Partnerships with Monarchs:
Unveiling and Re-examining the Pattern of
"Third World" Economic Development in the Petroleum
and Energy Sector

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Table of Contents

Introduction

- Preliminary Remarks
- Summary of Objectives
- Summary of Arguments

Part A
Negotiating with the Monarch—A Typical Scenario

- The Case of Vietnam and the Petroleum Sector
- Mapping the Scenery: The New Monarchs of the 20th and 21st Centuries
- Simplified Typology of Today’s Monarchs

Part B
Dissecting Two Typical Petroleum and Energy Foreign Direct Investment Transactions

I. Case #1: The Upstream Transaction

A. History, Development, and Semantics:

1. The Concessionary Model
2. The Service Contract Model
3. The Production Sharing Contractual (PSC) Model

B. Comparison of the Three Systems (Concessionary, PSC, and Service Contract)

C. The Dynamics of Negotiation in the PSC Regime and the Role of Lawyers

1. Operatorship
2. Participating Interest, Joint Venture Interest, and Transferability
3. The “Carry” of Costs and Expenses
4. The Work Program
5. Standards of Commerciality and Contractor’s Withdrawal Rights
6. The Host Country’s Fiscal Regime and Bonus Requirements
II. Case #2: The Mid-Stream Transaction

A. Anatomy of an IPP Transaction

B. IPP Transactions, Project Financing, and “Off-Balance-Sheet” Accounting

C. Risk Allocation as Core Principle for Project Financing and IPP Transactions, and the Dynamics of Lawyering.

D. Relationship between Risk Management and Legal Structure -- An Example of Contractual Risk Allocation in the Construction Phase of an IPP Investment

   1. Type of Contractor Compensation
   2. Type of Contract Delivery Method
   3. Type of Remedies or Damages
   4. Type of Equity Structure – Variation of Financing Structure and Legal Organization to Accomplish Risk-Spreading Objectives

      a. Vendor Equity Financing
      b. Government Participation
      c. The Build-Operate-Transfer or Build-Own-Operate-Transfer (BOT/BOOT) Legal Model for Infrastructure Building

E. A Critical Look at Project Financing and the Reality of Large-Scaled “Third World” Economic Development Projects

   1. The Interdependence between Multilateral Financing and Project Financing
   2. The Triple Benefits Enjoyed by the Corporate Sponsor
   3. The Monopolistic and Exclusive Nature of Project Financing in Real-World Application
Part C
– Reflection, Recommendations, and Conclusion

- The Need for Reflection

- Five Suggestions

1) Systematic Training on Multiculturalism for the International Business Executive and Legal Practitioner, and Rewriting the Agenda of MNC Corporate Counsel

2) Expanded Ethical Concepts Governing Lawyers to Accommodate A Legal Transnational Practice

3) Use of Voluntary Corporate Compliance Programs as a Means to Police MNCs’ Conduct, under a “Management-Based/Self-Enforced Regulation” Model

4) Integration of Certain Prophylactic Principles of Law into International Deal-Making and the “Legalization” Movement
   a) The “Public Trust” Theory and Government as the People’s Agent
   b) The “Corporate Derivative Fiduciary Duty” Theory
   c) The “Third Party Beneficiary” Theory

5) Incorporation of Two Practical Procedural Safeguards into the Current Pattern of Dispute Resolution Methods in International Deal-Making

- Rethinking Globalization, Legal Regionalism, International Harmonization and Standardization of Law

- The Role of MNCs and the Need for a Formalized Public Interest Approach Toward International Deal-Making

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By Wendy N. Duong

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L’Eveque D’York: “Le Roi est la force et il est la loi.”

Becket: “Il est la loi ecrite, mais il est une autre loi, non ecrite, qui finit toujours par courber la tete des rois.”

J.Anouilh, Becket ou L’honneur de Dieu, 3iemme acte (1958)

Translation:

L’Eveque of York: The King is the force and he is the law.

Becket: “He is the written law, but it is another kind of law, the unwritten one, that finishes by making the royal head turn…”

From the third act of Anouilh’s “Becket or the Honor of God” (1958)

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1 Assistant Professor, University of Denver (DU) College of Law. DU Library Specialist, Ms. Diane Burkhardt, and my research assistant, Nha Tran Tran, assisted in some of the research needed for this Article. My special thanks go first to Megan Davis, and then to Reid Bumgarner, who received the highest grades in my classes, and whose research, dedication, intelligent hard work and last-minute concentration made the completion of this Article possible. Last but not least, I want to thank my colleagues at DU College of Law, Professors Ed Dauer, Julie Nice, and Paula Rhodes for their support and contribution.
INTRODUCTION

As the first of a series, this Article explores and critiques the current patterns of “Third World” economic development in the capital-intensive petroleum and energy sector. The overall purpose of this series is to raise the level of awareness in the international and legal academic communities with respect to special issues in the negotiation of foreign direct investment (FDI) contracts in this important industry, in order to spur further studies and dialogues.

• Preliminary Remarks

For decades, the developing nations have served as the new frontiers for multinational corporate expansion, as U.S. big businesses took their activities abroad in search of new consumer markets, new discoveries of natural resources, and drastically cheaper labor.

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2 The term “petroleum industry” is used herein to refer to integrated companies that specialize in, inter alia, the exploration and discovery of petroleum, including both Crude Oil and Natural Gas. For examples of Crude Oil and Natural Gas legal definitions in petroleum agreements, see Note 286, infra. The term “energy,” when used to describe the sector, includes companies whose business is in the generation and trading of energy as a commodity, whether or not the source of energy is petroleum.

All terms capitalized, bold-faced, and italicized in this Part are either legal concepts, industry jargon that has evolved into legal concepts, generally established defined terms in investment contracts, which have become legal norms by customary usage, and/or acronyms and shorthanded terms adopted for the convenience of reference.


The 1980s and 1990s represented a major transitional period for the global economy. During this period of time, Eastern and Central Europe transitioned into market economies following the collapse of the Berlin Wall and the breakup of the Soviet Union. China actively sought membership in the World Trade Organization (WTO) and, after much controversy, succeeded. Small countries geographically distant from Europe such as Cambodia and Vietnam initiated economic reforms, actively soliciting Western investment. The developing markets, especially Asia (prior to the currency crises of the late 1990s), were believed to have grown faster than the developed nations. Trends of privatization and deregulation in the former centralized economies offered US businesses a lesser-regulated environment where the strength of the U.S. dollar also increased the investor’s economic power. Overall, because the transitional economies needed technology, infrastructures and new commodity markets (by way of both imports and exports), the investment horizon there


was most suited for major-scaled and capital-intensive investments by the multinational corporations (MNCs). The economic prosperity of the Clinton era (with its restoration of balance to the global market after the Asia and Latin America currency crises in the late 1990s) reinforced the U.S.’s position as an economic superpower, fortifying the dominance of corporate America in the global economy.

In particular, because domestic reserves have been depleted or otherwise off limit due to environmental restrictions, U.S.-based oil and gas companies continued to expand their exploration activities to the “frontier” land that previously was closed to the West. The international petroleum and energy industry has always spoken the language of tremendous wealth, and


Recent economic studies challenge the conclusion that economic integration among the developed economies has fundamentally raised the correlation of U.S. growth with growth in other G-7 nations (Canada, France, Germany, Italy, Japan and the United Kingdom). See, e.g., Doyle & Faust, “An Investigation of Co-Movements among the Growth Rates of the G-7 Countries,” Federal Reserve Bulletin 428 (October 2002).
with wealth has come power and leverage. Petroleum resources often dominate a national economy, constituting the “crown jewels” of a country. Major international oil and gas companies (IOGCs), therefore, have quickly partnered with petroleum-producing governments.12 Yet, the “crown jewels” of the “Third World”13 may, or may not have brought about a better life for the average “Third World” citizen.14 To date, many developing nations with petroleum

12 In this Article, the acronym MNC will be used to refer to “Multinational Corporations,” and IOGC will refer to “International Oil and Gas Companies,” as a specific type of MNCs.

13 I ask for my readers’ indulgence and tolerance with my use of this term. The term “‘Third World’” is used herein for convenience only, referring collectively to the newly industrialized economies, the transitional economies, the developing economies, the lesser-developed economies, and the least developed economies. Terminologies such as “developing country” and “least-developed country” have been used in the GATT-WTO framework to grant exemptions, preferences, or transitional grace periods to nations that need economic help in order to achieve parity with the developed nations of North America and Western Europe. See, e.g., Agreement on Trade-Related Investment Measures (TRIMS). IS THIS THE BLUE BOOK FORMAT FOR THIS CITE? In this Article, “Third World” simply refers to any and all countries that do not belong to Western Europe or the developed North America, both of which exemplify the Anglo-American Common Law and the Civil Law traditions.

In the 1980s, the term “Third World” was still used in the general community at large to refer to “a collection of disparate nations which may have some similarities in their relative poverty and in their aspirations; but their economies are careering in different directions at a bewildering rate.” Anatole Kaletsky, “A Dismal Look – For Some; Less-Developed Countries” (Financial Times May 25, 1984). In more recent scholarly literature, the term “Third World” has been used in phraseologies such as “Third World poverty, violence, and lack of resources,” in connection with challenges made against the common characterization of non-European societies as “backward and inferior.” See, e.g., Antony Anghie, “Civilization and Commerce: The Concept of Governance in Historical Perspective,” 45 Vill. L. Rev. 887, 911 (2000) (author used terms such as “Third World state” and “Third World poverty” to discuss race, history, and international law) (emphasis added). See also Balakrishnan Rajagopal, “Locating the Third World in Cultural Geography,” Third World Legal Studies, 1, 7-11 (1998-1999) (arguing that conception of impurity and backwardness is essential to all understandings of “Third World”) (emphasis added); Karin Mcielson, “Rhetoric and Rage: Third World Voices in International Legal Discourse,” 16 Wis. Int’l L.J. 353, 361-62 (1998) (observing “Third World” challenge to accepted Western notions of history and international law) (emphasis added).

Recently, the term “Fourth World” has emerged, referring to the collective grouping of indigenous peoples or “nations” whose cultural properties, traditions, territories, and right of self-determination have been at risk or historically displaced, such that the conventional notion of “statehood” can no longer squarely apply to them under traditional concepts of international law. See, e.g., “Ward Churchill, “Social Justice Movements and Latcrit Community: The Law Stood Squarely on Its Head: U.S. Legal Doctrine, Indigenous Self-Determination and The Questions of World Order,” 81 OR. L.Rev. 663, 700 (2002) (describing the “Fourth World” as one comprised of indigenous nations, possessing the least right to genuine self-determination: referring to the “fourth world” as being a “Host World” upon which the other three have been constructed) . Accord. Franz Schurmann, The Logic of World Power (1974); Jacqueline Stevens, Reproducing the State (1999); Sadruddin Aga Khan & Hassan bin Talal, Indigenous Peoples: A Global Quest for Justice (1987); Julian Burger, Report from the Frontier: The State of the World’s Indigenous Peoples (1987).

14 Baker, 20 Wis.Int’l L.J. at 102-105. See also Roger D. Billings, Jr., “Why Business Fails in Russia,” (35 The Int’l Lawyer No. 1, 123 (Spring 2001) (discussing social and legal problems in post-Yeltsin Russia as example that natural resource and attempt at democracy did not guarantee economic or societal success).
resources are still struggling with poverty, corruption, and the social turmoil often associated with the unhealthy economic gap between the rich and the poor within their own populace. For example, both the Republic of Chad and Nigeria offer examples that rich petroleum reserves have not cured poverty issues or otherwise helped stabilize society.

The dawn of the new millennium has borne witness to significant events that further impact the global economic landscape: the atrocities of September 11, 2001, the U.S.-led global coalition for fighting terrorism, and the unilateral approach of the U.S. (and its U.K. ally) in striking preemptive war against

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16 See, e.g., Baker, 20 Wis. Int’l L.J. at 102 (discussing inequality of income and gap between rich and poor in developing nations, as well as gap in economic power between North and South).

• Chad has recoverable reserves estimated at one billion barrels. Present in Chad is a consortium comprised of Chevron, Conoco, ExxonMobil, and Shell. See “An Mbendi Profile: Chad: Oil and Gas Industry–Overview,” found at http://www.mbendi.co.za/indy/oilg/ch/p005.htm. Major petroleum activities in connection with oilfield and pipeline projects began as of 2000. See CIA The World Factbook, http://www.cia.gov/cia/publications/factbook/print/cd.html (access as of 10/23/2003). Approximately 80% of Chad’s population is reportedly living below the poverty line. The infant mortality rate is at 95.75 percent. The average life expectancy at birth is approximately 48.51 years. Id.

• Nigeria is OPEC’s 12th largest overall producer, the 10th largest oil producer in the world, the third largest in Africa, and the most prolific oil producer in Sub-Saharan Africa. The estimated proven oil reserves are 22.5 billion barrels with production at 2 million barrels per day. The estimated proven natural gas reserves are 124 trillion cubic feet. Nigeria also has four refineries with a total capacity of 445,000 bbl/d. http://www.mbendi.co.za/indy/oilg/ng/p005.htm Nigeria has continuously been listed by Transparency International as the most corrupt country in the world. See Transparency Annual Report 1994 (Chairman’s Foreword); New York Times, “Nigeria Under Shagari Called Garden of Graft” (Jan. 20, 1984) at 1 col. 3. See also Transparent International 1996-2002 Corruption Indices. http://www.transparency.org. As of 2000, approximately 60% of the Nigeria’s population is reportedly living below the poverty line. The infant mortality rate is at 95.75 percent. Life expectancy at birth is approximately 51 years. See CIA The World Factbook, http://www.cia.gov/cia/publications/factbook/print/ni.html (access as of 10/23/2003).
Iraq. These events provide at least two new opportunities for corporate America to engage itself, again, in the economic reconstruction of remote countries such as landlocked Afghanistan and oil-rich Iraq. While geopolitical factors and local or regional interests may be different, the reconstruction and development of Afghanistan and Iraq will bear similar characteristics to patterns that have been observed in the transitional economies during the 1980s and 1990s.


18 With respect to the US-UK political and military alliance and occupation of Iraq (contrasted against France’s vehement objection), the following facts suggest a similar (perhaps coincidental) alliance between U.S.- and U.K.-based IOGCs (as contrasted against French interests) in the petroleum and energy industry:

1) In the late 1990s, prior to the Exxon-Mobil merger, Mobil Corporation sold many of its downstream assets (refineries and service stations) in Europe to British Petroleum (BP), and the two companies formed alliances for the European market. See, e.g., David Lascelles, “BP and Mobil aim to get in front and stay there...” (Financial Times, Feb. 29, 1996); Peggy Hollinger, “BP and Mobil in European fuels merger: Annual Sales of Joint Operation to Exceed Dollars 20bn” (Financial Times, Feb. 29, 1996). See also Martha M. Hamilton, “Three Big Oil Firms Weigh Joint Venture; Merger of Refining, Marketing Operations Redefine Industry” (The Washington Post Oct. 8, 1996) (discussing merger trends: Mobil-BP and Shell-Texaco-Saudi Arabia’s Armaco alliances).


3) As explained below, the Royal Dutch-Shell group’s subsidiaries and affiliates have substantial presence in both the U.S. and the U.K, and occupy substantial shares of those national markets. See http://www.shell.com/home/Framework?siteId=uk-en&FC2=/uk-en/html/iwgen/about_shell/zzz_lhn.html&FC3=/uk-en&FC2=uk-en/html/iwgen/about_shell/shellukoverview_09100930.html See also 10K Annual Report of Shell Oil Company (1998), found at http://www.sec.gov/Archives/edgar/data/89629/0000950129-99-000930.txt; http://www.shellus.com/welcome/who/shell.html. Thus, an observer may say that as of today, the dominant international players in the petroleum industry are U.S. and U.K interests. In contrast, France’s Total-FinaElf (a combination of two Western European interests, TotalFina and Elf Aquitaine) today stands alone against its US-UK competitors such as Exxon-Mobil, Texaco-Chevron, and BP-Amoco. The French integrated oil and gas company was created through two successive mergers: 1) The former Total joined with Belgian oil company Petrofina to form TotalFina, and 2) TotalFina combined with French oil company Elf Aquitaine to create TotalFinaElf. See http://www.total.com/en/profile/history/index.htm and www.totalfinaelf.com

19 The terms “reconstruction” and “development” are used herein as laymen’s terms. The Articles of Agreement of the two International Financial Institutions within the World Bank Group, the International
Summary Of Objectives: This Article establishes two propositions, and hence serves the following two-fold purpose:

1. Confidential negotiation between MNCs and governments of the developing economies has long shaped the pattern of “Third World” economic development. Quite often, the host government of a developing nation, or its instrumentality, acts as the MNC’s business partner. A stern cynical critic may exclaim that a substantial part of global economic development has remained the prerogatives of corporate moguls and “Third World” “monarchs.” Their contractual arrangements demonstrate ways in which MNCs seek, inter alia, to reduce political risks and to form long-term government-foreign investor partnerships. As an example, the “Production Sharing Contract” or its variation – a cooperative model between IOGCs and host governments – has evolved into a standardized model for petroleum exploration all around the world, and has dominated startup foreign direct investment (FDI) in the petroleum industry for the past three decades. An IOGC-host government partnership such as the Production Sharing Contract model presents special legal issues, due not only to the unique nature of multinationals doing business in the developing nations, but also the special status and sovereign powers of governments, well-supported in international law and political philosophy. This Article explores these unique issues in the context of petroleum and energy FDI transactions, typically supported by complex corporate financing, a “non-recourse” method of third-party funding called “Project Financing,” and/or funding provided by the Multilateral Organizations such as the International Monetary Fund (IMF) and the World Bank group (hereafter called “Multilateral Financing”). The petroleum and

I am not sure that it is possible or feasible to coordinate or orchestrate asymmetry or parallelism between the building of a democratic political system and economic development projects such as infrastructure building or natural resources development. Compare, Dexter Filkins, “Iraqis Receive U.S. Approval of Constitution” (New York Times March 2, 2004), to Yochi J. Dreazen, “How a 24-Year-Old Got a Job Rebuilding Iraq’s Stock Market” (Wall Street Journal Jan. 28, 2004). See also Andrew Higgins, “US. Ambitions Run into Reality on an Afghan Road” (Wall Street Journal Feb. 6, 2004) (describing obstacles in the early steps of infrastructure construction in Afghanistan).

20 The term “monarch” was first used by Mr. N.E. Maryan, formerly senior counsel for Exxon-Mobil, and adjunct professor of law at Georgetown University. See N.E. Maryan, Jr., Negotiating with the Monarch: Special Problems when the Sovereign is your Partner, 745 PLI/Comm, 11, 130 (1996).


22 After the global depression of the 1930s and the Second World War, delegates of some 44 participating nations met at the Bretton Woods Conference in New Hampshire in 1944, and fashioned two multilateral institutions of the then new economic order: the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank) (hereinafter called the “Multilaterals,” “Multilateral Agencies,” “Multilateral Organizations,” or “Multilateral Institutions”). See Bederman, International Law Frameworks (Foundation Press 2001). These two institutions, comprising some 183 state-members, are the grandest and most established Multilaterals.
energy sector is selected as a case study because of its global workforce and its vast economic power, both of which have physically changed the face of the world. (After all, it is the U.S. petroleum and energy sector that accumulates multi-million-dollar foreign asset base, and dispatches U.S. expatriates to handle transactions and projects in remote parts of the world such as Vietnam, Indonesia, Nigeria, or Chad.)

2. The nuts and bolts of the negotiation between MNCs and “Third World” governments are veiled from the general public. The legal and business issues involved in “Third World” economic development often remain the esoteric domain of a handful of sectoral lawyers and business executives, further obscured by industry jargon and technological nuances. As a result, the job of examining the conduct of MNCs tends to become a cry from the ivory tower, which studies the pivotal role of MNCs from a non-industry perspective. Although there is abundant literature calling attention to, and challenging the conduct of MNCs, there exist at least two gaps in the stream of scholarly literature seeking to analyze the impact of MNCs’ conduct. (By “gaps,” I don’t mean a total absence of well-crafted literature; rather, I refer to the scarcity of in-depth scholarly literature written from an industry’s critical analysis.) These gaps are explained below.

The first is the kind of legal academic literature that identifies and analyzes certain transactional patterns representing MNCs’ behaviors, as these transactional patterns become part of the “law of the contract” (lex contractus) governing the parties’ conduct. When these transactional patterns are

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Multilaterals also include the regional institutions such as the Inter-American Development Bank, the Asia Development Bank, the European Bank for Reconstruction and Development, as well as other World Bank affiliates such as the Multilateral Investment Guaranty Agency (MIGA) and the International Finance Corporation (IFC). These Multilaterals are also called the “International Financial Institutions (IFI).” See, e.g., Margaret Hanson, “The Global Promotion of Transparency in Emerging Markets,” Global Governance 9, 63-79 (2003) (discussing roles of IFI’s). The term “Multilateral Financing,” therefore, refers to funding provided by these Multilateral Agencies.


24 I identify the following sources of law as governing MNCs’ conduct: (i) lex loci, the national laws of the home jurisdiction (where the MNC is incorporated) and the host jurisdiction (where the MNC does business and builds or acquires assets) Lex loci can be divided into lex loci contractus (the law of the place of contracting) and lex loci solutionis (the law of the place of performance); (ii) lex situs (the law of the place where the investment project is located); (iii) lex fori (the law of the forum that adjudicates disputes involving MNCs’ conduct); (iv) lex mercatoria, the body of international economic law that represents the universal and customary norms of commerce observed by an international “merchant” community; and last but not least, (v) lex contractus, the body of contract law selected as the choice of law governing the investment contract, including all provisions of the investment contract resulting from the parties’ negotiation, so long as such provisions do not conflict with the governing contract law. The transactional patterns conducted by MNCs in connection with their FDI projects (as examined in this Article) become part of lex contractus, as well as lex mercatoria, potentially.

