WARNING ALERT #1

- With a Sovereign State there must be a treaty, or a specific dispute resolution agreement protected by a bilateral or multilateral treaty.
- With a Corporation there must be a dispute resolution clause or agreement.

WARNING ALERT #2

- Consent
 - All of the above mechanisms require the consent of the parties. Consent is given prior to the existence of any dispute. This consent is agreed in the Dispute Resolution Clause existing within or attached, as an agreement, to the original contracts between the parties.

DANGER

- Are Directors liable?
 - YES; and so they should be.

Contact

Colin Roberts

Natural Resource Geo-strategy Pty Ltd

col.roberts@me.com

+61 (0) 437 483 479

+44 (0) 7908 255 5 31

www.colinroberts.com

PERTH, ISLAMABAD, BRISBANE, KAMPALA, NOUAKCHOTT, SOFIA, HARGEISA,
EDINBURGH, BELFAST & LONDON