Of these sources of applicable law, lex fori is the least influential and the least invoked, unless it is the law of the more developed jurisdiction that serves as the situs for dispute solution. See, generally, Donald C.
repeatedly used, they are elevated to legal norms that help shape international economic law, or modern *lex mercatoria*. In-depth scholarly literatures in this category are few and far between. Existing literatures are either practitioners' succinct contributions to law review discourse, or are often practice guides written by, and designed for, sectoral specialists in the private bar in order to enhance their practice experience, or to provide them with a forum for discussion and a source of continuing legal education material. Between the two ends of the spectrum – from specialty law textbooks to the practice guides - there exists a vacuum, a demand for a more abundant and meaningful scholarly literatures focusing on the transactional patterns that drive trends in global economic development and help form modern *lex mercatoria* and *lex contractus*. Accordingly, I perceive a great need for the legal community at large to examine the dynamics involved in the formation of these multi-million-dollar MNC-government partnerships. With this Article, I hope to meet that need by unveiling and explaining the esoteric and technically complex international

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25 Modern international commercial law (as well as the broader category of “international business law” or “international economic law”) is rooted in the ancient *lex mercatoria* (the “law merchant”), a medieval body of customary legal rules used in international trades to supplement the often incomplete commercial laws of nation-states. See, generally, Friedrich K. Juenger, “American Conflicts Scholarship and the New Law Merchant,” 28 Vand. J. Trans. L. 487 (1995) (also discussing rules of decisions applied by international arbitrators); Karyn S. Weinberg, “Equity in International Arbitration: How Fair is ‘Fair’? A Study of Lex Mercatoria and Amiable Composition,” 12 B.U. Int’l L.J. 227 (1994). *Lex mercatoria* was common at least to European nations, but obviously Asian countries, the Arab world, the Americas, and Africa also observed customary rules of commerce. Ancient creative literature originated from non-Western European traditions such as the anonymously authored *Arabian Nights* made endless references to traveling merchants trading transnationally, in regions such as the Middle East, Asia Minor, the Far East, and Africa. For a discussion of lex mercatoria from the Western perspective, see, e.g., Hononold, The Influence of the Law of International Trade on the Development and Character of English and American Commercial Law, *The Sources of International Trade* 70-71 (Schmitthoff ed. 1964); F. De Ly, *International Business Law* and *Lex Mercatoria* 15-20 (1992). Accord Janis, An Introduction to International Law (Aspen 3d ed. 1999) at pp. 282-283. Accord Eric Engle, “Corporate Social Responsibility: Market-Based Remedies for International Human Rights Violations?” 40 Williamette L.Rev. 103 (Winter 2004) (“Medieval *lex mercatoria*...was fundamentally a private law of contract and arbitration. *Lex mercatoria* concerned only private parties, was binding, and was a result of voluntary agreement..."


petroleum and energy transactions, in order to dispel myths and develop a general understanding of the processes and some of the key legal issues involved.

The second gap in legal literature concerns the need for the scientific gathering of empirical data and their interpretations, reflecting or pointing to any correlations between “Third World” poverty, “Third World” governments’ behavior, and MNCs’ corporate behavior as well as their FDI business strategies, in order to prove or disprove general notions that may have been taken for granted. Without such interpretation and established linkage, the tasks of analyzing or monitoring MNCs’ conduct or fashioning policies and relief for effective “Third World” economic development may run the risks of becoming cliché, rhetoric, and even euphemism. So far, any such empirical undertakings have been the exclusive province of economists, international think-tanks, and the Multilateral Institutions in support of their own missions.


For an individual effort at drawing correlations between free trade-NAFTA and “Third World” poverty using Mexico as an example, see Richard C. Williams, “Globalization and its Effects on the Developing World” (Rocky Mountains Harvard University Club presentation, April 27, 2003) (unpublished manuscript available on file with the author). Richard C. Williams, Ph.D., concludes that since the execution of NAFTA, poverty statistics have become worse, based on statistical data from websites for the Alliance for Responsible Trade, the London School of Economics, the International Labour Organization (ILO) and research websites of the World Bank and its affiliates. For example, since the implementation of NAFTA, the percentage of the Mexican population living in poverty (i.e., below $7.30 a day) falls from 58.5% to 79%. At the beginning of globalization (approximately the 1960s), the rate of world unemployment, underemployment, and incomes under $1/day was less than 20%. As of 2003, this percentage stood at approximately 40%, according to ILO data. These conclusions represent Dr. Williams’ views and work, and sources supporting Dr. Williams’ conclusions have not been verified for purposes of this Article. Interestingly, other interpretation of World Bank data contradict Dr. Williams’ conclusion – global poverty rate did fall from 29 percent to 24 percent, according to 2000 World Bank factsheets. See Tony McAdams, 19 J. Legal Studies Education at 254, n. 100, citing World Bank Group, ‘Does More International Trade
should undertake similar inquiries, as they are the premier group to voice critical and interpretative analyses of prescriptive standards and normative behaviors, especially when law, politics, and cultures collide and intertwine, as in the case of “Third World” economic development. Specifically, questions must be raised by way of objective data establishing the linkage between “Third World” poverty, FDI patterns, the cause-effect relationships between trade and FDI, “Third World” inhabitants' cultural norms, “Third World” governments' political behaviors and macroeconomic policies (or lack thereof), MNCs' profit-driven behaviors and corporate policies, and last but not least, the international relations and global economic policies of MNCs' home countries. This mammoth task can either be the solitary effort of legal academia, or better still a joint project for the interdisciplinary scholarly community, the think-tanks, and the international organizations (including the Multilaterals). It is hoped that this Article will contribute to the spurring of further studies conducted by the legal academy, and to firmly establish the need to draw empirical data and

Openness Increase World Poverty?” FACTSHEETS: ASSESSING GLOBALIZATION, at http://www.worldbank.org/html/extdr/pb/globalization/paper2.htm (as of April 2000). The same World Bank data support the conclusion that globalization and free trade have increased the gap in income between the rich and the poor. Id.

make meaningful conclusions. In other words, better studies and statistics are needed to support causative claims.

- **Summary of Arguments:** This Article will proceed as follows:

  ▲ **Part A** describes a real-life situation, using the Socialist Republic of Vietnam as an example where an MNC-IOGC partnered with a “Third World” “monarch.” (This real-life situation will serve as context for Part B).

  ▲ **Part B** dissects and explains the principal legal and business issues, as well as the dynamics of negotiation, in two types of FDI transactions: (i) the international “upstream” petroleum project, and (ii) the international “midstream” independent power-generation project (IPP) in which natural gas discovered is used to generate electricity. The discussion in Part B encompasses four unique legal and business issues encountered by the international petroleum and energy sector in its partnerships with “Third World” governments, together with my specific recommendations for improvement:

  (1) **The transfer and sharing of risks among dominant corporate players in the international petroleum and energy sector.** I argue that this pattern may create de facto monopolistic cartels, precluding and suppressing the embryonic growth of a true entrepreneurial middle class in the native population, notwithstanding the government’s “free enterprise” open-door economy policy that invites the MNC to be in the country in the first place! These de facto cartels may foster, promote, and fortify the power base of the host government’s ruling elites, who become the “monarchs” of the 20th and 21st century. This monopolistic pattern defeats the ultimate objective of free enterprise: the spreading of wealth and attainment of prosperity based on level-playing field

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29 See, e.g., Tamara Lothian & Katharina Pistor, “Local Institutions, Foreign Investment and Alternative Strategies of Development: Some Views from Practice,” 42 Colum.J.Trans’l L. 101 (2003) (Conclusions by commentators after panel discussion with practitioners: “Today, there is much more empirical support for the claim that law matters for foreign investment. Nevertheless, new law and development initiatives that use these data...are as problematic today as they were in the early 1960s...There are three main problems: (A) the data are poorly specified; (B) the concepts are incoherent; and (C) the promise of new reforms is rarely realized in practice...A further gap in the current understanding of investment patterns arises from the lack of detailed case studies...Given this lack of useful data, new insights likely could be drawn from the experiences of practical people in real-world investment projects located in countries at the forefront of market reform...” Commentators also acknowledged the need for “an agenda for further research,” and the lack of information describing investment patterns due to lack of first-hand knowledge) (emphasis added).

30 For example, one such causative claim that needs to be examined is whether the shareholder wealth-maximization model of U.S. corporate laws and its underlying philosophy has occasioned more economic inequality in the U.S., compared to other nation-members of the Organization for Economic Cooperation and Development (OECD). OECD statistics since 1996 seem to support this conclusion. See, e.g., OECD Analysis of Economic Inequality, cited in Mark Roe, Political Preconditions to Separating Ownership from Corporate Control: The Incompatibility of the American Public Firm with Social Democracy,” 53 Stan. L. Rev. 539, 577 (2000). To the best of my knowledge, the impact of the U.S. shareholder wealth maximization model upon global economic inequality, especially in the “Third World,” has not been tested, challenged, or otherwise examined or reexamined by way of empirical data or sampling studies.
and individual innovation and creativity, toward the creation of a healthier and larger middle class in those places that need it the most.

(2) The payment of bonuses by MNCs to governments, and the need to substitute cash bonuses and payments with industry-sponsored social programs. This pattern may create an opportunity for legitimized corruption under the guise of discretionary exercise of sovereign power, and may turn global economic development projects into auctions, thereby feeding more “grease”\(^{31}\) into a governmental apparatus that may already be plagued with corruption and abuse of power, if that is the case.\(^{32}\) Accordingly, I suggest that the industry should join efforts to lobby “Third World” governments for the abolishment of cash bonuses required as a means for the nation-state to capture Economic Rents in Production Sharing Contracts or similar investment contracts. Cash bonuses should be replaced with direct social programs designed to contribute directly to the local community of “Third World” inhabitants.

(3) The popular “Stabilization Clause” as a risk-management tool, and a negotiated contractual restriction upon a nation-state’s legislative or rule-making sovereign power. While the Stabilization Clause serves the purpose of eliminating and controlling political risks, it may help perpetuate the close-knit and collaborative nature of certain economic partnerships between governments and MNCs. Both sides to the deal may be motivated to solidify their long-term presence or elitist foothold in the country. Further, the very nature and purpose of the Clause makes it inherently incongruent and legally problematic. The Clause also evidences the lack of bargaining power in “Third World” economic negotiations, cloaking the MNC as the preferred, desired business partner of a poor country’s ruling elites. Finally, the Clause (together with all other contractual provisions supporting it) demonstrates the paradoxical negotiating objective of the MNC in structuring the contracting capacity of the host government or its State-Owned Enterprises (SOE) -- the MNC needs to recognize the sovereignty’s power and, at the same time, must limit and denounce such sovereign power when the “monarch” is engaging in commercial activities.

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\(^{31}\) Interestingly, the United States’ anti-corruption law in international business, the Foreign Corrupt Practices Act (FCPA), 15 U.S.C. §78dd-l(1998), creates an exception from liability commonly described by lawyers and corporate executives as the “grease payment” exception. 15 U.S.C. §78dd-l(b)(1998). Payments to expedite the performance of routine governmental action are permitted under the Act, provided that all statutory criteria constituting the exception are met. U.S. v. Kay, No. 02-20588, 2004 U.S. App. Lexis 1740 (5th Cir. 2004); United States v. Castle, 925 F.2d 831, 833 (5th Cir. 1991) (recognizing that “grease” payments are not illegal under the FCPA because they are considered part of the custom of doing business in a certain foreign country) See also Toral Patel, “Corrupt Practices in India: No Payoff,” 20 Loy. L.A. Int’l & Comp. L.J. 389 (January 1998) (discussing “grease” payment exception in the context of India).

Non-Recourse Project Financing as a means to isolate MNCs’ corporate assets from political risk exposures in the developing economies. Project Financing has poured billions of dollars of funding into the “Third World,” either separately or as piggy-backs of Multilateral Financing. (In this regard, Multilateral Financing serves as a “step-up” credit enhancement tool for Project Financing). For the corporate investor, both financing structures – Project Financing and Multilateral Financing -- operate as a risk-allocation mechanism that ultimately puts risks of loss upon the taxpayers of the developed nations, as well as the poor inhabitants of the “Third World.” Both financing techniques can also operate to preclude participation by smaller or medium-sized entrepreneurships, in favor of mega-MNCs who typically join forces to share risks among themselves, thereby reinforcing the existence of de facto cartels dominating the sector and the region. Further, Project Financing should no longer be the “privileged” financing method exclusively for elitist mega-projects. Neither “brand-name” recognition of project participants nor the existence or availability of Multilateral Financing should serve as a “step-up” credit enhancement tool for private bankers in assessing Project Financing eligibility for “Third World” development projects. Funding from smaller-sized banks should be made available to smaller or medium-sized entrepreneurships, including native businesses, so long as the income-producing nature of the project can be verified and contractually assured under “Project Financing” concepts.

Part C: As a conclusion, Part C raises the need for reflection and further reassessment of the current patterns, including the following recommendations.

1) The role played by MNC counsel, international business transactions (IBT) lawyers and executives in the shaping of global economic development should be examined and reassessed. Even transactional lawyers should be made keenly cognizant of their role, not only as zealous counsel advancing the interest of their clients, but also as members of an international legal community advocating an “international rule-of-law” system built upon “general

33 Although the post-Enron federal legislation, the Sarbanes-Oxley Act of 2002 (Public Company Accounting Reform and Investor Protection Act), Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.), has changed the requirements for the reporting of “off-balance-sheet” transactions for the protection of the investing public, the new law does not change the principal characteristic of Project Financing – that “Project Financed” loans are non-recourse and, hence, helps shield the borrower and its corporate assets from collateral risks or otherwise from individual obligations beyond project tasks and revenues.

34 The potential harm of one important benefit of Project Financing, the “off-balance sheet” treatment of debts popularly enjoyed by corporate project sponsors in the past decades, may have incidentally been lessened or corrected by the post-Enron legislation, the Sarbanes-Oxley Act of 2002. Sarbanes-Oxley Act of 2002 (Public Company Accounting Reform and Investor Protection Act), Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.). See also Notes 305-08, infra.

35 The development of these recommendations is reserved for for subsequent articles as part of this same series.
principles of law common to the major legal systems of the world,”36 or “the general principles of law recognized by civilized nations.”37 This concept should expressly be added to various state bar codes of professional responsibilities to reflect and meet the demand of a global economy. The imposition of this “double hat” function upon international corporate counsel and IBT lawyers -- both as

36 Restatement (Third) of the Foreign Relations Law of the United States (ALI) Section 102s (1)(c) and (4) (“Derivation from general principles common to the major legal systems of the world” constitutes a “source” of the rule of international law (the “doctrine of sources”); “general principles common to the major legal systems, even if not incorporated or reflected in customary law or international agreement, may be invoked as supplementary rules of international law where appropriate”).


While legal norms representing the consensus of “civilized nations” as both “source” and “evidence” of customary international law are well-rooted in modern international jurisprudence, the danger of legal favoritism leaning toward Anglo-American jurisprudence should be guarded against, as this has caused divergence in the North-South dialogue. Cf., e.g., Rudi Dornbusch, “Check the Laws Before you Invest Abroad,” Business Week (Oct. 28, 1996) at p. 34 (discussing report published by the National Bureau of Economic Research characterizing the world’s legal traditions into two major systems: Anglo-American common law and French civil law; concluding that the rest of nations followed either of the two major systems as a result of colonialism. Rafael La Porta, et al., Law and Finance, NBER Working Paper 5661(1996) (visited February 24, 2004) <http://www.nber.org/papers/w5661>. The conclusion ignores the hybrid nature of the legal systems of the diverse developing world, as well as their own native legal heritage, and, in particular, omits traditional Islamic law (the Shari’a). Noel J. Coulson, Commercial Law in the Gulf States: the Islamic Legal Tradition (1984); S.E. Rayner, The Theory of Contracts in Islamic Law: A Comparative Analysis with Particular Reference to the Modern Legislation in Kuwait, Bahrain and United Arab Emirates (1991). See also Konrad Zweigert & Hein Kotz, An Introduction to Comparative Law (1977) and Parvia Owsia, Formation of Contract (1994). The diversity of legal and cultural traditions among the developing economies should receive recognition, and the approach universally accepted by modern anthropologists – that cultural diversity and cultural relativity contributes to the study of normative and prescriptive behaviors -- should become part of the foundation for international law. See, e.g., Margaret Mead, Coming of Age in Samoa: A Psychological Study of Primitive Youth for Western Civilization (1928); New Lives and Old: Cultural Transformation-Manus, 1928-1953 (1956); And Keep Your Power Dry: An Anthropologist Looks at America (1942); The Study of Culture at a Distance (1953) (with Rhoda Metraux, editors); A Way of Seeing (1970) (with Rhoda Metraux); World Enough: Rethinking the Future (1975) (with Ken Heyman).

The incorporation of multiculturalism into customary international law comports with the emerging trend to reassess “development” as an economic, political, legal, and cultural concept. For example, the European Union has vowed to promote, for instance, “the African-Caribbean-Pacific State (ACP)’s efforts to achieve self-reliant and self-sustained development based on...social values, their human capacities, their natural resources and their economic potential...” Lome Convention, Part IV, Article 4 (1990) (emphasis added). The Lome Convention is an agreement based on “a residual sense of responsibility for the colonial past,” intended to aid the evolution of former dependent territories into the world economy. See European Commission, “Green Paper on Relations Between the European Union and the ACP Countries on the Eve of the 21st Century – Challenges and Options for a New Partnership, http://www.oneworld.org/euforic/greenpap/chap2.htm.; European Commission, “Development: Bilateral and Development Cooperation Relations with Africa, the Carribean and the Pacific -- ‘What are the Current Justifications for Development Aid?’” http://europa.eu.int/en/comm/df08/faq/enfaq08.htm. Now, it is a question of whether this commitment is merely lips’ service or may lead to unintended consequences notwithstanding the best intention.
zealous advocate and as watchdog of the public interest -- has legal support because:

(i) In most national legal systems, the doctrine of social responsibility has helped write public interest concerns directly into the role of profit-making corporations;38 and

(ii) In modern societies governed by the rule of law such as the U.S, lawyers are often described as “officers of the court.”39 Correspondingly, the IBT lawyer, regardless of her transactional specialty or employment, should be considered a member of the global legal community at large – a community aspired and inspired by the rule of law recognized by “civilized nations.”40

2) The regulation of MNCs’ global conduct should be initiated with the national jurisdiction where the MNC is incorporated and headquartered, by way of “enforced self-regulation” or “management-based regulation,” a regulatory model that compels the regulated entities to improve or disclose their internal management to achieve public goals.41 Mandatory periodic disclosure of voluntary corporate compliance policies and programs, which should include multiculturalism training for international executives and lawyers, should be part of this regulatory model.

3) Existing legal principles common to “civilized nations” that can serve the prophylactic function against corporate ills such as fiduciary duties, third party beneficiaries, principal-agency relationship, and the public trust doctrine in property law should formally be injected into modern international economic law, and implemented through the existing mechanism of real-life commerce. In order to achieve this goal, practical modifications to the negotiation and dispute resolution of publicly or quasi-publicly financed international contracts should be considered and implemented. The voices of independent public interest and advocacy groups and non-governmental organizations should be injected into the negotiation and dispute solution process. This is what I call “a public-

38 See, e.g. Model Business Corporation Act, as amended, Section 3.02(13) MBCA (empowering corporations to “make donations for the public welfare or for charitable, scientific, or educational purposes); see also Note 197, infra.

39 See Note 406, infra.


interest approach” to the formation and interpretation of MNC-“Third World”
government investment contracts in which property of the “people” is
immediately at stake.

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PART A
NEGOTIATING WITH THE MONARCH -- A TYPICAL SCENARIO

The following real-life scenario, constructed based on public
information, is used as a hypothetical to set the stage for discussion, and to
provide the context for legal analyses. All names of private parties have been
omitted.

- **The Case Of Vietnam And The Petroleum Sector**

  In the heat and humidity of an April day in Hanoi, the dancing tropical
sunshine in the courtyard of the Defense Guesthouse complemented the spirit
of festivity. It was a special day for PetroVietnam, the state-owned oil company
of the Socialist Republic of Vietnam, which had approval authority over all
petroleum-related investment projects in the country. PetroVietnam's chairman
reported directly to the Prime Minister. In a deal-closing ceremony to take
place that evening, PetroVietnam would officially be granting a U.S.-based
international oil and gas company (IOGC) exploration rights in a contract area
off the Vietnamese coast (the “Vietnam Deal”).

  For the first time in Hanoi, the national flags of the U.S., Russia, Japan,
and Vietnam stood together, forming the backdrop for the signing table.
(Historically, the U.S. used to be at war with North Vietnam; Japan used to
occupy Vietnam; and the Soviet Union was North Vietnam's ally in its war
against the U.S.) Ironically, 19 years ago, it was also during an April afternoon
that U.S. ambassador Graham Martin escaped Vietnam on the last helicopter
out, carrying with him the folded American flag, leaving behind broken ideals
and the despair of hundreds of thousands South Vietnamese collaborators.

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42 See e.g., R. Thomas Collins, Jr., Blue Dragon: Reckoning in the South China Sea (RavensYard

43 VIETNAM'S PETROLEUM LAW (Luat Dau Khi) (National Politics Publishers Hanoi 1993) (version
applicable in 1994). See also PetroVietnam Company Overview,

44 As of January 2002, Vietnam reportedly has oil-proved reserves of 1.4 billion bbl, and natural gas
reserves of 1.3 billion cubic m. See CIA The World Factbook,
http://www.cia.gov/cia/publications/factbook/print/vm.html. Vietnam has no refinery. Accordingly,
although it exports crude oil in volumes as high as 9 million tons, it also imports processed oil products in
volumes as high as 9.5 million tons. The import value of oil and gas products was estimated at $1,000
million for 1997. Plans for refinery constructions are aimed for the early part of the 21st century. See
STA-USA on the Internet, U.S. Department of Commerce,
facing the prospect of communist “reeducation” camps. Almost 20 years had passed since then, but in April, 1994, no U.S. ambassador to Vietnam had been appointed. Under the Reagan-Bush “roadmap” policy, the U.S. and Vietnam had not even normalized diplomatic relations. President Clinton had just lifted the trade embargo, once implemented against Vietnam under the Trading With The Enemy Act. For the deal-closing ceremony, the display of national flags was PetroVietnam’s choice of a symbolic gesture, representing the mutual economic interests that served to alleviate old-time hostility. Vestiges of that prolonged, notoriously devastating war between the U.S. and communist North Vietnam, once making international headlines daily, was surely a creature of the past.

In 1994, Vietnam was looking forward to its 10th year anniversary of *Doi Moi* (“Renovation”), a market economic policy paradoxically implemented under a Leninist, single-party political structure. Heated territorial disputes spearheaded by China over the Spratley Islands were looming over Vietnam’s sovereignty claims to deep-water offshore drilling projects in the South China Sea. Yet, the political tension in the region had not deterred IOGCs from pouring their technology and capital into the Vietnamese continental shelf.

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45 Frank Snepp, Decent Interval (Random House NY 1977) (describing the fall of Saigon from the perspective of a CIA analyst assigned to Vietnam).


47 50 USCA App. Section 1 et al. The initial embargo against communist North Vietnam was entered into in 1954. In 1975, President Ford issued another embargo against South Vietnam under the International Emergency Economic Powers Act, 50 U.S.C. Section 1701 et seq., following the fall of Saigon.

48 To date, the territorial dispute over the groups of islands in the South China Sea has never been resolved, although claimants had signed the “Declaration on the Conduct of Parties in the South China Sea,” a mechanism to ease tension yet falling short of a code of conduct. See also Jonathan I. Charney, “Central East Asian Maritime Boundaries and the Law of the Sea,” 89 Am. J. Int’l L. 724 (1995); Brian K. Murphy, “Dangerous Ground: The Spratly Islands and International Law,” 1 Ocean & Coastal L.J. 187 (1995); Wendy Duong, “The Long Saga of the Spratlys Island: An Overview of the Territorial Disputes in the South China Sea Among Vietnam, China, and other ASEAN Nations,” Texas Transnational Law Quarterly (November 1997) and Currents -- International Trade Law Journal (South Texas College of Law Summer 1997). The oil-related South China Sea disputes have spanned over two decades, involving not only the interest of the ASEAN nations, but also of more economically powerful states such as China and Japan. Henry Scott Stokes, “Oil Riches Off China’s Shores” (New York Times Jan. 19, 1982).

One reason why the private sector is not deterred by territorial disputes is the relative success of the “Joint Development Zone (JDZ)” as a method of resolving sovereign claims over competing economic interests. See, e.g., Ernst Willheim, “Australia-Indonesia Sea-Bed Boundary Negotiations: Proposals for a Joint Development Zone in the ‘Timor Gap’,” 29 Nat. Resources J. 821 (1989); see also Henry Scott Stokes, “Oil Riches Off China’s Shores,” NY Times, Jan. 19, 1982, at D1. The concept allows private investors to develop the contract area economically, and then bring all sovereign interests together to negotiate joint use...
For three reasons, the deal had great significance to Vietnam, both figuratively and economically. First, the exploration block was named after a Vietnamese folklore about a holy dragon reigning in the South China Sea, representing the forefather of the nation. Second, the deal, closed immediately after the U.S.’s lifting of the trade embargo, could be construed as Vietnam’s welcome-back gesture for U.S. companies. Third, the deal supposedly benefited the people, who, under the Vietnamese Constitution, collectively owned all land, sea surfaces, minerals and natural resources. PetroVietnam was simply an agent of the Central Government, which constitutionally represented the people of Vietnam.

The deal was equally significant to the IOGC, not only for profit-making reasons and successful financial engineering, but also for historical pride and perhaps even institutional nostalgia. In 1994, the IOGC was returning to Vietnam, only to claim the fruit of its work by resuming what it had started 19 years ago. During the 1960s and early 1970s, the IOGC had purchased seismic data gathered on the continental shelf offshore South Vietnam and had begun interpretation. In the spring of 1973, South Vietnam invited the IOGC and some other 26 oil companies to submit bids on some 30 offshore blocks. In June, 1973, the IOGC was awarded exploration rights on two of the 30 blocks. By the end of 1973, the IOGC had sold 30% of its interest to a Japanese partner. This U.S.-Japan joint venture was awarded more blocks in February, 1974, and continued to “farm out” its interest to other international partners. Just before Christmas of 1974, the well reached its target depth, and the IOGC declared an oil discovery. But things were changing drastically in South Vietnam back then. While the well was being spudded in March, 1975, the North Vietnamese army was also mobilized to advance along the Ho Chi Minh Trail toward Saigon. On April 30, 1975, a North Vietnamese tank crashed through South Vietnam’s Presidential Palace in the heart of Saigon, ending the two-decade war. The IOGC’s expatriate staff had barely had time to copy seismic data surveys and


well logs, to suspend drilling operations, and then to sail the drilling ship to Thailand. The IOGC’s oil discovery later became the property of a joint venture between the new Vietnam and the Soviet Union. The U.S. oil and gas giant had lost the fruit of its work to the Soviets.51

But things changed again, and in 1994, the IOGC was beginning a new chapter of commerce with the same government that had chased it out of Vietnamese waters some 19 years ago. By virtue of a “Production Sharing Contract,” the IOGC would be conducting petroleum exploration as a contractor of the Socialist Central Government. For its technological work programs, advancement of costs, and investment in the country’s subsoil, the IOGC would be compensated by way of a share in the production of the resources found. In this “Production Sharing” scheme, PetroVietnam (as the government’s agent) would be receiving the people’s share of the oil, and the sales proceeds of such oil share would supposedly be used for the people’s good. Yet, outside Vietnam, various Vietnamese American activists and the handful of NGOs advocating liberal democracy in East and Southeast Asia52 had focused on Vietnam’s poor human rights records, although the country had signed on to the majority of the human rights conventions.53 The indirect implication of their allegations was that perhaps the billions of “Third World” inhabitants were often disregarded in these commercial deals. While such public outcries arguably may create a “shaming” or “moral stigmatization” effect and, hence, may contribute to shareholder activism movements54 or scholarly

51   R. Thomas Collins, Jr., Blue Dragon: Reckoning in the South China Sea, at pp. 21-23 (RavensYard Publishing Ltd. VA 2002).


54 As early as the 1970s, Georgetown law student shareholders of General Motors, aided by their corporate law professor, submitted extensive shareholder proposals to the giant corporation. See, e.g., Douglas M. Branson, “Corporate Social Responsibility Redux,” 76 Tulane L.Rev. 1207, 1215 (2001-2002) (discussing Power-to-the-People initiatives and expanded use of shareholder proxy proposals and public interest directors); Janis Sarra, “Convergence Versus Divergence, Global Corporate Governance at the Crossroads:
literatures debating corporate social responsibility in the IOGC’s home base, such shaming or stigmatization hardly impacts the negotiation between “Third World” governments and MNCs, which quite often take place in faraway lands, conveniently tucked away from the American collective conscience. In those faraway lands, freedom of speech, freedom of information, and freedom of choice can be luxuries rather than a matter of right.

On the other hand, those who believe in government-private sector partnerships as free enterprise’s solution to global economic development may take a different stance. In the Vietnam Deal, if petroleum was found, a long-term relationship between the IOGC and the “people” would commence, creating jobs, stimulating the Vietnamese economy, and eventually raising citizens’ standards of living via the creation of a healthy middle class. It is hoped that this middle class will cry out for a taste of liberal democracy, which ultimately results in campaigns for political freedom, forcing the single-party state to change. If no petroleum in commercial quantity was found during the term of the Production Sharing Contract, the IOGC could withdraw from the country and write off its loss, and the question would become whether the


Vietnam’s 1992 Constitution guarantees freedom of speech, but only “in accordance with the provisions of law.” It protects religious freedom, but also declares that no one “can misuse beliefs and religions to contravene the law and State policies.” 1992 CONST, arts. 68, 69, 70, see also Note 49, supra.
interests of the other group of “people” across the ocean, the IOGC’s shareholders, would have been served by such an unprofitable business endeavor.

From both a business and policy perspective, the poor people of the host country may be sitting over possible petroleum reserves worth billions, while having no technology or capital to develop them. They need the IOGC’s technology, know-how, and capital, which, if properly used, will lead to a more equitable distribution of energy resources, and hopefully a better life for “Third World” inhabitants. Since IOGCs are in the business of looking for petroleum reserves, their investor-shareholders bear the investment risks inherent in share ownership, should IOGCs hit “dry holes” during exploration expeditions. The standard of conduct, therefore, should be whether the IOGC duly complies with Generally Accepted Accounting Standards and Practices (GAAS/GAAP) in the proper disclosure of their material foreign direct investment. Sophisticated disclosure legal regimes such as U.S. federal securities laws (as strengthened by the post-Enron Sarbanes-Oxley Act of 2002) should adequately safeguard the interest of the IOGC’s shareholder public.

Parties to the Vietnam Deal considered it a phenomenal success. The IOGC and PetroVietnam closed the deal worth almost hundreds of millions of dollars in record time. The IOGC even successfully brought into the deal the Russians and the Japanese to share investment risks, and to satisfy the political agenda of the Vietnamese Communist Party’s Politburo. Since the deep-water block was adjacent to the waters subject to sovereignty disputes among China and the ASEAN nations, Vietnam naturally desired to position in the contract area the most impressive cast of characters representing powerful international interests. The deal was accomplished under the most extenuating and difficult circumstances because of geographical, cultural, linguistic, and political differences. Vietnam had a history of warfare and revolutions; its legal system was either in disarray or at best primitive; the IOGC’s behind-the-

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58 “Dry holes” is a colloquial expression in the oil and gas industry, referring to unsuccessful exploration endeavors. See Wendy Duong, The Long Saga of the Spratlys Island: An Overview of the Territorial Disputes in the South China Sea Among Vietnam, China, and other ASEAN Nations, Texas Transnational Law Quarterly (November 1997) and Currents -- International Trade Law Journal (South Texas College of Law Summer 1997) (discussed “dry hole” as realpolitik solution to offshore territorial disputes spurred by oil and gas exploration activities).


60 The non-U.S. interests were represented and publicly announced at the closing ceremony for the Vietnam Deal in Hanoi, 1994. Accord R. Thomas Collins, Jr., Blue Dragon: Reckoning in the South China Sea, at pp. 21-23 (RavensYard Publishing Ltd. VA 2002).

scene counterparts from the host country were die-hard former revolutionary leaders and Party members indoctrinated in the ABCs of Leninism. In the words of a senior international lawyer representing an IOGC, his client might have successfully negotiated with a new form of post-Cold War “monarchy.”

- **Mapping the Scenery: The New Monarchs of the 20TH and 21st Centuries**

  In the case of Vietnam, the new monarch is the Politburo, the real ruler of the nation, viewed by Vietnamese American activists as a nucleus of highly ranked party members not necessarily motivated by free enterprise or liberal democracy as defined in Western political philosophy. In the words of another IOGC executive, the people of Vietnam may “deserve a better government,” but age-old sovereign power and the sanctity of “statehood” conceptually rooted in customary international law preclude outsiders or other nations from intervening in the country’s political processes. The country’s populace, on the

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62 See Note 20, supra. N.E. Maryan, Jr., Negotiating with the Monarch: Special Problems when the Sovereign is your Partner, 745 PLI/Comm, 11, 130 (1996).


64 Notes of author’s personal interview with former Vice President for Negotiation of Texaco International (September 2000) (on file with author).


66 Modern international jurisprudence outlaws territorial conquest or the use of force to invade a nation for economic gains or to control its political processes. The coming into force of the United Nations Charter ended the legality of acquisition of territorial title by military conquest. See, e.g., U.S. Department of State, Documents on International Affairs 2662 (John W. Wheeler-Bennett ed. 1932) (Statement by Secretary of State Henry Stimson (the Stimson Doctrine), announcing that the U.S. would no longer recognize title to territory seized by armed force); League of Nations’ Assembly Resolution (March 11, 1932), codified in the Chaco Declaration (August 3, 1932); the Saaverda Lamas Pact (October 10, 1933); the Montevideo Convention on the Rights and Duties of States (December 26, 1933); Inter-American Conference on the Maintenance of Peace (1936); Declaration on the Non-Recognition of the Acquisition of Territory by Force (Eighth Pan-American Conference 1938). See also Ward Churchill, “Social Justice Movements and Latcrit Community: The Law Stood Squarely on Its Head: U.S. Legal Doctrine, Indigenous Self-Determination
other hand, has shown much yearning for America’s affluence and *laissez-faire* spirit. Any anti-Americanism attributed to the people of Vietnam as the aftermath of war was at best an unsubstantiated myth -- In 2000, the Clintons’ entourage to Vietnam was enthusiastically received as highlight of Vietnamese modern life, especially among youths.67

Perhaps the “monarch” analogy is especially appropriate for Vietnam because, notwithstanding the population’s earnest zeal and healthy appetite for freedom and entrepreneurship,68 the Vietnamese Communist Party holds on to its political supremacy, its exclusive state ownership over key industrial and economic sectors, as well as the licensing authority of its bureaucracy, generally criticized as corrupt and ineffective.69 According to Vietnamese American activists, the fruits of foreign direct investment projects in Vietnam serve the self-interest and political agenda of the government or government-connected elitists, unchecked by principles of liberal democracy or sound macroeconomic management.70 The effect of foreign direct investments has not

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During my business travels in Asia in the mid 1990s, I interviewed, at random, Vietnamese villagers in the outskirts of Hanoi and peddlars in the inner-city neighborhoods of Ho Chi Minh City. All interviewees could not tell the difference between France, America, Cuba, and Russia. All these countries were lumped together in the generic label of “West” (local term: “Tay”). The opposite of “West” is not “East,” but “Us” (local term: “Ta”). “West” or “Tay” also included Japan, Taiwan, and Singapore. When asked whether they considered me a “West” (Tay) or an “Us” (Ta), the interviewees replied that I was probably a “West” although I spoke the local language fluently. China was neither “West” nor “Us,” but was referred to as “China” in the local language (literal translation: “Center of the Universe”). The North Vietnamese villagers had a vague understanding that America, rather than “West,” once bombed North Vietnam. The South Vietnamese peddlars, however, had some intellectual distinction between America and France, and enthusiastically claimed that they once were “friends,” worked for, serviced, or knew someone in America (notes on file with author).


70 MNCs’ “entanglement” with repressive regimes for profit-making in infrastructure development, security arrangements, labor utilization, or environmental-impact projects has become the basis for a number of lawsuits brought by inhabitants of the “Third World” in U.S. courts, thereby testing the limit of
sufficiently “trickled” down to the mass public despite economic reform, thereby widening the gap between those elites and the poor public, occasioning even more seeds for discontentment and disintegration of the social fabric. If this is empirically true, the utility of free enterprise and government-MNC partnerships as vehicles to prosperity and liberal democracy appears to be just a notion of idealism. In this pessimistic view, even goals of the multilateral General Agreement on Trade and Tariff (GATT) and its World Trade Organization (WTO) framework can be a fallacy, although these multilateral systems are symbols of free trade, a concept supported by David Ricardo’s “comparative advantage” economic theory. Viewed this way, the government-private sector partnership is simply a bridge to legitimize the return of colonialism.


Even in the past era of colonialism where conquest was the accepted mode of territory annexation, nation-states still observed the display of sovereign powers and protocols, at least as lips’ services in diplomatic relations. For example, territorial accession by the weaker countries was still the result of formal treaties. Moreover, as in the case of Vietnam, colonialism was viewed by France as a “civilization mission” (mission civilisatrice) and the territorial occupation illustrated the well-intentioned extension of sovereign power by France. See, e.g., Nguyen Van Trung, Chu Nghia Thuc Dan Phap o Viet-Nam: Thuc Chat va Huyen Thoai (French Colonialism in Vietnam: Truths and Myths) (Saigon: Nam Son Publishing 1963); Vinh Sinh & Nicholas Wickenden, Phan Boi Chau and His Autobiography, VIETNAM REV. (Autumn-Winter 1996) at 206; Ho Tam Hue Tai, Radicalism and The Origin of the Vietnamese Revolution (1992); accord Wendy Duong, Gender Equality and Women’s Issues in Vietnam: The Vietnamese Woman – Warrior and Poet, 10 Pac. Rim L.& Pol. J. No. 2 191-326, at 313 (March 2001). During the years that preceded the negotiation of the 1884 Patenotre Treaty, which solidified French colonialism in Vietnam, see Nguyen Xuan Tho, Les Debut de L’Installation du Systeme Colonial Francais au Vietnam (1858-1897) [Buoc Mo Dau Cua Su Thiet Lap He Thong Thuoc Dia Phap Tai Viet Nam (1858-1897)] at pp. 413-462 (Paris 2002), a Vietnamese envoy was dispatched by the King of Vietnam to Paris, during which
The image of the new or renewed “monarchy,” however, does not just apply to Vietnam. Whether the host country is a ravaged country in the aftermath of war, a lesser developed country ruled by a dictatorship, or a formerly Marxist society ready to embrace free enterprise, it is no surprise that host countries overall have been reluctant to give up state control over natural resources and in major industries such as the petroleum or energy sector. The scarcity, potential, and impact of petroleum on a country affects the core of its economic and political strength. Accordingly, government ownership or control is typically the scenario facing an IOGC, regardless of differences in national political or legal regimes.

At the onset, to make certain that the forthcoming analysis is not slanted with preconceived notions of corporate conduct, I will premise my focus on the petroleum and energy sector on the following two observations.

▲ First, the political, economic, and business risks of petroleum and energy projects abroad far exceed those associated with other ventures. This is due to the following factors:

a) Petroleum resources worldwide as well as in the U.S. have declined, leaving the explorationist with little choice but to reach out for potential reservoirs in certain parts of the world plagued with both geological difficulties as well as differences in legal and political systems.74

b) An IOGC’s investment in the petroleum and energy sector is long-term, requiring decades of investment of cash, human capital, as well as technology.

c) Petroleum exploration and development is heavily influenced by geopolitical factors. The existence of the Organization of Petroleum-Exporting Countries (OPEC) as an international oil-producing cartel proceeding the Emperor of France was quoted as stating to the Vietnamese mandarins who led the envoy: “La France est beinveillante pour toutes les nations et proteger des faibles, mais ceux qui l’entravent dans sa marche ont a craird sa severite!” (Translation by Colonel Aubaret: “France is compassionate toward all nations and toward the protection of the weak, but those who stand in the way of France’s marche will know the severity of its action.”) See “The Literat i of Vietnam,” Vol. 2, at p. 100 (Saigon 1969) (edition no longer in print), and notes from the personal collection of certain descendants of the last royal family of Vietnam, recording the November 5 1863 proceedings in Paris, reprinted in Vietnam Dan Chu (Democracy for Vietnam), No. 84 (Denver Edition) (September 2003). See also Shawn Frederick McHale, Print and Power: Confucianism, Communism, and Buddhism in the Making of Modern Vietnam (University of Hawaii Press 2003).

is an example of economic and political influences on the petroleum market. International contractual mechanism has helped achieve certain degree of stability to the market notwithstanding these geopolitical dynamics. Thus, the partnership between an IOGC and the host government is not just a reality, but also a global economic necessity. The concept of injecting public interest consideration or a global watchdog function into these partnerships (other than through the host government as allegedly representative of the “people”) presents the most challenging and perplexing task. Such a task should take into account all interests and policy considerations, and hence cannot be accomplished overnight.

\textbf{Second}, humans’ search for natural resources to better life is not a phenomenon of modern technology. It is an age-old, ongoing endeavor rooted in world history. This endeavor parallels technology progress, and transcends national borders because of the natural geographical groupings of mankind. The United States, because of its technological, economic, and political power, has become the headquarters of several petroleum and energy multinationals. The lawyer and the executive who handle cross-border petroleum and energy transactions encounter legal and business dynamics that are succinctly different from the conduct of oil, gas, and mining activities in the United States. In fact, in most petroleum-producing countries, a constitutional framework based on the U.S. model of rights may completely be alien (the Vietnam Deal is but one example). The dissimilarities in legal systems and constitutional rights models are so varied that any attempt to classify countries for such a purpose may be fraught with error. I will use this as the caveat to the following simplified typology, developed only to map the scenery for discussion.

\textbf{Simplified typology of today’s “monarchs”}

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76 Approximately 90 percent of all transnational corporations are headquartered in the northern hemisphere. Joshua Karliner, The Corporate Planet: Ecology and Politics in the Age of Globalization 6 (1997); accord Tony McAdams, “Globalization: New Demands for the Legal Environment of Business Course,” 19 J. Legal Studies Education 240, at p. 249 (2001). Recent business trends include successful mergers between the top integrated oil and gas companies, thereby concentrating economic powers in a handful of giant MNC-IOGCs. Examples are mergers that created Texaco-Chevron, Exxon-Mobil, and Bp-Amoco. See also Note 17, supra.

77 Under the Vietnamese Constitution, explicit in the provision of rights is the imposition of citizens’ duties owed to the State. See VIETNAM’S 1992 CONSTITUTION, art. 51 (“The citizens’ rights are inseparable from his duties. The State guarantees the rights of citizens; the citizen must fulfill his duties to the State and society.”). The clear consequence of this constitutionally imposed “citizen’s duty” is the sacrifice of individual liberty for state interests, as declared by the government.

78 Horrigan, “Foreign Natural Resources Investment,” supra (chapter 7, section 7.01).
The following typology categorizes today’s “monarchs,” based partly on their political structure, but primarily on the extent of governmental power and involvement in the national petroleum or energy sector. Since the degree and type of government involvement is the principal factor to distinguish the following eight classifications, there may be overlaps among the groups. For example, a developing country that exercises all types of ownership or control specified in this typology may fall under all of the eight groups.

(1) The single-party and “Marxist-remnant” dictatorships. (By “dictatorship,” I am referring to the fact that the country has only one political party, which is the ruling party. Opposition is prohibited.) This category consists of the remaining “gang-of-four” nations that still adhere to Marxist ideology (Vietnam, China, Cuba, and North Korea). In these countries, the communist party is the gatekeeper of the national economy, notwithstanding any “open door” policy, economic reform, or investment incentives. The degree of civil liberty oppression or governmental economic domination varies, depending on the country or a particular ruler in power.

(2) The “U.S. embargoed” and “economically sanctioned” “monarchs.” This group may overlap with group 1 above, because Marxist countries such as Cuba and North Korea are officially on the U.S.’s “economically sanctioned” list. This group also include countries such as Iran or Libya, sanctioned by act of Congress, and countries such as Sudan and Myanmar, sanctioned by Executive Orders. U.S.-based nationals and

79 Out of those four nations, only Cuba and North Korea remain on the U.S.’s embargo list under the Trading with the Enemy Act. China has opened to the West since the 1970s after President Nixon’s visit to Beijing, and Vietnam followed China’s example in 1985 with its “Renovation” national economic policy and its 1987 Foreign Investment Law modeled after China’s original Foreign Investment Law. See, e.g., VIETNAM’S 1987 FOREIGN INVESTMENT LAW (Luat Dau Tu Nuoc Ngoai), as amended (Office of The State Committee for Cooperation and Investment) (December 29, 1987). Compare New Investment Guidelines (New China News Agency June 29, 1995); The People’s Republic of China’s Foreign Investment Regulations, FE/2342/S2 (June 29, 1996).


businesses (and at times their own or controlled foreign subsidiaries) are banned from economic relations with these countries (including some countries in group 1 and all of group 2). Some of the U.S. ’s economic sanctions, such as the Cuba boycott, raise unresolved questions challenging U.S. foreign policies.

(3) Modified democracy: the single-party, so-called “laissez faire” economies. This group of “monarchs” paradoxically combine economic laissez faire philosophy with a single-party, non-Marxist political regime. One such example is Singapore, which has long referred to its single-party political philosophy as “modified or Asian-styled democracy.” In Singapore, although private ownership of economic sectors is permitted, only state-owned enterprises are allowed to engage in certain types of industry. The utility sector in Singapore, for example, has traditionally been subject to such governmental ownership and control.

83 Export Administration Regulations, 15 C.F.R. §736.2 (b)(3) . See also Export Administration Act of 1979, 50 App. U.S.C. §2404 (a)(1); Cuban Assets Control Regulations, 31 C.F.R. Part 515, Sections 515.204 and 515.559(a) and (b).


85 Senior Prime Minister Lee Kwan Yew of Singapore is a proponent and advocate of Asian-styled modified democracy. See Lee Kwan Yew, “Democracy, Human Rights and the Realities,” speech by the Prime Minister to the “Create 21 Asahi Forum, Tokyo (November 10, 1992), printed in 16 SINGAPORE MINISTERIAL SPEECHES (1993). See also, e.g., Frank Ching, “Eye on Asia: Is UN Declaration Universal?” FAR.E.ECON.REV. August 28, 1997, available at 1997 WL-FEER 11441604. Lee Kuan Yew’s approach to Singapore’s political economy is economic determinism. The Cambridge-educated Senior Prime Minister believes that a prospering economy and social order are the major components for success, and he uses political authoritarianism to achieve this end result, trading off democracy or individual liberty for economic prosperity. Han Fook Kwang, Warren Fernandez, Sumiko Tan, Lee Kuan Yew: The Man and His Ideas (Singapore Times, 1998); Lee Kuan Yew, The Singapore Story: Memoirs of Lee Kuan Yew (Singapore Times 1998). See also Rafael X. Zahralddin-Aravena, “Chile and Singapore: The Individual And The Collective, A Comparison,” 12 Emory Int’l L. Rev. 739 (1998) (criticizing that although Singapore’s economic success fulfilled Prime Minister Yew’s economic vision, the small nation already reached its height so far as output quantities were concerned, leaving the fostering of creativity to be desired; author pointed out shortcomings of Yew’s economic determinism).

86 For example, Singapore Power, the state-owned utility company of Singapore, controls the utility sector in this one-city country. Singapore, however, is in the process of restructuring and privatizing its electric power sector, which will transform the monopoly into a competitive market. Two subsidiaries of state-owned Singapore Power, PowerSeraya and PowerSenoko, along with Tuas Power, are currently generating electricity. PowerGrid, another subsidiary of Singapore Power, maintains and operates the country’s electricity transmission and distribution system. The Singaporean government currently owns majority stakes in all of these firms through holding companies. The process of privatization has been repeatedly delayed, and current plans call for the Singaporean government to divest its stakes in the electric utility sector in 2004. See http://www.eia.doe.gov/emeu/cabs/singapor.html#ELEC.
(4) **Non-Marxist state ownership of natural resources.** The analogy of MNCs doing business with “monarchs” is also appropriate in most developing economies that, at some point and to some degree, have declared state ownership over natural resources, land, or surface use, regardless of political regime. In the developing nations falling under this group #4, natural resources are owned by the state, or by the “people” administered through the state. (Despite the economic dominance of countries such as U.S., Canada, France, and the U.K., which recognize private ownership of natural resources, state ownership of minerals is in fact the more common global regime.) State ownership can be established by treaty or constitutional authorities, as in the case of Russia, Mexico, Albania, and Yemen, and/or by specific petroleum legislation, as in the case of Russia, Kazakhstan, Bolivia, Guatemala, Peru, and Cambodia. Governments may also mandate the type of contract or form of

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87 Countries in Group #4 may overlap with group #1, because group #4’s political structure may either be single-party or multiple-party-based, or they can be multiple party-based in name and on paper, but single party-based in reality (meaning that no one else but the incumbent party can afford to run in a national election). This group #4 is distinguishable from Group #2, because Group #2 are “off the limit” so far as U.S.-based MNC-IOGC’s (and their foreign subsidiaries, as the case may be) are concerned, due to economic sanctions imposed by the United States.


89 Although countries such as the U.S. and Canada give effect to private ownership of underlying minerals, under specific factual circumstances, questions concerning sovereign or private rights over certain minerals continue to arise in the country’s national jurisprudence. See, e.g., Amoco Production Co. v. Southern UTE Indian Tribe, 526 U.S. 865 (1999).

90 More recently, countries such as Brazil and Venezuela have adopted new statutory or constitutional provisions that open some limited upstream operations to private companies, although ownership of hydrocarbons will remain exclusively with the state.

91 For Russia, see Federal Treaty (agreed and initialed in Moscow by the plenipotentiary representatives of 19 of the 21 Republics within the Russian Federation, Art. II, 1992 WL 472427 (Rus. Legis.)); for Mexico, see Constitucion Politica De Los Estados Unidos Mexicanos, Art. 27 (1917); for Albania, see 1994 Foreign Investment Law of Albania, No. 7764, “There is Freedom of Investment,” found at: http://r0.unctad.org/en/subsites/dite/idistats_files/pdfs/Albania_profile.pdf; see also Under Albanian Constitution, found at: http://www.oefre.unibe.ch/law/icl/al00000_.html#A010; for Yemen, see Yemen Constitution, article 7, adopted on: 16 May 1991, found at: http://www.oefre.unibe.ch/law/icl/ym00000_.html.

doing business in the petroleum or energy sector, as in the case of Brazil, Mexico, and the Philippines. Countries may also by law designate specifically the agency, ministry, or state-owned oil and gas company that has the authority to enter into contractual arrangements with foreign entities, as in the case of Vietnam, Ghana, Mexico, or New Zealand (ii) as in the case of Cambodia, Australia, and Niger, the procedure by which such contractual


For Cambodia: see Cambodian Investment Law, at http://www.mekongexpress.com/cambodia/general/caminvestlaw.htm;


94 For Vietnam, see Note 43, supra.

95 In Ghana, petroleum operations are governed by the Petroleum Law of 1984, which empowers GNPC [Ghana National Petroleum Corporation] to operate in all open acreage of the country on its own or in association with foreign partners. The basic contract between the state, the GNPC and the private companies is the Production Sharing Agreement. See Mbendi Information for Africa, Ghana: Oil and Gas Industry, at http://www.mbendi.co.za/indy/oilg/af/p0005.htm.

Petroleos Mexicanos (PEMEX) of Mexico and PetroVietnam of Vietnam are examples of how a government may entrust mineral resource development entirely to state ministries or grant monopoly to state-owned enterprises (SOE). See, e.g., “The Role of State Oil Companies,” Oil & Gas J. 37 (Aug. 16, 1993).


arrangements can be entered – whether by international tender or bidding, or by informal negotiation.

State ownership can also be exerted, not only over natural resources, but also over land and surfaces, similar to such property concepts existing in U.S. property law as rights-of-way or easements. Governments, via their sovereign power, may charge a fee for land-use or surface right-use for any investment project that requires a local site. Finally, even if surface rights can be privately owned or used, the host country may proclaim governmental authority to acquire such rights via the process of eminent domain or equivalent.

(5) Various degrees of state control over natural resources, particular types of industry, and related property rights. Other “monarchs” who do not proclaim state ownership nonetheless may exercise various degrees of state control over natural resources, land use, and/or particular major industries such as telecommunications, media, transportation, mining, energy, utility, and defense technology. Or, a country may proclaim both exclusive state ownership over specific types of natural resources, and, at the same time, exert blanket state control over certain sectors or industries, regardless of whether those sectors or industries involve natural resources. Further, the government may also declare certain protected areas as subject to state control due to environmental, safety, or national security reasons. Finally, even if all resources, land, and surface rights can be privately owned or acquired, the government may still either own or control access routes for transportation or use of seaports and other export or distribution outlets. All such title, access and usage must be negotiated and specific government-private sector partnerships formed as a result.

(6) “Monarchs” as gatekeepers: various degrees of state control over foreign direct investments across the board, regardless of sector or industry. A country may also impose minimum state equity ownership over

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99 See, e.g., Willard v. First Church of Christ, Scientist, 498 F.2d 987 (9th Cir. Cal. 1972); Restatement (Third) of Property, Servitudes, Section 2.6, Reporter’s Note (T.D. No. 1, 1989); Holbrook v. Taylor, 532 S.W.2d 763 (Kentucky 1976). See also Othen v. Rosier, 226 S.W.2d 622 (Texas 1950) (implied easement).


101 One such example is the case of Broken Hill Proprietary (BHP), an Australian-based Multinational, whose gold discovery and development in Coronation Hill, Australia, was halted due to the government’s designation of the area as having aboriginal significance, after BHP had spent substantial efforts and energy exploring the area and evaluating commercial prospects of the gold deposit. Darden, supra, at p. 60.

FDI projects as a whole, regardless of the type of industry or sector to which the FDI project pertains. This can be illustrated by the history of local equity ownership requirements for FDI projects in Mexico. More importantly, at a national level, state control and ownership can be part of a bigger political agenda, perhaps not spelled out in the written law or in any publicly available governmental policy statements. On an ad hoc basis, at any point in time and in the absence of contrary national laws, under its sovereign “jurisdiction to prescribe,” the government may rely on its national interest to justify its role as gatekeeper of the economy or of a particular industry or project, regardless of its political or economic philosophy.

(8) **De facto or decentralized state control: unwritten custom, and the discretionary power of town lords and village chiefs.** Regardless of political systems, it is always the government, or its various offices or instrumentalities, who can deny visas, travel documents, permits, licenses, and who can engage in the use of force and police power, including the issuance or execution of search and arrest warrants. Ad hoc exercise of sovereignty will determine, on a real-life basis, whether a foreign investor has right of entry to the local market, or whether local entrepreneurs can master their own fate by seeking direct partnership with foreign investors outside of the host government’s control. Further, at the provincial, township, or village level, oral traditions and cultural norms, including certain local governmental practice and preferences not documented in the written laws, create enormous discretionary power for various town lords, village chiefs, neighborhood police commissars, or heads of governmental instrumentalities or political subdivisions in the developing world. (Professor Michael Gordon calls this body of unwritten law and custom a country’s real-life “Operation Code”).


105 Id.
of governments ranges across a wide spectrum, and constitutes a major influence in the pattern of “Third World” global economic development.

The term “monarchy” may not be just rhetoric, after all.

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**PART B**

**DISSECTING TWO TYPICAL PETROLEUM AND ENERGY FOREIGN DIRECT INVESTMENT TRANSACTIONS**

In this Part B, I will examine and dissect two types of major foreign direct investment transactions:

1) The “upstream” petroleum transaction like the Vietnam Deal, in which the host country grants the MNC-IOGC the right to explore for oil and gas on national territory (hereinafter “the Upstream Transaction”); and

2) The “mid-stream” independent power-generation project (IPP) transaction, in which natural gas discovered as a result of the Upstream Transaction will be used to generate electricity to service the country and/or the region, as part of the MNC-IOGC’s strategy to develop a long-term gas sales market (hereinafter the “Midstream Transaction”).

Both transactions constitute the bread and butter of the integrated IOGCs (entities such as ExxonMobil, Chevron-Texaco, Unocal, ConocoPhillips, Royal Dutch/Shell Group, StatOil, TotalFinaElf, BP-Amoco, or Mitsubishi Oil). The Midstream Transactions, in particular, are the core business of the power

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107 This Article does not address classic Downstream Transactions. (There are professionals who consider all “Midstream Transactions” to be part of the Downstream segment of the petroleum industry.) Classic Downstream Transactions are diverse in nature and may not always involve high capital or high risks. They can be end-user-oriented and do not always result in large-scaled partnerships between MNCs and host governments. For example, 1) a franchise agreement may be executed between the Marketing Division of the IOGC and a gas station owner in a host country; 2) an agreement to distribute and sell petroleum products to a country may be executed between the Marking Division of an IOGC and an individual distributor or agent, who is a native of the host country. Depending on the language of the distributorship agreement, the IOGC may not need a presence within the host country, and may completely rely on its local distributor to market and sell the IOGC’s petroleum products; or 3) an agreement to supply parts or services to an oil refinery in Southeast Asia may be executed between a major supplier company and the IOGC that owns the refinery, involving millions of dollars and shipments across the world. All three agreements are categorically part of the downstream segment of the petroleum industry.

developers such as El Paso Energy, Pacific Energy, Dynergy, Duke, Coke Industries, Tractebel USA (a subdivision of Lyonnais des Eaux of Europe), and the now bankrupt Enron.108

Both types of transactions also generate subcontractor relationships between the above MNCs and (i) the oilfield service industry (companies such as Baker Hughes and Schlumberger); (ii) the international engineering and construction industry (companies such as Halliburton, Raytheon, Fluor Daniel, and Bechtel); as well as (iii) the heavy industry manufacturers (companies such as General Electric, Westinghouse, or Carterpillar). The magnitude of these projects is evident, both in terms of the amount of capital required, as well as the brand-names of the corporate players involved.

I. Case #1: The Upstream Transaction109

In industry jargon, activities of the petroleum industry can be categorized into three distinct segments: upstream (where the natural resources and raw material are found); downstream (the refining, marketing, selling, distribution, and trading of energy products or commodities – collectively the delivery of those products to the ultimate consumers); and mid-stream (infrastructure development, processing, transporting, or converting raw material into energy products or commodities, and/or any other processes that connect the upstream segment to the downstream segment). Although the upstream-midstream-downstream dichotomy may be unique to the petroleum sector or to mining activities, the concept behind these segment classifications is actually meaningful in any manufacturing business that involves the discovery and utilization of raw materials to be uncovered from nature at the source, especially when the business has developed a vertical expansion, whereupon the same holding entity owns the entire chain of products and services: from raw material discovery (upstream), manufacturing or production activities using the raw material uncovered (midstream), and ultimate consumer distribution (downstream).

Because the industry’s technical and business issues typically drive legal considerations, terms such as upstream, midstream, and downstream have been built into the vocabulary of the international business lawyer servicing the

108 At one time, Enron Corporation was an energy developer and pipeline company before it turned essentially to energy trading as its core business over the course of several years prior to its financial collapse. Enron began trading natural gas commodities in 1989. MSNBC Interactive, "Enron Rise and Fall," and "Who’s Who in the Enron Scandale," found at http://www.msnbc.msn.com/id/4311642// See also 10K Annual Reports of Enron Corporation 1988-2000. In 1999, Enron began to sell off large chunks of its power development services and subsidiaries. International IPP Transactions became part of Enron’s Wholesale Energy Services. See http://www.enron.com/corp/investors/annuals/. One of such transactions, Enron’s 60%-owned Dabhol power project in India discussed in Part B.II of this Article, was reported as an unconsolidated equity affiliate. 10K Annual Reports of Enron Corporations, 1995-2000.

109 The analysis of Case #1 applies specifically to the international petroleum sector. It does not apply in general to the U.S. domestic oil and gas legal regime.
petroleum and energy sector, and hence take on legal meanings. For example, an “upstream” exploration contract (such as the Vietnam Deal) typically involves high capital, and contains unique legal issues inapplicable to a downstream transaction (such as a franchise contract enabling a gas station franchisee to sell gasoline to the ultimate consumers).110

In U.S. modern petroleum terminology, the upstream segment is typically divided into three major functions or phases: the Exploration for petroleum, the Development of such petroleum at the wellhead, and the Production of such petroleum prior to transport to a refinery or ultimately for end-user distribution. Between Exploration and Development, there may be a sub-phase called Appraisal, during which the reserve discovered is appraised for technical development. These four phases constitute Petroleum Operation or Petroleum Activities. From the U.S. oilman/woman’s perspective, these phases of upstream activities have replaced the formerly popular word, the exploitation of petroleum resources, which has taken on a negative connotation associated with the era of colonialism, especially in international operation involving the “Third World.”111

A. History, Development, and Semantics: It has been said that petroleum exploration is a unique activity, whereupon the party with capital, technology and know-how agrees to pay an owner of natural resources for the right to do work free of charge.112 This is not an overstatement or ironic expression, and will make perfect sense if the capital and technological commitment made by an IOGC is viewed as a fee for access to the natural resources that may be found in some landowner’s backyard. Simply stated, the landowner needs a contractual mechanism under which the expert operator will

110 See Note 107, supra.

111 Today, the term “exploitation” is still used in academic discourse, as a legal or business term in certain developing countries, or in earlier model form agreements. See Model Form International Operating Agreement, published by Barrows Company Inc., reprinted in Andrew B. Derman, Monograph Series No. 16: International Oil and Gas Joint Ventures: A Discussion with Associated Form Agreements (ABA Section of Natural Resources, Energy, and Environmental Law (1992), at 94; Keith W. Blinn, Claude Duval, Honore Le Leuch & Andre Pertuzio, International Petroleum Exploration and Exploitation Agreements: Legal and Economic Policy Aspects 108-09 (1986). See also Venezuelan Hydrocarbons Law (2001) (referring to exploration, exploitation, collecting, transportation and storage as petroleum “primary activities”); Bolivarian Republic Of Venezuela Decree With Force Of Organic Law Of Hydrocarbons, Chapter I, Fundamental Provisions, Section I, Article 1, Scope Of The Decree-Law; found at: http://www.petroleumworld.com/oillaw.htm. “Exploitation” in Venezuelan law means all upstream phases subsequent to exploration (or what is known in the U.S. as Development and Production). It follows, therefore, that that the division of upstream activities into the three phases (Exploration-Development-Production) is not necessarily universal. The three phases represent modern American terminology. In the Russian Federation, for example, the term “Development” is used to encompass both the Development phase and the Production phase. The Russian terminology, therefore, consolidates petroleum “exploitation” activities into two phases: Exploration and Development. CITE FROM NHA TRAN. The lack of universality is further complicated by linguistic difficulties and translation issues.

be given access to “farm the field” 113 and uncover the natural resources for the benefit of both parties.

To achieve this goal, historically, governments and IOGCs have negotiated their interests in one of two systems: Concessionary or Contractual. As will be explained below, the differences between the two systems are rooted in the development of Anglo-American versus the French legal concept of mineral resource ownership.

1. The Concessionary Model. In the Concessionary system, private ownership of mineral resources is allowed.114 The term mineral is handily used here to refer to all natural resources underground, although in geological terms, petroleum may not qualify as a mineral. In most commercial contracts and legal regimes, petroleum is defined as including both oil and gas.

Like the term “Exploitation,” the term “Concession” can be dated back to colonial time and, hence, equally tainted due to political correctness.115 Today, it can be used synonymously with a country’s petroleum fiscal regime called the “royalty/tax” system. Where the government (and not private landowners) owns minerals (as in the case of offshore reserves), under the Concessionary system, the government will transfer title of minerals to the IOGC that extracts and produces the resources, since private ownership is allowed. The government will then charge (i) royalty, in its capacity as owner, and (ii) income or profit taxes upon the IOGC’s corporate income, in the government’s capacity as taxing authority. A Concessionary System may also be described as a licensing system, in which the IOGC-contractor is required to obtain a license for each phase of operation (Exploration, Appraisal, Development, and Production). The IOGC-licensee can receive and claim title to net proceeds of petroleum sales after it has paid tax and royalty to the government. Despite the

113 In the international petroleum sector, the legal expression “Farm-In/Farm-Out” is used to describe an assignment of interest in a contract area. For example, in the Vietnam Deal, after the IOGC and PetroVietnam have signed the Production Sharing Contract (PSC), the IOGC may “farm out” part of its interest in the PSC to another oil company to share risk and equity. John S. Lowe, “Analyzing Oil and Gas Farmout Agreements,” 41 Sw. L. J. 759, 763-64 (1987).


115 The term Concessionaire may be used to refer to an IOGC operating in a Concessionary System, but it is not part of the American terminologies, although private ownership of minerals in the U.S. can readily serve as an example of a Concessionary system. The term may still be used in academic discourse.

availability of petroleum private ownership, the license in the Concessionary System denotes that Petroleum Activities may heavily be regulated by the state.117

In contrast, under various **Contractual Systems**, the government owns the minerals. An IOGC-contractor only has the right to receive a share of production or revenues from petroleum sales in accordance with contractual terms. Generically, there are two types of contracts: a **Service Contract** and a **Production Sharing Contract (PSC)**. A Service Contract can be further divided into two categories: a **Classic or Pure Service Contract**, and a **Risk Service Contract**.

2. The Service Contract model. In a Service Contract arrangement, ownership by, or title transfer to, the contractor is removed all together.118 The IOGC-contractor gets compensated for the performance of its technical services. It can get a straight fee regardless of success or failure of the exploration endeavor (a **Classic or Pure Service** arrangement). Where such fee is not paid unless and until petroleum is discovered and produced, the contract is a **Risk Service** arrangement, because the contractor is taking the risk of exploration failure. If there is no petroleum discovery, the contractor loses its investment and does not get paid by the government.119 Thus the real difference between a Pure Service Contract and a Risk Service Contract depends on whether the contractor’s fee is contingent upon profit. Today, a Classic or Pure Service Contract (where the contractor gets paid regardless of exploration failure)120 is very rare. It may still be found in the Middle East, where governments already have substantial capital and seek only certain expertise or technology from a contractor for hire.121

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118 A Service Contract may give the Service Contractor the right to purchase petroleum from the government. In that case, the contractor may end up having title to the petroleum it has purchased.


120 Pure Service (risk-free) Contracts are the norms in the oilfield service industry. Examples of oilfield services are rig services, drilling services, helicopter services, crew transportation services, emergency medical services, etc. These subcontractors will get paid regardless of whether the exploration venture results in an economically viable petroleum discovery. Ron Baker, A Primer of Oil Well Drilling, 35-44 (University of Texas at Austin, Petroleum Extension Service,5th ed. 1994), printed in Smith, Dzienkowski, Anderson, Conine, Lowe, & Kramer, International Petroleum Transactions (2d Ed. Rocky Mountain Mineral Law Foundation 2000).

121 A species of Pure Service Contracts is the Technical Assistance Agreement, which allows a host country to take advantage of the MNC-IOGC’s technological and managerial expertise without compromising the sovereignty’s ownership and control. See Agreement between PETROVEN and Exxon, found at 2A Collection of International Concessions and Related Instruments 280 (edited and annotated by Peter Fischer with collaboration of Thomas Walde), excerpted and reprinted with permission of Thomas
3. The Production Sharing Contractual (PSC) Model. In the following discussion, the term “Production Sharing” and the acronym PSC are used interchangeably.

“Production Sharing” concepts dated back to French Napoleonic traditions – that mineral wealth was not owned by individuals, but rather by the state for the benefit of all citizens. In contrast, private ownership of minerals has its root in Anglo-American legal traditions, as typified by the United States. The earliest use of the Production Sharing system occurred in agriculture. Farmers, as tenant-sharecroppers, farmed the field, the title to which was held by the government or landlords. Sharecroppers were then compensated by a share of production. With the passage of time, the “Production Sharing” philosophy did not remain a French Napoleonic product. (Ironically, the current French petroleum fiscal system is not PSC-based, but, rather, is a royalty-tax regime in which private ownership of minerals is recognized).

The first PSC was executed in Indonesia -- a former Dutch colony -- in the early 1960s, under the authority of the Indonesian 1945 Constitution, when the country began to take on its status as an oil-producing nation in the “Third World.” The Production Sharing scheme came about as the gradual result of changes in the pattern of international petroleum exploration since the end of World War I. The enhanced bargaining positions of petroleum-producing countries.

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122 F. H. Lawson, et al., Amos and Walton’s Introduction to French Law 93-94 (3d ed. 1967); Marcel Planiol, 1 Treatise on Civil Law §§ 2392-2394 (Louisiana State Law Inst. trans., 12th ed. 1939) (1959). The Civil Code gave owners of property ownership of the subsurface estate, Code Civil art. 552, but Napoleon decided in 1810 that mines should be at the disposal of the state, effectively depriving the surface owner of all control over the mineral estate. The government then granted concessions to private property owners for mining.


125 Indonesian Constitution, Article 33 (1945) (“All the natural wealth on land and in waters are under the jurisdiction of the State and should be used for the benefit and welfare of the people.”) See also The Petroleum Report – Indonesia’s Petroleum Sector (U.S. Embassy, Jakarta, Indonesia June 1990).

126 The Republic of Indonesia, the world’s largest archipelago, achieved independence from the Netherlands in 1949. The country’s current problems include poverty, strained relationship with the IMF, low investor confidence due to lack of reliable legal recourse, corruption, political instability, and security in the region. Approximately 27% of the population live below poverty line (statistics as of 1999). As of January 2002, the country reportedly has an estimated oil reserve of 7.083 billion bbl, and a natural gas reserve of 2.549 trillion cu m. The country also has pipeline facilities for crude oil, natural gas, and petroleum products. See The World Factbook, http://www.gov/cia/publications/factbook/print/id.html.
countries throughout the years, as well as adverse actions taken by new regimes in places such as Libya and Iran.\textsuperscript{127} motivated U.S. oilmen (and women) to devise a new system more appealing to governments than the earlier Concessionary system. Hence, the earlier Concessionary System modeled after the U.S. oil and gas leases was replaced with negotiated share of production, as high as a 50-50 profit split between the IOGC and the host government, as in the case of Venezuela in 1948.\textsuperscript{128} Overall, the IOGC-contractor is compensated for its working interest via a grant of a negotiated percentage of petroleum production, which typically consists of 1) production representing its recovery of costs (called "\textit{Cost-Recovery Oil}," if oil is discovered); and 2) production representing the contractor’s profit (called “\textit{Profit Oil}” if oil is discovered). In a PSC System, the IOGC-contractor may still be required to pay tax and royalty to the host government, depending on the local law.

B. **Comparison of the three systems (Concessionary, PSC, and Service Contract).**

The PSC is much akin to the Risk Service Contract, because under both arrangements, the contractor is not compensated \textit{unless and until} it finds and produces petroleum. There is no “Production Sharing,” nor fee for service, if the exploration venture fails.\textsuperscript{129} Principally, the differences between the PSC system and a Service Contract system depend on whether the contractor is compensated in \textit{cash} or in \textit{kind} (for example, payment made in \textit{Crude Oil}\textsuperscript{130} is payment in kind). In a Service Contract, the contractor may earn only a fixed fee, whereas in a PSC, the contractor can participate in the upside potential of production. If compensated in kind, the PSC contractor receives a share of production and hence can take title to the Crude. In such a case, the PSC contractor enjoys rights of private ownership just like in a Concessionary system. So, essentially, the main difference between the PSC system and the Concessionary system can be stated as follows: The point of title transfer (from the owner to the IOGC-contractor) may shift from the wellhead (as in a Concessionary system), to the point of petroleum export (as in a PSC system).\textsuperscript{131} The PSC is simply an innovative deviation of the Risk Service Contract,


\textsuperscript{129} Failure does not necessarily mean that the contract area is devoid of potential reserves. Failure simply means that under a set standard of “\textit{commerciality},” as defined by contract, exploration efforts have reached certain financial or technological limits, and it is no longer economically viable for the IOGC-contractor to continue its search.

\textsuperscript{130} For a definition of “\textit{Crude Oil},” see Note 286, \textit{infra}.

\textsuperscript{131} See, \textit{e.g.}, Law and Policy in Petroleum Development (Frances Pinter (Publishers) Ltd. London, England, 1979).}
engineered by U.S. independent oilmen/women to meet the demands of the oil-producing countries.

It follows, therefore, that in a PSC system, the government, via its instrumentality, will also receive a share of production by splitting profit with the IOGC-contractor, in addition to receiving tax and royalty as sovereignty. This “share” formula is called the Profit Split. (In contrast, in a Pure or Classic Service Contract, the government bears the risk of exploration failure, or it may pass the risk on to the contractor as in a Risk Service Contract). Unlike the Service Contract model, where the IOGC is simply a contractor and the host government is a principal, the Production Sharing scheme enables the government to become the IOGC’s equity partner, earning both a profit and sharing in costs, in addition to collecting tax and royalties.

A PSC typically covers all upstream activities (Exploration, Appraisal, Development, Production). The Exploration Phase alone may cover a term of five years. Examples of the PSC System include Egypt, Guyana, Indonesia, and Malaysia.\footnote{See, e.g., Model Production Sharing Contract Between PERTAMINA and Private Companies (1977), printed in VI A Collection of International Concessions and Related Instruments 59 (Peter Fischer ed. 1985); Robert Fabrikant, “Production Sharing Contracts in the Indonesian Petroleum Industry,” 16 Harv. Int’l L. J. 303, 313 (1975).} As of the mid-1990s, the number of PSCs outnumbered Service Contract agreements by a ratio of 5 to 1.\footnote{Johnston, Daniel Johnston, International Petroleum Fiscal Systems and Production Sharing Contracts (Daniel Johnston & Co., Inc. 1994).} It is fair to conclude that in various modified forms compared to the original Indonesian PSC, Production Sharing has become a standardized model for petroleum exploration around the world, and has dominated start-up petroleum foreign direct investment for the past three decades.

Today, Indonesia’s PSC model sets the standards for PSC terms, at least for the developing nations or for Asia-Pacific.\footnote{Notes 125 and 126, supra; Oon, The Politics of Oil in Indonesia: Foreign Company-Host Government Relations (Cambridge University Press 1986) at p. 17, cited in Johnston, supra at 261. Accord, Foley & Gussis, “Tax & Fiscal Regimes: A Comparative Analysis,” and XXX Frame, “Risk and Reward – Assessing Upstream Potential,” Oil and Gas Production Sharing Contracts, Concessions and New Petroleum Ventures in the Asia-Pacific Basin, Conference Proceedings (Institute for International Research, Houston, Texas, April 1993).} The PSC may take thousands of hours of lawyers’ and executives’ time, culminating into hundreds of pages of documentation carefully drafted, reviewed, and negotiated. Or, the PSC may involve certain standard terms already incorporated into the country’s petroleum legislation, not subject to negotiation. The National Association of International Petroleum Negotiators (AIPN), the networking group for IOGC “upstream” executives and lawyers, has published its own recommended model PSC, widely respected and observed in the industry.\footnote{See http://www.aipn.org/}
Thus, the degree of negotiation in a PSC transaction depends on whether the host country has a model contract, whether that model contract is specifically part of the country’s legislation, and whether it is feasible for the IOGC to propose modifications, exemptions or deviations from the model contract or the law. Even if the local law allows modifications, the host government may, or may not be willing to negotiate different terms, depending on the leverages of the parties under the circumstances. Further, where the model contract is part of the country’s legislation, or where the model contract does not exist, norms of practice or contractual precedents from prior deals may provide the IOGC with the framework for negotiating its proposed relationship with the government. In reality, a very poor country with a primitive legal and fiscal regime would typically “negotiate” from an agreement drafted by the IOGC’s lawyer, with not much leverage for demanding any other specificity or supremacy, and would grant as many of the IOGC’s requests as needed to keep the IOGC interested.

Naturally, the IOGC’s share of production must be sufficient not only for it to recoup all costs, but also for it to make adequate profit. The Profit Split, therefore, is among the key economic factors that drive negotiation. Other essential features of the Production Sharing system include:

--title to the hydrocarbons remains with the state, and no private ownership is permitted, except for the share of production granted to the contractor as its compensation.

--the state maintains overall control and the contractor is responsible for conducting Petroleum Activities.

--The IOGC-contractor submits *Annual Exploration Work Programs and Budgets* for scrutiny and approval by the state.

--The IOGC-contractor provides all financing and technology and bears all risks.

--The IOGC-contractor will be entitled to certain amounts of petroleum discovered to recover its costs (**Cost-Recovery**). After Cost Recovery, the remaining production will be shared according to the **Profit Split**.

--All equipment purchased or imported into the host country will become the property of the state, except for leased equipment or equipment provided by service subcontractors. This is the direct result of state ownership over natural resources and assets connected to Petroleum Activities.

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C. The Dynamics of Negotiation in the PSC Regime And The Role of Lawyers.

The capital-intensive and high-risk nature of upstream transactions, as well as their complexity, necessitates substantial lawyer’s involvement. Preceding the actual contract negotiation is the process of international tender and bidding, based on the government’s terms or requests for proposals, whereupon a contractor or consortium of contractors is chosen to conduct Petroleum Activities. Typically, the government enters into a PSC with an Oil and Gas Contractor for a given Contract Area. A Contract Area that is the subject of an IOGC’s PSC with a host country may cover more than one exploration Block. A Block is simply an area designated by the government as the subject of a call for tender or bidding in order to generate foreign investment interests. (An IOGC-contractor may have an interest in a block in the United Kingdom, which has a Concessionary system, and another block in Indonesia, which has a PSC system).

Even before the tender or bidding process, much time and effort may be spent for the examination and exchange of geological data, the performance of various field trips and technical studies, and various informal exploratory sessions and meetings between government officials and representatives of the IOGC to explore mutual interests and evaluate the potential of the project. During these preliminary meetings, the IOGC may test the level of competition, and solicit or lobby for government support. In each step preceding the contract award and the actual negotiation of the PSC, lawyer involvement may be desired or required.

For the actual contract negotiation, the give-and-take depends on the overall objectives of both sides. In an ideal situation, host governments desire capital investment and technology transfer from IOGCs. IOGCs, on the other hand, require ready access to the Contract Area, government approvals and support for Petroleum Activities, and ultimately a share of production sufficient for the companies to recoup all costs and achieve desired profit goals. In principle, these two sets of interests are mutually complementary to each other, leading to bargained-for positions. In an ideal world, both sides do their job with the best intention and conscience – governments duly safeguard the people’s resources and are inspired to use the proceeds of petroleum sales for the betterment of their societies; IOGCs are respectful of the host country’s environment, labor, natural sources, and cultural heritage, and are willing to curtail excessive profit goals in the interest of the host environment and local community, in order to be competitive and to fulfill corporate social responsibility. Conflicts, nonetheless, occur when either party is motivated to alter the equilibrium of the risk allocation dynamics to secure the maximum advantage for itself, at the cost of the other side. In the worst case scenario, both sides neglect the public interest at heart.

Specifically, potential conflicts over the dynamics of give-and-take may occur in connection with the following seven legal and business concepts essential to the PSC regime. I will explain these concepts as the context to examine the current pattern of global economic development, and to raise
certain arguments regarding its windfall or pitfall. The **seven** PSC legal and business issues are listed below.

1. **Operatorship.** By virtue of an **Operating Agreement** or **Joint Operating Agreement** (JOA) executed separately from the PSC, the IOGC-contractor will assume the status of an **Oil and Gas Operator**, who will conduct Petroleum Activities in the Contract Area. The Operator is the entity that controls or monitors all technical and management issues (subject to voting control by equity interest owners), and hence drives the progress and success or failure of the Petroleum Operation. An upstream Production Sharing deal is often a twin-contract deal -- the PSC and the JOA together constitute the legal documents describing the deal and the legal relationships created thereby.\(^{137}\) While the PSC defines the rights and obligations of the IOGC as a contractor and/or business partner of the host country (and hence is sometimes referred to as the **“host government contract”**), the JOA, on the other hand, defines the rights and obligations of all project participants, including those non-government entities who may share investment risks with the IOGC, as well as the commercial arm of the host country serving as the IOGC’s local partner. The JOA establishes internal procedures, and addresses management, control, and operational issues. The PSC is prone to standardization by operation of local law, because the state authority that exercises sovereign power over the project is a contractual party. The JOA, on the other hand, is generally not standardized by operation of law, although it may still be subject to legal requirements of the local jurisdiction. Obviously, the PSC and JOA for a particular project must be coordinated and, quite often, are negotiated concurrently.

2. **Participating Interest, Joint Venture Interest, and Transferability.** The JOA Operator and PSC Contractor can either be a single company, or a **Consortium** of companies and interests, or a **Joint Venture**

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\(^{137}\) This does not include various financing documents, legal agreements preceding the actual negotiation of PSC terms, or other legal agreements subsequent to the execution of the PSC/JOA in order to implement the project.
consisting of, at a minimum, two Joint Venture partners. A Consortium or equivalent can be defined as an alliance of companies, whose rights, obligations, and extent of cooperation are determined solely by contract. Generally, the Consortium has no independent juridical status because it is not formed under any system of national law, although the consortium formation agreement may contain choice-of-law and choice-of-forum provisions reflecting the consensus of the parties thereto in the event of a contractual dispute. A Joint Venture, on the other hand, may be incorporated or unincorporated, depending on the law of the place where the joint venture is formed (lex situs).

Thus, under either a Concessionary system or a PSC system, the Joint Venture form may be used to formalize the partnership between the IOGC and the government, or a State-Owned Enterprise (SOE) of the host jurisdiction. (In the Vietnam Deal, PetroVietnam served dual purpose, as representative of the nation-state, and as an SOE acting as the nation-state’s commercial arm). The business partnership formed by the Joint Venture Contract creates joint venturers’ obligations to share risk, equity, costs and expenditures, and enables joint participation in management and operatorship. The host government typically will prefer the Joint Venture form, because it allows state-owned companies and governmental instrumentalities to receive technology transfers and training more directly and continuously, and even to participate in project management and operatorship side by side with the technologically abled foreign investor. Where the local law requires such Joint Venture to be incorporated, the result is the formation of a local company or juridical entity established to conduct Petroleum Operation and Petroleum Activities, of which both the IOGC and the SOE are functionally shareholders.

If unincorporated, the Joint Venture is in essence a partnership as that term is understood in U.S. law, but the unincorporated international Joint Venture will be governed by the law stipulated in the Joint Venture Contract’s “choice-of-law” or “governing law” provision. U.S. courts have defined an Unincorporated Joint Venture as a partnership having a specific purpose, for a specific duration, and designed for a specific project, although the Joint Venture Contract may still contain disclaimer language alleviating joint and several liability among joint venturers (except to the extent provided by the Joint Venture Contract).

Where equity, risks, and costs are shared in an Unincorporated Petroleum Joint Venture arrangement, the result is typically the creation of Participating Interests. A Participating Interest obligates its holder to share in costs and expenses, and entitles him or her to take a percentage in equity and profit. An Unincorporated Joint Venture structure where the host

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139 Id.

140 If the Joint Venture is incorporated, the Joint Venturers’ ownership interest will be given the legal term accorded by the law of the place of incorporation (lex situs).
government or its SOE holds a Participating Interest in the project may also be described as a "Government Participation" system.\textsuperscript{141} Where there is Government Participation, the Joint Operating Agreement (JOA) establishes the rights and obligations of the government and the IOGC both as interest owners and business partners, even though the IOGC may alone assume \textit{operatorship} of the field due to its technical capabilities.

The Participating Interest held by the IOGC may be reduced after the PSC has been signed. This is because even though the IOGC alone executes the PSC with the host government, it may later decide to seek additional foreign investors to share risks and costs by selling part of its Participating Interest to third parties. In such a case, the “assignment,” “transfer,” or “assignability” clause in the PSC becomes extremely important. The clause also provides the legal mechanism for the IOGC to remove itself from the project or escape further contractual obligations by transferring all of its Participating Interest to a third-party assignee, who will take over the IOGC’s work commitments \textit{vis-à-vis} the host government by assuming the IOGC’s Participating Interest. The PSC’s “transfer” clause will lead to the execution of a separate \textit{farm-in/farm-out agreement} to effectuate the terms of the transfer (the transfer is a \textit{farm-in} for the assignee-\textit{farmee}, and a \textit{farm-out} for the assignor-\textit{farmor}).

If the transfer is completely made “offshore” away from the jurisdiction of the host country, the government will look solely to the initial IOGC-contractor for all work commitments and obligations under the PSC. In most cases, the host government will not want such secretive “offshore” transfer that manages to escape the host country’s jurisdiction or power to regulate. It will prefer to preserve its right to approve or veto the IOGC’s transfer or choice of an assignee, or otherwise impose certain conditions upon such a transfer. For example, the assignee may be required, as a matter of standardized procedure, to establish its economic viability as an enterprise, and/or its technical ability to perform under the PSC to the satisfaction of the host government.

Whether or not the choice of an assignee remains the exclusive domain of the IOGC, or is subject to the host government’s approval (either \textit{pro forma} or via \textit{ad hoc} review), as a matter of practical economics, farm-in candidates cannot just fall out of “nowhere.” Farm-in companies are usually other IOGCs or state-owned companies fully supported by neighboring countries having an economic interest and political foothold in the region. These farm-in candidates must visibly and demonstrably measure up to the capabilities, resources, and stature of the original IOGC who executed the PSC, and to whom the host government looks for the completion of exploration Work Programs. These farmees can either be well-established independent oil producers, or consortia thereof, or, more typically, those MNCs with brand-name recognition in the petroleum sector – only the giants who dominate the industry can afford to take

\textsuperscript{141} See, e.g., Derman, International Oil and Gas Joint Ventures: A Discussion with Associated Form Agreements, Section of Natural Resources, Energy and Environmental Law, Monograph Series Number 15 (The American Bar Association, 1992).
the risks and costs of international Petroleum Operation. Naturally, the original IOGC will be looking for farm-in partners who share its business philosophy, who can provide cost sharing and capital contribution, and who can form substantial allies with the original IOGC-contractor long-term. The smaller entrepreneurs have little chance to gain an equity position in such an environment of networks and alliances fortified by the kind of financial backing and grouping that naturally defeat competition from the lesser equipped.

Farm-in/farm-out arrangements are routinely done in the industry, amounting to an effective risk-spreading and business-alliance framework. In most cases, the host government gives pro forma approval, requiring screening for, and proof of, financial and technical capability. But in reality, the host government will likely be making these approval decisions based on geo-political factors. A farmee not favored by the government due to its activities elsewhere in the country or in the region will be unlikely to receive the host government’s support. For example, in the Vietnam Deal, the Vietnamese government would probably not approve a farmee who held a Participating Interest in another contract area granted by the Chinese government, over which contract area Vietnam and other ASEAN nations each had asserted a competing territorial claim. Naturally, Vietnam would not favor such a farmee due to its national interest and resulting hostility toward China. As another example, both the IOGC-contractor and the host government may favor a farmee who is already developing an adjacent contract area, or who has already obtained rights of exploration in several contract areas in the country or the region. Such a farmee may have greater economic incentives to acquire additional interests in adjacent areas in order to achieve economy of scale in its overall development strategies. In summary, the choice of a farmee can be both geo-political and economic.

If, however, the original IOGC manages to effectuate a farm-out completely “offshore” purely for purposes of cost and risk sharing, while maintaining as the primary contractor in the host country, the IOGC may be able to avoid any geopolitical factors triggered by the governmental approval process and, hence, will have more flexibility in choosing a partner based solely on its internal economic needs. The choice, however, will still be bound by the monopoly nature of the industry as a whole -- only a handful of players can afford to assume the risks and costs associated with petroleum ventures in the developing economies. The result is that only a few dominant MNC players, locked together in farm-in/farm-out positions and in original contractual arrangements with governments, will “reign” over the economy of the entire country or the region, if and when petroleum is found. Overall, risk-sharing alliances among IOGCs are often made subject to strict confidentiality undertakings.

142 See, e.g., John S. Lowe, “Recent Significant Cases Affecting Farmout Agreements,” 50 Inst. on Oil & Gas L. & Tax’n 3-1 (1999).

143 See Note 48, supra (discussing territorial disputes in the South China Sea).

144 See AIPN Model Form International Study and Bid Group Agreement, Art. 14.
While such confidential international farm-in/farm-out arrangements may bear all characteristics of large-scaled acquisitions, they may not be governed by any national law’s anti-competitive regulatory regime, let alone any regional oversight. **First**, these farm-in/farm-out arrangement does not implicate the IGOC’s home jurisdiction’s anti-trust concerns or interest. **Second**, the transitional economies may not have developed effective and sophisticated anti-competitive laws. **Third**, the speculative nature of upstream endeavors – that prospective profit is rendered uncertain by various geological appraisal risks – can make the gauging and assessment of anti-competitive effect either premature, speculative, impossible, or inappropriate. Farmers and farmees are obligated to **spend** money before they can make money, if they make money at all! In other words, due to the “hit and miss” nature of exploration programs, all players, no matter how dominant or monopolistic, may go home with losses rather than gains, and this is the reality of the business. Accordingly, how can there be any anti-competitive effect on a market when, at the end of the day, there may be no commodity and no market at all? It is evident, however, that the inter-corporate farm-in/farm-out arrangements, as well as the MNC-government partnerships, are all tightly negotiated partnerships, generally well-sealed from the public light, motivated by the high-risk, high-cost transactional dynamics between parties who control technology, capital, and access to the uncovered “crown jewels,” all in a less than ideally stable economy. The screening and approval of the host government of farm-in/farm-out arrangements, which may amount to acquisition of enormous ownership interests of natural resources, often falls short of any systematic anti-competitive regulatory framework, and justifiably so. The result, nonetheless, is still the creation of **de facto** cartels – a group of IOGCs joined together in consortia or farm-in/farm-out arrangements, supported by governments.145 The cartel dominates and shapes a transitional country’s petroleum industry and hence its national economy. The domination has impact beyond the border and can reach regional or global dimension. The reality is: foreign direct investment in petroleum projects will continue, but only if the losses suffered by IOGCs in exploration endeavors on balance are outweighed by their gains in an environment with rapidly declining petroleum resources. More so than ever, the capacity of small- or medium-sized independent producers is diminishing in an increasingly competitive globe.

An example of a business environment consisting of **de facto** petroleum cartels, is the current oil development picture in poverty-stricken Chad: all four IOGC giants -- Exxon-Mobil, Chevron, Conoco, and Shell -- have joined forces to develop the industry there. Three out of the four are U.S.-based corporate giants, and although Shell is a Dutch company, it has substantial producing subsidiaries or affiliates in the U.S. 146 Critics of MNCs may opine that a U.S.-

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145 Commentators have long cautioned against the risk of global monopoly for the new millennium. For the year 2000, worldwide mergers totaled nearly $3.5 trillion. Ed. Crooks, “Deals Start to Dry Up,” (Fin. Times (London) April 12, 2001) at 3; Tony McAdams, 19 J. Legal Studies Education at 264. This figure does not include **de facto** combinations of capital such as the pattern discussed in this Article.
based de facto cartel has situated itself for the control of Chad’s national economy, and potentially of petroleum-producing Africa. On the other hand, the rational economist may legitimately pose the following question: Where will Chad be, some 20 years from now, without the involvement, cooperation, alliances, and resources of these “cartel” members who are both financiers and technology specialists? the hope brought to Chad by the monopolistic petroleum industry, no matter how thin or how flawed, is still better than no hope at all.

The picture is clear: modern “monarchs” participate, cooperate with, and support private de facto cartels, either as a matter of choice or simply lack of choice. Due to the high risk, capital-intensive, and technically complex nature of upstream Petroleum Activities (especially when the host country is in an economically embryonic stage), these monopolistic partnerships effectively preclude the development of a native or local entrepreneurial class capable of investing in, and benefiting directly from, the natural and energy resources of their own homeland. When the modern monarchs shake hands with the MNC rainmakers, the door to true capitalism is forever closed to the inhabitants of the transitional economies, or the hopefully emerging entrepreneurial middle class. The true owners of natural resources stand anonymously, unobtrusively, and passively at the mercy of those in power and control, who finalize the handshakes based on confidential negotiations. There can never be, for the oil-producing countries that remain poor, the jovial scene of the “Beverly Hillbillies” moving their horse-carts merrily into their Beverly Hills mansion because oil has been found on their land in Texas! The only hope for true ownership of petroleum by the people is when the SOEs that are commercial arms of the host government (such as PetroVietnam in the Vietnam Deal) are eventually privatized, and shares are offered to the public for direct purchase. In such a case, all traumatic problems of the past chaotic experience with privatization of the state-owned economy will be apt to re-occur, as has been experienced with China, Germany, the former Soviet Union, and Eastern Europe. But even if this “privatization” scenario can successfully materialize one day, the public at

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146 For information regarding Shell Oil Company and its substantial operation in the U.S., see Note 18, supra.

that time might still be too poor and too sick to afford ownership of shares in a petroleum publicly traded company! (Countries stricken with poverty such as Nigeria and Chad suffer from high infant mortality and short life expectancy, which together belie the hope for true prosperity or improved standards of living).  

3. The “Carry” of Costs and Expenses. Although holders of Participating Interests are required to contribute equity and to bear their proportionate shares of costs, this may not always mean that the Participating Interest holder will have to contribute cash flow to support expensive exploration activities. Where the host government or its SOE insists on holding a Participating Interest in the project, such a Participating Interest may be “carried” by other investors or participants all through the various stages of Petroleum Activities. The “Carry” means that all financial burdens and the risk of exploration failure are borne by foreign investors, even though the host government is entitled to hold a Participating Interest. If exploration fails, the host government will not have to pay back the Carry.

Understandably “Carry” is the norm in the developing nations. Typically, the IOGC-contractor will only “carry” the Participating Interest held by the host government or its SOE. (The IOGC-contractor will not be looking to “carry” the interest of any of its other partners, especially if the IOGC is counting on these partners to share investment risks! In fact, most likely the IOGC-contractor will be looking to other foreign partners to share its “carry” of the government.) The host government’s economic dependency upon the IOGC who “carries” the government’s costs is inescapably evident, yet the party who is economically dependent is also the party who plays the role of the sovereign regulator overseeing the IOGC’s conduct in the country.

Quite often the IOGC’s “Carry” obligation will be effective through the exploration phase, where risks of failure are the greatest. Accordingly, during PSC negotiation, the IOGC’s goal will be to minimize its “Carry” obligations as much as possible, not to extend the “Carry” beyond the exploration period. After a commercial discovery, the government or its SOE should be able to obtain financing for its obligations via a pledge against its forthcoming share of production. In other words, the government’s “carried” interest is typically a non-cost-bearing interest, which may be converted into a cost-bearing interest upon production startup. The IOGC will want to assure that all “carried” costs and expenses be ultimately reimbursed out of production. The contractual framework under which “carried” costs and expenses are reimbursed is part of the “Cost Recovery” terms.

4. The Work Program. The exploration program typically consists of kilometers of seismic data, a definite number of wells to be drilled (Obligatory Wells), and, in some cases, an additional number of optional wells to be drilled (Non-obligatory Wells). These work commitments constitute the IOGC-

148 See Note 16, supra, discussing public data on the natural resources and living conditions of Nigeria and Chad.
contractor’s Work Program – a contractual undertaking made to the host country in exchange for access to the country’s natural resources. This is why the IOGC-contractor finds itself peculiarly in the position of someone who promises to perform work for free. The right to install and work a drilling rig on sovereign ground is literally the consideration in exchange for the IOGC’s Work Program!

The Work Program may even impose penalties for contractor’s non-performance, and can be secured by a Standby Letter of Credit issued for the benefit of the host government, in order to safeguard against the IOGC-contractor’s default.149 If the IOGC-Contractor fails to finish the Work Program, the host government can draw upon the Letter of Credit to make good its damages, and, in addition, sue the IOGC-Contractor for breach of contract in the underlying PSC transaction. The role of the Standby Letter of Credit can also be fulfilled by similar instruments such as a bank’s financial guarantee, a surety performance bond, and/or a “parent” or corporate” financial or performance guarantee provided by the IOGC’s parent holding company.150 In summary, not only does an IOGC-contractor do “work for free,” but it may also be penalized or made subject to further financial loss if it fails to perform or complete the work.

One way for the IOGC to control financial risks is to put a maximum limit or ceiling on the Work Program. This limit can either be “money-driven,” or “work-driven.” If the Work Program limit is “work-driven,” the PSC may specify that the IOGC is required to drill a specific number of wells, and that the wells meet certain criteria or purpose. In a “money-driven” Work Program, the contractual commitment is typically to conduct exploration up to a maximum budgetary limit – a financial cap. When the ceiling is reached, the IOGC-contractor has no obligation to perform additional exploration activities or spend more money. It may then withdraw from the host country or otherwise validly abandon the project.

Where there is a discovery of a reserve in the Contract Area, two major issues will immediately arise. First, under most contractual arrangements, discovery of petroleum will entitle the contractor to the exclusive rights of exploitation. However, this may not be a universal rule. Accordingly, a specific “exclusivity” provision may become necessary in the underlying PSC. Without a express “exclusivity” provision, the host government, due to geopolitical factors, may require the IOGC to take on an equity partner after the reserve has been found, thereby interfering with project management and limiting the IOGC’s chance for maximizing profit. To the extent the country’s law requires


certain procedural prerequisites, the IOGC-contractor must make sure it complies with and performs all such requirements in order to secure exclusivity.

Second, the IOGC-contractor will have to determine whether the reserve is substantial enough for the IOGC to proceed to the subsequent phases of Development and Production. If the reserve is substantial enough to justify the costs, it may be found to be “commercial.” This determination may necessitate certain governmental action, because the government, either by law or contract, may have reserved a licensing or approval authority for itself with respect to each and every step of Petroleum Activities. This approval authority is even more crucial with respect to a declaration of “commercial discovery,” as will be explained below.


The nature of exploration work is such that the more exploratory activities are conducted in the Contract Area, the more likely the investor may discover petroleum if the Contract Area indeed has reserves. The logic is simple: The contractor will need to drill as much as possible, as long-term as possible, in order to “hit that stream.” The more wells are drilled, the more chance there is for the IOGC-contractor to make a commercial discovery.

The limit set on the Work Program forces the IOGC to perform “educated guesswork” by estimating into the future the costs or work involved to secure the maximum chance for a commercial discovery. This guesswork has to be done in an environment full of uncertainty and variants, even with the most sophisticated geological sampling and technical analysis. To deal with these appraisal risks, the IOGC-contractor may have to secure for itself a “withdrawal right,” or the right to disengage from future obligations, in order to bring the investment or project to the conclusion when it determines that further work and expenditures contradict sound economic judgment. The host government, on the other hand, may insist on the opposite course of action – it wants to reserve for itself the right to call for a higher commitment than originally contemplated, either in terms of monetary spending or the drilling of additional wells. A balance of these competing demands and interests must be obtained by negotiation in order to achieve the compromised mixture of “give-and-take.”

It follows, therefore, that a decision by the IOGC to withdraw from the project does not necessarily mean that the Contract Area is devoid of deposits. Instead, it is the IOGC’s economic judgment whether the finds are “commercial” enough to be worth the costs of developing them. Accordingly, critical to an exploration contract is the “commerciality” clause, which sets the standards for determining whether a petroleum discovery is economically feasible and appropriate for development (as opposed to being abandoned).

Commerciality is the legal concept that, if triggered, will allow the IOGC the right to exit the project based on its economic judgment, in order to “cut its losses and go home” without further obligations to the host government. The concept thus conditions contractual obligations upon the viability and
profitability of a project.\textsuperscript{151} In the ideal negotiating situation, the IOGC-contractor will want total final discretion over the legal definition of commerciality. It wants to control its right to proceed and invest more money, or simply withdraw in order to prevent an economically losing proposition. The determination may even depend on external factors such as high production costs in an environment of declining oil price, or whether a marginal reserve can be jointly developed with another substantial reserve in order to achieve economy of scale. At times, the IOGC may procure a \textit{“claw-back”} right to return to the project after it has withdrawn for lack of commerciality, as economic viability may be a fluid judgment depending on both external and internal factors or changed circumstances.

In contrast, the host country will also want to have the discretion to declare whether a discovery is commercial, as such declaration will mark the end of the Exploration phase and the beginning of the Development phase, which may ultimately lead to petroleum production that can change the future of a country. Here, conflicts may arise and intense negotiation may result. At best, the government will want to put the burden of proving non-commerciality upon the IOGC-contractor, and will want to scrutinize and have approval or veto authority over the IOGC-contractor’s determination of commerciality. Realistically, for national interest reasons, no government will want to yield such absolute discretion to the foreign investor. Quite often, commerciality determination becomes a joint decision by the IOGC and the host government. Where the scale tips will depend on leverage and bargaining power under the circumstances.

Likewise, as an extension of the “commerciality” concept, the IOGC-contractor may want to protect its power of control by contractually dividing the exploration work commitment into sub-phases. It may want to retain the right to evaluate and withdraw at the end of each sub-phase, thereby maintaining its discretionary flexibility whether to renew or extend the time duration for exploration. It may also want the discretion to reduce or expand the Contract Area. (This flexibility is even more critical in case of a gas discovery (rather than oil discovery), because the development of a gas discovery will depend on possibilities of long-term gas sales contracts in the region, or other acceptable marketing schemes.) At the other end of the spectrum, the host government will also want to maintain its power to approve or disapprove each of the

\textsuperscript{151} As a legal concept, \textit{“commerciality”} may occur in contexts other than petroleum exploration. For example, in a construction project concerning a production or manufacturing facility, commerciality may mean whether the income-producing plant is able to perform up to specified capacity. In the construction process, \textit{“mechanical completion”} alone is not sufficient; the plant must also be capable of \textit{“commercial operation.”} These are often legal terms defined in the contract to help determine whether the construction contractor has satisfactorily fulfilled its obligations to the owner/developer of the facility. Typically such commercial operation standards are determined and certified by the owner-developer as well as by the host government. If the plant does not meet the test for commercial operation, the contractor is not discharged from performance obligations and may have to pay liquidated damages. The risk resulting from the plant not meeting commerciality criteria, therefore, can be shifted entirely to the construction contractor. \textit{See, e.g.,} John Mauel, \textit{“Common Contractual Risk Allocations in International Power Projects,”} 1996 Columbia Bus. L.R. 37. \textit{See also Part B.II infra} (discussing Case #2, the Midstream Transaction).
contractor’s decisions and, in general, will want the contractor to prolong or expand exploration work in hopes of future finds for development.

6. **The Host Country’s Fiscal Regime and Bonus Requirements.** Despite the differences in legal systems, an economist may be able to chart precisely the economic consequences for either party by scrutinizing the terms of the PSC. In other words, in any legal system, it is possible to calculate and figure the percentage of the Government Take versus the Contractor Take out of the production of petroleum found in a Contract Area. The Government Take consists of the taxes, royalties, production share or Government Participation claimed by the host country or its SOE, plus any payment of bonuses asked of the IOGC-contractor at various points during the contract’s life. All these elements together constitute the host government’s petroleum Fiscal Regime. The Contractor Take, on the other hand, refers to the after-tax, after-cost share of petroleum (or fees paid, depending on the legal system) to which the contractor is entitled.152

From a macro-economic standpoint, a petroleum-exporting country’s Fiscal Regime is the legal and economic mechanism by which “Economic Rent” is captured via the Government Take, in order for the country to maximize its wealth. Various “Economic Rent” theories explain the government’s Fiscal Regime, and may provide insight into the conflict, as well as may justify the balance, between the economic interests of host governments versus those of IOGC-contractors. Under these theories, “Economic Rent” is the difference between the value of petroleum and the costs to extract it.153 “Costs” consist of not only the expenses of Petroleum Activities, but also the profit claimed by the contractor. Accordingly, Economic Rent is the same as excess profit available for grab by either party, after IOGCs have recouped all of their expenditures and captured their desired profit:

\[
\text{Value of Petroleum} - (\text{Expenses} + \text{Profit}) = \text{Economic Rent} = \text{Excess Profit}
\]

Governments, in the role of resource owners analogous to landlords, will attempt to capture as much Economic Rent as possible through taxation, royalties, its share of production, and required bonuses. IOGCs, on the other hand, will want to maximize profit to the farthest-reaching limit, whenever possible. In other words, IOGCs want to claim excess profit, if the fiscal and legal regimes so allow. The Government Take, therefore, serves to curtail IOGCs’ excess profit.


Among the elements constituting the Government Take, tax and royalties may be set by national legislation and, hence, can rarely be negotiated. The IOGC, however, can negotiate within the range of royalty rates provided by law, and/or it can negotiate or apply for tax holidays or exemptions, or a ceiling limit upon business income tax (at times called profit tax). Typically, royalty rates have not exceeded 15% of the value of production.\(^{154}\) As to income tax, quite often, governments or their contracting SOEs have been willing to pay for the IOGC-contractor's tax out of the government's share of production, and then provide the IOGC a receipt to enable it to seek income tax credit back home, especially when, as in the case of the U.S., the home jurisdiction taxes worldwide income and then provides the taxpayer with a credit for the amount of income taxes paid to foreign governments in order to avoid double taxation.\(^{155}\)

Where the host government or its SOE absorbs the IOGC's income tax obligations (as described above), naturally the IOGC-contractor will have to accede to a higher production share for the government, since such production share must encompass the payment of the IOGC's income tax to the host jurisdiction. For the IOGC-contractor, the benefit of having the governmental entity assume the IOGC’s local tax burden is merely the streamlining of paperwork created by the enforcement of the host government's taxation scheme – the foreign investor does not have to worry about it, since the SOE, a governmental instrumentality, will then be paying taxes on the IOGC's behalf.

Government Participation can be another bite of production added to the Government Take. (There are jurisdictions that opt not to charge a royalty and, instead, focus on Government Participation or production sharing). Government Participation can also guarantee certain rights of control for the host government or its SOE with respect to the management and operation of Petroleum Activities. Excessive Government Participation, therefore, can be a disincentive to the IOGC's decision to invest.

Negotiation thus centers around balancing the Contractor Take against the Government Take – both sides want the biggest bite of Economic Rent. Ideally, the government's goals are to design a Fiscal Regime that:

- provides a fair return to the nation-state as well as to private industry (otherwise, no foreign investor would invest);


• avoids undue speculation or unpredictability (which will dissuade foreign investment);
• limits undue administrative burden upon the government as well as foreign participants (which will also dissuade investment);
• provides sufficient flexibility to cope with the country’s changing needs; and
• creates healthy competition and market efficiency.  

In reality, due to unequal bargaining powers, their desperate need for technology and foreign capital, and their inexperience, the lesser-developed transitional economies stand to give up more than gaining in the negotiation process. Accordingly, the goals set forth above can be purely aspirational. For example, the exclusivity of the “MNCs and Friends Club” may negate the goal of fostering healthy competition or stimulating entrepreneurship in the host country (The only group of “entrepreneurs” that may benefit from training and technology transfer is the contracting SOE, controlled and selected by the government). Accordingly, various measures by which a government captures Economic Rent become the sovereignty’s tools to correct the imbalanced pendulum. Yet, as explained below, these measures themselves may also become the seeds of vice.

Specifically, since tax and royalties are typically set by law, and production shares or Government Participation are carefully negotiated via contracts, the payment of bonuses to governments as resource owners becomes the only flexible mechanism for the host government to capture Economic Rent. In other words, where appropriately administered, required bonuses paid by an IOGC-contractor to the host government are proper ways for the government to minimize or eliminate the IOGC-contractor’s excess profit. Accordingly, contractual terms such as Signature Bonus (payable to the host government upon contract execution) and Production Bonus (payable to the host government upon production startup) have become acceptable norms of the international petroleum industry. The host government may decide to award the PSC to the IOGC-contractor who can voluntarily minimize its profit margin by offering to pay the highest bonuses to the host country. The company does not have to do this unless it voluntarily offers to do so, or unless the host government mandates bonuses as a bidding requirement. Hence, not all PSCs have bonus provisions, although bonuses have provided the competitive edge and increasingly become the norms for PSCs around the world.

Bonuses thus increase the Government Take, and can be payable in cash, or as equipment, supplies, social programs, or technology transfer. From the perspective of the investor, Production Bonuses are better deals than Signature Bonuses -- at the time of production startup, appraisal risks

regarding exploration failure have practically been eliminated, as a commercial reserve has been found. If there is no commercial reserve discovered, Signature Bonuses already paid are considered part of the IOGC’s investment losses.

In reality, the Government Take (achieved through the developing nation’s petroleum Fiscal Regime) does not always result in wealth and well-being for the nation-state or its populace. This is particularly true in countries with a bad reputation for corruption and dictatorship, but this fact can also be the result of governments’ incompetence, mismanagement, and other macroeconomic errors. The bonuses thus become the vulnerable places where abuse of governmental power can occur. The inverse movement and disparity between a hefty Government Take in petroleum Fiscal Regimes and the progress or sustained development for the nation-state and its populace can best be illustrated in an analysis of the bonus system, as detailed below.

Bonuses, when payable in cash, can be a direct source of hard currencies to the host government. The import of hard currencies – meaning currencies of the economically strong industrialized nations such as the U.S. dollar, the Euro, or the Yen, to which the weaker currencies may be pegged -- can help solve a developing country’s “balance of trade” or “balance of payments” problems, which can jeopardize the country’s good standing in the international monetary system administered by the IMF. In a pervasively corrupt country where bribery is received at the very top, hard currencies poured into the country can also become illicit contributions to the “bloated Swiss bank accounts” of corrupt government officials. The most recent scandal and federal anti-bribery investigation initiated by the U.S. Department of Justice involved finder’s fee and acquisition payments made by defunct Mobil Corporation (now Exxon-Mobil by virtue of corporate merger). The payments


Balance of trade problems refer to the surplus or deficit that results from comparing a country’s expenditures spent on imports to receipts derived from its exports. Balance of payments, of which balance of trade is a component, refers to the tabulation of a country’s credit and debit transactions with other countries and international institutions. Healthy volumes of exports payable to the exporting countries in hard currencies, and abundant in-bound flows of foreign capital into the country will supply the country with surplus hard currencies sufficiently to make the economy strong. http://www.imf.org/external/pubs/ft/weo/2002/02/pdf/chapter2.pdf.

were made to a U.S. citizen and owner of a merchant bank, who allegedly acted as agent for the government of Kazakhstan. These payments (in the millions) were allegedly made in connection with Mobil's acquisition of, and development activities in, the Tengiz field in Kazakhstan. According to U.S. prosecutors, these payments were eventually channeled into private bank accounts allegedly owned or controlled by the President of the Republic.160 Similar bribery allegations have been made against the giant international construction company, Halliburton, with respect to its work in Nigeria.161

A Press Release issued by Transparency International (TI) (an NGO specializing in international anti-corruption campaigns), which accompanied TI's 1997 Corruption Perception Index (CPI), alerted the public that there was a direct link between levels of corruption in the developing economies and foreign direct investment. The CPI compilers concluded that a large share of corruption was the explicit product of MNCs, headquartered in leading industrialized nations, using massive bribery and kick-backs to obtain contracts in the developing world and countries in transition.162 Other anti-corruption activists outside of the TI's network have also argued that “a country becomes or remains poor under a familiar formula: its corrupt government, which represents the "elites" in terms of power concentration, maximizes the Swiss-bank accounts of its leaders by selling the national economy to a group of companies who pay rich bribes for the guaranteed right to monopolize their respective sectors in the local and regional market.”163 If this view and allegation can empirically and consistently be proven, the “development” model of global economics is an abject failure.164 With the web of corruption in place as a way of life, there is no way for the “rich” democracies to help the approximately 3 billion people who are citizens of some 100 impoverished nations, unless the flow of capital and resources can get to the people who need


160 Id.


164 The adequacy, completeness, and neutrality of the CPI and its conclusions may be challenged, but at a minimum, its efforts raise public awareness and create a chance for consideration by policymakers, as well as studies and research by institutional experts.
them. But is this web of corruption perpetuated by MNCs, and which one comes first, the chicken or the egg? Serious attention, therefore, must be given to the empirical patterns of relationships between FDI capital, the current status of anti-corruption law, trends of international legal cooperation, and the poverty statistics of the developing world.165

Following the release of the 1997 CPI, in December, 1997, after much debate and controversy, an anti-bribery international convention was signed, joining together all members of the Organization for Economic Cooperation and Development (OECD), and three other non-member-states in a global combat against corruption.166 The OECD Convention on Combating Bribery of Foreign Public Officials in International Transactions of 1998 ("OECD Convention") entered into force within a year of signature, and as of April 2003 had been ratified by 34 nation-states.167 In the U.S., on November 10, 1998, President Clinton signed into law the International Anti-Bribery and Fair Competition Act, implementing the OECD Convention.168

The OECD Convention obligates its signatories to enact national legislation prohibiting international briberies. Most developing nations (commonly lumped together as the “bribe-receiving” nations) are not members of the OECD and, hence, are not bound by the Convention’s mandates. It is ironic, however, that several “bribe-receiving” nations have always had either policy statements or written laws condemning and sanctioning briberies by their officials, long before the OECD Convention came into being. For example, in Vietnam, Party leaders officially stressed the fact that corruption offended the nation’s cultural value, as well as the Communist model of rigid party disciplines,169 yet the principles stated by national leadership contradicts the


For a view exploring the correlation between corruption and “Third World” economic development, see Bill Shaw, “The Foreign Corrupt Practices Act and Progeny: Morally Unassailable,” 33 Cornell Int’l L.J. 689 (Symposium Fighting International Corruption & Bribery in the 21st Century) (author argued that FCPA and its progeny is not moral imperialism but a product of economic forces). The view expressed by Professor Shaw, however, is not a case study, but only a scholarly proposition to advocate the utility of universal business ethics standards for internationalism.


169 For a report on governmental salaries, criminal sanctions, and real-life enforcement cases giving death sentences to corrupt and drug-trafficking officials in the Social Republic of Vietnam in the early and mid-
realty of life on the street. The question in “Third World” real-life is whether those anti-corruption laws and policies exist on paper only, in a country such as Vietnam, where government bureaucrats typically earn approximately US$30-50 a month, and where the colloquial expressions of “jungle’s law” made by “sleeping state representatives” are used by commoners to refer to the nation’s legal system.

One can argue that in practice, the OECD Convention was not designed to improve the morals, ethics, or reality of the developing world for the benefit of its inhabitants. The Convention was viewed as the direct result of the U.S.’s international lobbying efforts to persuade the Western industrialized nations to adopt anti-corruption law analogous to the U.S. anti-bribery legislation, the Foreign Corrupt Practices Act (FCPA). The U.S. objective was to put its business executives on par with their counterparts from other OECD nations. If the signatories to the OECD Convention, bound by its mandates, enact anti-bribery national laws, U.S. businesses will no longer be disadvantaged in “bribe-receiving” countries, simply because U.S. businessmen are governed by the FCPA while their competitors from other “bribe-giving” countries are not. For years, U.S. businesses have cried out loud for this level playing field. The Convention thus represents a victory for U.S. companies, especially when other industrialized nations have quickly taken action to comply with the mandates of the OECD Convention.

1990s, when foreign direct investment in Vietnam was gradually increasing into its peak (prior to the Asian currency crisis), see William A. W. Neilson, et al, Vietnam Investment Manual (Frederick Burke, ed. 1995), at 42-43; ECON. INTELLIGENCE UNIT, COUNTRY REPORT: INDOCHINA: VIETNAM LAOS CAMBODIA 15 (4th quarter ’1993); see also BBC, Worldwide Monitoring, Voice of Vietnam, Hanoi, “Vietnam: Party session stresses reform to improve efficiency, reduce corruption” (February 25, 1999) (Vietnamese radio broadcast a resolution issued following the latest party Central Committee plenum, authorizing the Politburo to undertake research to meet the need to increase the fight against corruption, saying that party officials at all levels should be made responsible for “anticorruption activity.”) For another example of national anti-bribery criminal law in Asia, see, e.g., Teodoro Kalaw IV, “Anti-Corruption Laws and Regulations, the Republic of the Philippines,” 37 Asia Bus. L.Rev. 45 - 51 (July 2002) (survey of the Philippines’ anti-bribery criminal sanctions imposed both upon the giver and the receiver of bribes).


In addition to the OECD Convention, regional efforts also evidenced the ongoing international campaign against bribery. The Organization of American States (OAS) was instrumental in bringing about the Inter-American Convention Against Corruption of 1996 (the “Inter-American Convention”). The Organization of African Unity (OAU) and the Global Coalition for Africa (GCA) have spearheaded efforts toward ultimately a similar convention for African countries, which has not come into being. Similarly, the Paris-based International Chamber of Commerce (ICC) has also initiated efforts to invite companies worldwide to adopt rules of conduct designed to combat extortion and bribery in international trade.

In the world of scholarly idealism, the OECD Convention can be viewed as a representative and inspiring statement of universal business ethics. As such, the Convention is an example of how “international legalization,” rather than interest-based bargaining, can advance normative values. Historically, the philosophical debates concerning international law and international relations fluctuate on a spectrum between the “value” model and the “interest” model. Normative and constructivist scholars see international law as an expression of morally driven norms (the “value” model); rational choice scholars understand law to be a creature of interest-based bargaining or other incentives based on the “logic of consequences” (the “interest” model). Commentators have referred to the formulation of international law to effectuate both the “value” and “interest” models as the “legalization” movement.

Journal of International Law 568, 586 (2001) (“The introduction of Australia’s anti-bribery offence clearly brings Australia into line with the U.S... ”)


179 Id.

defense, the OECD Convention is an example that both models can co-exist, serving as the showcase for the “legalization” movement.\footnote{For a “moral” defense of the FCPA, see, e.g., Bill Shaw, “Symposium Fighting International Corruption & Bribery in the 21st Century: the Foreign Corrupt Practices Act and Progeny: Morally Unassailable,” 33 Cornell Int’l L.J. 689 (2000).}

However, a careful look at the current norm of bonus payment in the petroleum sector may pose some legitimate doubt as to whether systematic efforts of legalization at the international level may effectively cure the root cause of poverty or its cousin – the vice of governmental corruption -- in the developing world. A misused bonus payment in the millions of dollars paid under a negotiated PSC scheme may constitute a “legitimate” bribe considered legal under the FCPA, which has tactfully been used as a model anti-bribery legislation for nation-states acting under the mandates of the OECD Convention.\footnote{See Report of the OECD Committee on International Investment and Multinational Enterprises (CIME), presented at the OECD Council at Ministerial Council Meeting in Paris on May 16, 2002. (found at http://www.oecd.org/dataoecd/52/59/2087917.pdf.)} Enacted in response to the \textit{Lockheed} scandal in Saudi Arabia in the 1970s,\footnote{Newsweek, “Payoffs: The Growing Scandal” (Feb. 23, 1976) at p. 26.} the FCPA does not prohibit bribes \textit{qua} bribes, because what is considered a bribe in one culture may not constitute a bribe in another culture. The FCPA only prohibits payments that qualify as ‘corrupt payments’ under statutory elements specified in the Act.\footnote{Foreign Corrupt Practices Act, 15 U.S.C. \textsection 78dd-1(1998).} One such element is the requirement that in order for the payment to be illegal, it must be made to a recipient who is a “foreign official.”\footnote{The term ‘foreign official’ statutorily means “any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization.” Foreign Corrupt Practices Act, 15 U.S.C. \textsection 78dd-1(a)(3)(1998); 15 U.S.C. \textsection 78dd-1(f)(1)(A)(1998) (emphasis added).} Payment made to the treasury allegedly for the “people,” as in the case of bargained-for Signature or Production Bonuses, does not meet this criterion and hence falls outside the prohibition of the FCPA.\footnote{Under the current interpretation of the FCPA, if payment is \textit{not} made to a foreign official, but rather, is made to the people, the corporate payor may not be prosecuted. Where corrupt payment is traced to a foreign official, courts have read into the FCPA a legislative intent to exempt the foreign official from prosecution and, instead, to scrutinize and deter only the conduct of the corporate payor. United States v. Castle, 925 F.2d 831 (5th Cir. 1991).} Further, to be liable under the Act, the company making the bribe must act with a “knowing” state of mind.\footnote{Foreign Corrupt Practices Act, 15 U.S.C. \textsection 78dd-1(a)(3), 78dd-1(f)(2)(A)(1998).} “Knowing” is defined to include “awareness of a high probability of the existence of [certain] circumstances [required for the offense].”\footnote{Id.} The legislative history indicated that a deliberate “burial of one’s
head under the sand” to refute knowledge will not serve to escape liability under the Act, so long as knowledge of the predicate circumstances can be proven or established. Thus, concepts such as “conscious disregard,” “deliberate ignorance,” or “willful blindness,” are meant by the legislature to be part of the statutory definition of “knowing.” While such “knowing” standard should be the widest net to catch all sins, in the case of petroleum bonuses, the difficulty of proof becomes the obstacle against effective enforcement of the law. How does the prosecutor prove deliberate blindness as to where a cash bonus payment goes after it reaches the nation’s Treasury, especially when such bonus payment is formally required by bidding or tender, or otherwise negotiated as payment allegedly for the benefit of the “people”?

In principle, the country’s leaders should be able to prefer or require cash payments in order to accumulate hard currencies for the Treasury, for use in various legitimate macro-economic or nation-building purposes. In reality, in a pervasively corrupt country, such huge cash amounts may enrich some high officials’ Swiss accounts, yet the IOGC may now legitimately “bury its head in the sand,” and decline to inquire or investigate further. In fact, it will make sure that documents exist to prove the company does not need to, and cannot inquire further. The PSC itself negates the MNC’s specific intent or knowledge of corrupt usage or purpose by the host government’s individual leaders. How cash bonuses or payments are used may be disingenuously legitimized as part of the host government’s exercise of its “sovereign power,” at least on paper or at the surface. Leaning upon the legitimacy of such “sovereign power,” the IOGC thus can rightfully disregard any concern it may have about how bonus money is going to be used, or where it is going. The IOGC may lawfully label such mysterious use as exclusive sovereign domain, and not of any concern to the payor. Consequently, the very nature of, and mechanism established for, the payment of cash bonuses or payments in PSC schemes becomes the very defense companies will rely on to negate FCPA implications FCPA accountability, therefore, stops at the border, where money changes hands.

The only safeguard left lies in the home jurisdiction’s corporate or securities law governing mandatory public disclosures -- how cash payments are documented and classified on the books and records of the IOGC according to applicable accounting and auditing standards governing publicly traded corporations. Under the FCPA, violation of accounting and auditing requirements with respect to the documentation and explanation of payments

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189 This phrase “bury one’s head in the sand” has become the colloquial expression used by industry professionals and international business lawyers to denote the type of deliberate ignorance that may constitute violation of the FCPA or U.S. export control law. Foreign Corrupt Practices Act 15 U.S.C. §78 dd-1 (1998), Export Administration Regulations 15 C.F.R. § 730.


191 Id. at pp. 919-921. Accord United States v. Jewell, 532 F.2d 697 (9th Cir.), en banc, cert. denied, 426 U.S. 951 (1976) (“knowing” includes both positive knowledge and state of mind of one who does not possess positive knowledge only because he consciously avoids it).
made in connection with international business activities may become separate violations of the FCPA.\(^{192}\) (The FCPA consists of two statutory components: the anti-bribery provisions and the accounting/reporting provisions.) The accounting and auditing requirements of the FCPA are part of the 1934 Securities Exchange Act governing, in general, public companies that are issuer-registrants within the framework of U.S. federal securities law.\(^{193}\) Under these legal standards, “reasonableness” rather than “materiality” constitutes the threshold that triggers the company’s responsibility to keep books, records and accounts, which “must accurately and fairly reflect” the transaction and disposition of the issuer’s assets.\(^{194}\) “Reasonableness” and “accurate and fair“ reflection can easily be met with respect to the bonus payments,\(^{195}\) since all the issuer-company needs to do is to document, in reasonable detail, that the payment was a bonus payment payable to the Treasury of a foreign country, using the executed PSC as evidence and support. The FCPA does not require the IOGC to investigate the actual use and disbursements of bonus payments. Nor does the Act require the IOGC to trace the final recipients of these bonuses, unless the IOGC has reason to believe that (i) there exists a corrupt intent on the part of the recipient to misappropriate and transfer the bonuses to the pocket of a foreign official, or (ii) there exists a reasonable likelihood that bonus payments are funneled to private accounts. Even when the IOGC may have reasons to know such unique circumstances, it is difficult for the prosecution to ascertain statutorily what the law requires the IOGC to do to prevent bonus money from turning into a bribe under the law. The IOGC can effectively clean its hands and legitimately walk away, leaving what occurs behind doors in governmental offices of the host country as within the exclusive province of sovereignty.\(^{196}\)

If indeed bonuses or any type of cash payments are meant for the benefit of the people, anti-bribery law enforcement with respect to the use and disbursement of multi-million-dollar cash payments to foreign governments should **not** stop at the border where money changes hands. Nor should it stop with the home jurisdiction’s internal audit or accounting requirements, whose focus is on the shareholder public and not on citizens of the “Third World.” Here is a perfect example where the interest of the shareholder public and “Third World” inhabitants can coincide – shareholders do not want exorbitant foreign bribes to cut into the maximum return on their investment, and “Third World” inhabitants do not want the money to end up in the unclean hands of their corrupt leaders.

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\(^{195}\) Zarin, Doing Business Under the Foreign Corrupt Practices Act (Practicing Law Institute 1999) at p. 6-23 et al (discussing legality of donations or concessions to governmental entities).

Imposition of stricter due diligence duties upon the IOGCs, which are in the best position to conduct such due diligence, should be considered as part of the spirit and objective of international anti-bribery campaigns and of the “legalization” doctrine that has led to bodies of international law such as the OECD Convention and the Inter-American Convention. Obviously, serious policy arguments may be raised as to whether or not IOGCs should be required to conduct due diligence and obtain assurances from the host jurisdiction with respect to the use and disbursement of cash bonus payments allegedly for the “people’s” interest. Similar policy arguments can also be made as to (i) the realistic effectiveness of such due diligence requirements, and (ii) the extent to which the due diligence should be conducted before their additional costs pose economic concern for the shareholder public back home.

In any event, the necessity of requiring further due diligence for each and every cash bonus made can be rendered moot if the IOGC community will use its leverage to replace cash bonus offers or requirements with bonuses in kind, aimed specifically at serving the local community and directly contributing to the people’s interest. For example, instead of complying with cash bonus requirements or offering to pay them, during negotiation IOGCs may suggest bonuses strictly in the form of IOGC-sponsored social or training programs for the local community; the construction, training and staffing of educational, medical, or community facilities and research centers; the construction of various industrial or technological infrastructures; the sponsoring of starving local artists and writers; the funding of university scholarships and grants; and/or other social programs similar to efforts normally undertaken by corporate citizens of the developed nations. As a condition precedent to payment, cash bonuses, if any, should be earmarked for the funding of independent local or international NGOs, local or international educational or medical institutions, and similar non-profit organizations operating in the host jurisdiction. If administered via an NGO, the use and disbursement of

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197 See, e.g., A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.Y. 1953) (articulating doctrine of corporate social responsibility as rationale for state legislature allowing corporations to make charitable contributions for public welfare, scientific, or educational purposes); accord Model Business Corporation Act, as amended, Section 3.02(13); E. Merrick Dodd, Jr. “For Whom Are Corporate Managers Trustee?” 45 Harv. L. Rev. 1149, 1154 (1932) (quoting Owen D. Young, CEO of General Electric); A.A. Berle, Jr. “Corporate Powers as Powers in Trust, 44 Harv. L.Rev. 1049 (1931); Faith Stevelman Kahn, “Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy,” 44 UCLA L.Rev. 579, 588 (1997). Compare, Warren Buffet, Knights, Raiders and Targets: The Impact of Hostile Takeovers 14 (John C. Coffee et al. eds 1988) (“not one CEO has reached in his pocket and pulled out ten bucks of his own to give to this marvelous charity...”); but see Milton Freeman, “The Social Responsibility of Business Is to Increase Its Profits” (New York Times Magazine, September 13, 1970) (“The doctrine of social responsibility [is] a ‘fundamentally subversive doctrine’ in a free society, and [I] have said that in such a society there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game...”).

198 Political contributions made abroad by U.S. companies are subject to FCPA implications, 15 U.S.C. 78dd-1(a)(3) (1998). In contrast, the OECD Convention does not mandate national laws addressing corrupt political contributions. Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD 1997). The U.S. Supreme Court has held that corporate entities are entitled
bonuses can be monitored via NGOs’ programmatic reports to safeguard against funding abuse or mismanagement. Short of a better alternative, if all members of the “MNC-IOGC cartel” will, by consensus, raise this suggestion to the host countries, governments will eventually be forced to minimize or alleviate cash bonus requirements (other than those exemplified above), or otherwise replace them with social programs, and any concern regarding the potential misuse of cash bonuses will practically be rendered moot. The tremendous leverage and bargaining power that the MNC-IOGC community has over host governments should be exercised in a systematic “public interest” and “social responsibility” approach. This approach can only be accomplished if the MNC-IOGC community engages in self-enforced regulation as a voluntary response to constant public scrutiny.199

The substitution of cash bonuses with social programs funded by MNC/IOGCs is also consistent with the IMF’s austerity measures imposed upon nation-loan recipients to steer them away from conducting themselves as the “welfare states.” Commentators have observed that the Bretton Woods institutions often advocate shrinking governments, social programs restrictions, higher interest rates, reduction of subsidies for basic goods, and elimination of tariffs as some of the free-market direction required of loan recipients.200 World Bank and IMF officials have reportedly claimed that resistance to open markets such as the antagonism exhibited by Latin America and Africa accounted for economic inequality and stagnation in those regions.201 In addition to deterring greed and preventing potential abuse of power within the nation’s bureaucracy, shifting the funding of social programs to the private sector and the MNC/IOGC community, with the involvement of locally formed or locally operating NGOs, may help the developing nations conform their national policies to IMF or World Bank fiscal philosophies.

(7) The Management of Risks and its Impact upon Legal Issues in MNC-Government Partnerships. The discussion so far reinforces one conclusion that requires no empirical validation: where the “Third World” government is not acting in the best interest of its people and is itself
to constitutional protection with respect to both commercial speech and political speech. Buckley v. Valeo, 424 U.S. 1, 20-21 (1976); see also Adam Winkler, “The Corporation in Election Law,” 32 Loy. L.A.L. Rev. 1243, 1246 (1999). The curtailing of political contributions made to foreign candidates and political parties abroad does raise perplexing constitutional and social policy issues, and will be topics of discussion for another day.

199 See Note 41 supra; Notes 412, 413, 421 infra (discussing authorities for management-based regulations). For a scholarly survey of transnational corporations’ existing self-regulations programs, see Ans Kolk, Rob van Tulder, and Carlijn Welters, “International Codes of Conduct and Corporate Social Responsibility: Can Transnational Corporations Regulate Themselves?” 8 Transnational Corporations No. 1, 143-60 (April 1999).

200 Tony McAdams, 9 J. Legal Studies Education at 252-53.

committing “bad acts,” naturally the government’s alliance with an MNC and the monopolistic, close-knit nature of their partnership can cause another layer of havoc to the country and its inhabitants. While this point may first seem obviously common sense, its full implication can best be illustrated by scrutinizing how an MNC-IOGC seeks to allocate and manage various types of investment risks.

Principally, an IOGC must face two types of investment risks. The risks of not finding a commercial reserve in a Contract Area are part of “Appraisal Risks,” dependent upon geological factors. These Appraisal Risks are distinguishable from “Political Risks,” which, despite their volatile and undeterminable nature, can relatively be assessed and controlled. Acts of government constituting Force Majeure are typically lumped together under the rubric of Political Risks. Legal risks – the risks of changing laws, new legislation, or adverse judicial or governmental agency rulings -- are part of Political Risks.

From the perspective of the foreign investor, Political Risks are part of project risks, encompassing all material hostile acts by governments, the assessment of which more an art than an exact science. In an investment contract, hostile acts by governments may be included in the legal definition of force majeure, or may occasion other force majeure events beyond a party’s control, such as transportation interruption, shortage of supplies or failure of delivery. The worst Political Risk that has been experienced with foreign investment in countries such as Cuba, Iran, Libya, and Vietnam was the nationalization or expropriation of foreign investors’ assets due to regime changes and revolutions. Today’s global economy and the interlocking financial markets make individual governmental act of nationalization and expropriation less likely, unless it is part of a drastic regime change or military coup.

The least obvious and least drastic Political Risk, but equally significant, is an across-the-board policy shift, or gradual material adverse governmental action (MAGA) that may occur per project, under the same regime that has approved the investment. Over time, MAGA can amount to “creeping

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nationalization or expropriation,” which refers to the gradual process of a state’s acquisition of control over foreign businesses within its borders, such that the foreign investor’s economic interest is materially impaired and jeopardized. While creeping governmental action may be characteristic of Political Risks in the developing nations, policy shifts are not unique to any part of the world. In the U.S., policy shifts may occur with every election.

An IOGC’s “Appraisal Risk” assessment and “Political Risk” assessment may be inter-dependent. Petroleum Activities are long-term endeavors – the production period can be of 20 or 30 years’ duration. Exploration (quite often an initial five years' commitment) may involve very high risks of failure – for years, the conventional explorationist often commented that out of 10 ventures, at least nine were unsuccessful, although recent technological advent -- particularly 3D seismic technology -- may have increased the probability of exploration success to a percentage much higher than the dismal 10% in traditionalist thinking. Within the corporate culture of IOGCs, only “upstream” professionals and explorationists are able to expend huge budgets without the kind of profit-making accountability usually expected of other income-producing units. All of this speculation, educated guesswork, and scientific geological evaluation lead to one conclusion: when the venture is successful, the IOGC must capture sufficient profit to accommodate failures elsewhere.

Further, since the industry is so capital-intensive, typically, the top-tiered IOGCs will not invest in a potential reserve unless the areas are capable of a significant volume of oil or natural gas. In other words, the commercial discovery must be of a substantial quantity for profit to be realized in such a high-cost investment. Likewise, in order to achieve high profit, IOGCs would naturally favor acquisition of very substantial Participating Interests, and will not welcome governmental Fiscal Regimes that keep the IOGC-contractor’s Participating Interest to a minimal percentage.

It follows, therefore, that Appraisal Risks and Political Risks may move inversely against each other. The IOGC’s decision to invest in a country means


205 Id.

206 Andrew B. Derman, International Oil and Gas Joint Ventures: A Discussion with Associated Form Agreements, Monograph Series No. 16 (ABA Natural Resources, Energy, and Environmental Law Section) (1992), at p. 65.

that, in its judgment, Appraisal Risks must have been outweighed by the projection of huge profit in a success case. The higher the Appraisal Risks are, the higher the level of capital investment is going to be, leading naturally to a much higher expectation of profit. The higher the profit margin is, the more motivated the IOGC will be in lowering Political Risks with a corporate strategy that helps maintain the political power base of the incumbent government with which the IOGC has signed a contract. It is in the interest of the IOGC if the incumbent government continues its strong political footing in the country and the region, thereby providing a stable environment for the IOGC to achieve its steadily high returns on its huge, long-term investment.

Notwithstanding the “social responsibility” doctrine, the current Anglo-American corporate law regime does not compel corporate entities to concern themselves with human rights. Rather, the emphasis is on shareholder primacy, financial accountability to investors, or at best the provision of a “voice” forum for other stakeholders such as employees or creditors. (Even in the U.S. “shareholder primacy” corporate model, the voice of non-controlling minority shareholders in public companies has typically been limited to a window-dressing opportunity to submit proposals or raise objections to management’s policy and direction, under stringent procedural limitations.) Thus, the human rights agenda has basically been left to the

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208 See, e.g., A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.Y. 1953) (articulating doctrine of corporate social responsibility as rationale for state legislature allowing corporations to make charitable contributions for public welfare, scientific, or educational purposes); accord Model Business Corporation Act, as amended, Section 3.02(13); E. Merrick Dodd, Jr. “For Whom Are Corporate Managers Trustee?” 45 Harv. L. Rev. 1149, 1154 (1932) (quoting Owen D. Young, CEO of General Electric); A.A. Berle, Jr. “Corporate Powers as Powers in Trust, 44 Harv. L. Rev. 1049 (1931); Faith Stevelman Kahn, “Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy,” 44 UCLA L.Rev. 579, 588 (1997). Compare, Warren Buffet, Knights, Raiders and Targets: The Impact of Hostile Takeovers 14 (John C. Coffee et al. eds 1988) (“not one CEO has reached in his pocket and pulled out ten bucks of his own to give to this marvelous charity...”); but see Milton Freeman, “The Social Responsibility of Business Is to Increase Its Profits” (New York Times Magazine, September 13, 1970) (“The doctrine of social responsibility [is] a 'fundamentally subversive doctrine' in a free society, and [I] have said that in such a society there is one and only one social responsibility of business –to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game...”).

209 Paul Redmond, “Sanctioning Corporate Responsibility for Human Rights,” 27-No. 1 Alternative Law Journal 23-27, 23 (February 2002) (“[National] corporate law does not repair these weaknesses. Its concerns are with financial accountability to investors, not accountability for human rights standards”); Eric Engle, “Corporate Social Responsibility: Market-Based Remedies for International Human Rights Violations?” 40 Williamette L.Rev. 103 (Winter 2004) (“Medieval lex mercatoria...was fundamentally a private law of contract and arbitration. Lex mercatoria concerned only private parties, was binding, and was a result of voluntary agreement...For these reasons, the analogy between contemporary human rights law and lex mercatoria is inexact...”).

210 See, e.g., McDonald’s Corporation 2001 Proxy Statement regarding management reaction to shareholder’s proposal addressing human rights for Chinese workers filed under SEC Rule 14a-8 CITE; Ralph Nader’s “Campaign GM” in the 1970’s; SEC. Transamerica Corp., 163 F.2d 511 (3d Cir. 1947) (Lewis Gilbert’s shareholder proposal that shareholders, rather than directors, select company’s auditors). Compare. Proxy fights by insurgents are expensive, and SEC Rule 14a-8 requires that shareholder proposals be limited to 500 words. In addition, the SEC has proposed changes to current Rule 14a-8 for the
voluntary models of “inspired” corporate conduct in response to public opinion. The “home” jurisdiction’s oversight over corporate “offshore” conduct, or the extraterritorial reach of the home jurisdiction’s mandatory law, becomes the most concrete tool with the sharpest teeth to police MNCs’ conduct. But the rigor of this policing and oversight depends on the geo-political dynamics of the home jurisdiction and the political agenda of its lawmakers. The fact that the geo-political dynamics drives the effectiveness of enforcement, or lack thereof, is a reality of the global community. It is precisely because of this reason that public international and humanitarian law has often been criticized as inspirational law or “soft” law, without enforcing teeth.211

Accordingly, the due diligence that IOGCs usually perform as part of their Political Risk management does not have to include a moral due diligence with respect to democratic or human rights values.212 Once the investment contract has been signed with the incumbent government, issues of politics within the country and relations between the incumbent government and its people become irrelevant to the IOGC’s corporate strategy. Part of the IOGC’s overall and long-term business goal is to gain the support of, and split profit with, the incumbent government, no matter how unpopular or tyrannic the regime may seem. Once fully invested in the country, IOGCs are naturally long-term supporters of the incumbent government, and are most likely to help minimize any political instability associated with the region or locale. Likewise, the incumbent government will have all the incentives in the world to keep its business partners in active business and in prosperity. Both sides are now fully imbedded in the self-interest structure. In the words of the cynical critic, the two partners are “married” for a long time.

What’s more, in planning its partnership with the government, the IOGC can also turn to other risk management alternatives. For example, it may seek Political Risk insurance protection, and in such a case, the international community and the full faith and credit of the United States may come to its assistance. For the right project, the MNC-government partnership will have full multilateral or bilateral support from governments of the developed nations available to it. Among the agencies providing Political Risk insurance and investment guarantees are the Multilateral Investment Guaranty Agency (MIGA), a World Bank affiliate; the U.S. Export-Import Bank (ExIm); and the benefit of shareholders. 15 U.S.C. sections 78a et seq; 17 C.F.R. sections 240.0-1 et seq. Regulation 14A, rule 14a-8. See also Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-39093, 17 C.F.R. pt. 240 (Sept. 18, 1997) available at http://www.sec.gov/rules/proposed/34-39093.htm. (“We propose to recast rule 14a-8 into a Question & Answer format that both shareholders and companies should find easier to follow, and to modify the rule to address concerns raised by both shareholders and companies.”).


U.S. Overseas Private Investment Corporation (OPIC). So long as the U.S. has not embargoed a country, or otherwise set limit on trade or investment, U.S.-

213 Political Risk insurance and investment guarantees are provided by the following institutions, two of which (OPIC and ExIm) are bilateral Export Credit Agencies (ECA) formed by the U.S.:

1) The Multilateral Investment Guaranty Agency (MIGA): Partly funded by the World Bank, MIGA insurance is available to all World Bank members that have ratified the Convention Establishing MIGA--the insured must be a national of a member country. In most cases, guarantees by MIGA must also be approved by the host country. MIGA also partners with private insurers through coinsurance and reinsurance programs. Non-commercial risks covered by MIGA include currency transfer restrictions, expropriation, breach of contract, and war and civil disturbance. Should it pay a claim, MIGA would succeed, by way of subrogation, to the right of the investor against the host country. See Multilateral Investment Guarantee Agency, World Bank Group, About Miga at http://www.miga.org/screens/about/about.htm (as of May 1, 2002). See also MIGA Annual Report (1996) (discussing growth in foreign direct investment).

2) The Overseas Private Investment Corporation (OPIC): Political risk insurance and investment guarantees can also be obtained by US nationals from OPIC. As a U.S. government agency, OPIC has as its goal the promotion of America’s best economic and global strategic interests. A product of the Foreign Assistance Act of 1969, OPIC is limited by statute to insure projects only in the developing economies. With an annual reserve of approximately $4 billion, OPIC provides both insurance and, to a more limited extent, financing, so long as there is a government-to-government (bilateral) agreement that sets out OPIC’s rights of subrogation. OPIC operates at no costs to U.S. taxpayers due to user fees charged by the agency. With 29 years of claim history, OPIC insurance programs have been extended to some 140 developing markets, and are backed by the full faith and credit of the United States. http://www.opic.gov/. See also Randi Cohen, “OPIC Insures Investment in Central and Eastern Europe and the Baltic States,” 1 New Euro L.Rev. 95, 121 (1992).

3) The Export-Import Bank (ExIm): First created in 1934 but not formally established until 1945, ExIm also absorbs, in the interest of U.S. producers and importers, credit risks that are typically beyond the reach of the private sector by providing both financing and investment guarantees. Initially, ExIm’s goals were to foster trade between the U.S. and the Soviet and Eastern blocs. Later, ExIm extended its scope to service the reconstruction of both Europe and Asia. Its objective is to supplement, but not to compete against sources of private capital. ExIm’s history shows a deliberate effort not to engage in turf battle with the World Bank or the IMF. Principally, ExIm guarantees working capital loans to U.S. exporters, and provides export credit insurance to protect U.S. exporters against foreign buyers’s failure to pay their credit obligations. It also lends money to foreign purchasers of U.S. exports, and provides guarantees to commercial lenders for repayment protection of their private loans. U.S. providers of the petroleum industry’s goods and services may benefit from ExIm assistance, provided that ExIm has assessed and approved the project, based on conditions such as reasonable assurance of repayment, and whether a transaction would have adverse economic impact on U.S. production and employment. http://www.exim.gov/.

In addition to export financing and bilateral credit support provided by the U.S., other industrialized nations may set up bilateral agencies of their own. For example, member states within the OECD have their own bilateral export agencies and programs. One such country is Japan, which provides assistance through the Export-Import Bank of Japan (JExIm). http://www.mof.go.jp/. All such bilateral agencies have their own criteria for Project Financing to facilitate “Third World” economic development.

These financing arms should be distinguished from grants, which may be construed as public aid, such as those provided by the U.S. Trade & Development Agency (TDA) http://www.tda.gov/, or long-term interest-free loans provided by the International Development Association (IDA), a World-Bank affiliate.
based IOGCs are free to partner with “Third World” governments regardless of their reputation or practices, subject only to the IOGCs’ risk assessment and evaluation of potential profit.

Even modern trends in international economic law can serve as a double-edged sword. Among the various widely accepted Political Risk management techniques are (i) the “internationalization” doctrine, and (ii) the Stabilization Clause, both of which render stability and standardization to an otherwise unstable investment environment in the transitional economies. Even modern trends in international economic law can serve as a double-edged sword. Among the various widely accepted Political Risk management techniques are (i) the “internationalization” doctrine, and (ii) the Stabilization Clause, both of which render stability and standardization to an otherwise unstable investment environment in the transitional economies. However, if the host government is a dictatorship, or otherwise grossly corrupt and incompetent, these very same risk-management techniques can help keep such incumbent government in power by fortifying the business partnerships it has formed with powerful and economically abled MNCs. These techniques lock the incumbent government into commitments that curtail the sovereign power of the country for the benefit of the foreign investor, thereby functioning as the type of “back-scratching” arrangements that serve the parties’ mutual self-interest.

• The “internationalization” doctrine. Conflicts of law (or “private international law,” as that term is used in Europe) can present the most haunting and perplexing issues for lawyers and academics yet they constitute the least significant issues for business executives. There is justification for the executive’s indifference to the “governing law” provision in an investment contract, because disputes are routinely resolved and compromises reached based on relationships and bottom-line economic considerations, rather than as a result of intense legal interpretation. In most “upstream” petroleum contracts, since drilling takes place on the host country’s territory, it is almost impossible to avoid the application of the local law (lex loci; lex situs). Savvy negotiators will not spend much time demanding the application of a neutral law other than lex loci or lex situs in contracts with the

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host government, although lawyers often explore, where possible, exemption or waiver from particular local legal requirements where needed.

The real efforts, however, are spent on the “internationalization” of the contract as a doctrinal approach to international business transactions.\(^{217}\) In its ultimate objective, the doctrine calls for the universal incorporation into the local law all those industry norms or practices that are so well-established they become part of modern \textit{lex mercatoria}, or, more broadly speaking, international economic law.\(^{218}\) The doctrine establishes that a cross-border investment contract cannot be dictated solely by varying local norms and rules. Consistency can only be achieved through the application of universally accepted international rules and standards. The doctrine thus creates a superior layer of “legalization” that limits or minimizes the adverse effect of local law for the sake of fostering international commerce. The doctrine transforms the contract from a local law contract to an international contract, bringing the project to international and industry standards, notwithstanding its local \textit{situs}.\(^{219}\)

From a broader perspective, the ‘internationalization” doctrine evolves as part of the international legal community’s efforts to eliminate or minimize the


\(^{218}\) See, e.g., Notes 24 and 25, \textit{supra} (explanation of \textit{lex mercatoria}). The phrase “\textit{international economic law}” has broader implication than “\textit{international commercial law},” which refers to the bodies of law governing international sales, international shipments of goods, and export-import transactions.

\(^{219}\) Ironically, although the international legal community pushes for, and has been successful in the internationalization of legal standards, living conditions have never been standardized. Global distribution of technology and consumer products are likewise non-standardized. Activists charge that manufacturers often transfer obsolete technology and a lesser grade of consumer products to the “Third World” as a dumping ground of consumerism. In the era of free trade, the “Third World” often exports the best of its products in order to compete globally and to generate hard foreign currencies revenues. When this trend is observed in agricultural products, it means that the poor of the “Third World” “starve” in order to feed the best products for the “First” and “Second World,” and to enable their country to accumulate hard currencies via export and satisfy international debt obligations. The result is a “Third World” standard of living that can shock conscience and quite often remain unknown to inhabitants of the developed nations. The by-product of these substandard living conditions is a “Third World” localized standard of morality, ethics, and behaviors incomprehensible to the developed nations, who ironically are often the driving force in the standardization of normative legal behaviors essential to the development of the international rule of law. The issue of moral decisions made in poverty perhaps is not a consideration in law-making, but has long been a topic of exposition for creative artists. See Victor Hugo’s \textit{Les Miserables} (popularized in American pop culture by way of a Broadway production almost a hundred years after Hugo’s death.) Globalization, in its most efficient and noblest form, should serve to equalize these inequities and differences.
Political Risks often associated with doing business in the developing economies. Internationalization gives the investment environment predictability through the standardization of legal behaviors. But the doctrine is not anything new; rather, it is simply an effort at "codifying" what has taken place in real-life deal negotiation. For decades, lawyer’s efforts have been spent on securing specific sovereign actions incorporating international norms into the local law. The lobbying for such sovereign action may be part of the due diligence necessary for Political Risk assessment before the IOGC invests in the country. The desired sovereign actions may include specific constitutional proclamation or ratification of international treaties and conventions, specific legislative or administrative measures, or contractually designed sovereign guarantees executed by the government on an ad hoc basis. If any such specific sovereign action cannot be obtained, principles constituting lex mercatoria for the international petroleum or energy sector must be provided in specific contract provisions, or otherwise expressly incorporated into the contract’s “governing law” or “choice-of-law” clause.

**The Stabilization Clause as Protection Against Political Risks.** The “internationalization” doctrine has precedential support from a long line of confidential arbitration decisions. These decisions support the arbitrators’ view that certain contracts are by their very nature internationalized and thus subject to international law and standards, especially if the parties by negotiation have consensually waived restrictions of local law. One such evidence of mutual consent and waiver is the Stabilization Clause (at times referred to as the “Stability Clause” or “Equilibrium Clause”). In various forms, the Clause restricts the host jurisdiction’s exercise of “permanent sovereignty” by contractually preventing the nation-state from subsequently modifying the governing law of the investment contract.


223 Id.

“Permanent sovereignty” signifies the “permanent” nature of the territorial state’s power to protect its territory and to maximize its resources, including the power to exclude unwanted foreign investment via the licensing process. The notion, however, should receive a broader connotation than just in the context of territory or property rights. Permanent sovereignty also empowers the government of a country to make law and proscribe conduct within its territory, and thus should be co-extensive or synonymous with the government’s “jurisdiction to prescribe” (as opposed to “jurisdiction to adjudicate,” which is traditionally a judiciary function within a government). Private international law (commonly known in the U.S. as principles of conflicts of law), has long provided the complex framework for deciphering this “jurisdiction to prescribe” by establishing legal boundaries for the exercise of national jurisdiction.

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228 A nation’s “jurisdiction to prescribe” does not necessarily stop at the physical borders, although its extra-territorial reach must be supported by a valid exercise of sovereign power rooted in customary international law. This means that certain nexus must exist to support the extraterritorial extension of national jurisdiction. The nexus can either be:

1) Territory (a sovereignty can proscribe conduct occurring within its borders);
2) Nationality (a sovereignty can proscribe conduct of its nationals);
3) Comity, reasonableness, or sovereign consent (two states can agree to allow each other prescriptive authority within each other’s borders or upon each other’s nationals, or one state may refrain from exercising its prescriptive authority beyond its borders in order to show respect or deference, or otherwise avoid relational conflicts with, another state);
4) Effects of conduct (the “effect” test): a sovereignty can proscribe conduct that produces an effect within its territory. The “effect” principle is best illustrated in the expansive reach of the U.S. antitrust law to even conduct of foreigners in other countries. See Hartford Fire Insurance Co. v. California, 509 U.S. 244 (1991) (expanding U.S. antitrust jurisdiction; reducing likelihood of U.S. courts invoking comity to decline jurisdiction over foreign acts causing substantial effect in the U.S. despite conflicts with foreign law).
In order to preserve the sanctity of “statehood” – that a sovereign nation consists of (i) people; (ii) a government; and (iii) territory – the notion of permanent sovereignty must be unassailable, inviolate, and incapable of being contracted away to a foreign interest; otherwise, a government can just “sell” or “pawn” a nation-state, its people and natural resources to a private party and waive sovereign power all together. In this line of logic, the nation-state should not lose its sovereign capacity to change the status or method of regulating the extractive or exploitive industry (with respect to natural resources), regardless of any previous contractual arrangement that the nation-state may have made in its commercial capacity. Likewise, a sovereignty can never waive its jurisdiction to proscribe conduct of private actors, unless it has undertaken an international obligation to restrain itself by way of treaty or reciprocity among nation-states in order to maintain international comity.

Yet, the “internationalization” doctrine practically serves to curtail the effect of a nation-state’s “jurisdiction to prescribe,” in the broader interest of international commerce. The Stabilization Clause can be looked at, in part, as a direct application of the “internationalization” doctrine. The Clause thus becomes the proper context for examining conflicts between the “internationalization” doctrine and notions of “permanent sovereignty” or “national jurisdiction to prescribe,” because enforcement of the Clause amounts to an erosion of the territorial state’s “permanent” power to legislate.

In one of its most popular forms, the Stabilization Clause creates a contractual commitment by the host government to “freeze” the local law applicable to the petroleum investment contract. For example, the Clause may provide that the PSC will be construed in accordance with the governing local law as it is in force on the date of contract execution. (The Clause may further impose a good-faith duty upon the host government to take all steps necessary to ensure the contractor’s rights are not altered by subsequent governmental action without the mutual consent of the parties.) The key

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Commentators have noted that the size and attractiveness of the U.S. market, as well the U.S.’s political and economic power, account for the geopolitical expansion of the U.S. prescriptive authority notwithstanding objections from other countries. See, e.g., Gerber, Prescriptive Authority: Global Markets as a Challenge to National Regulatory Systems, paper delivered at the Conference on Transnational Business Transactions sponsored by the Association of American Law Schools and the European Law Faculties Association, Barcelona, Spain (June 1-3, 2003).

229 Ian Brownie, Principles of Public International Law, 107 (4th ed. 1990) (discussing concepts of territory and sovereignty); Mark W. Janis, An Introduction to International Law 176-77 (2d ed. 1993); see also Note 457, infra.

230 “Third World” culturalists have used the term “culture brokers” in native literatures (originated during eras of colonialism) to refer to the collaborating natives who facilitated the extraction of natural resources and the solidification of the colonial bureaucracy, in exchange for personal financial benefits.
element of the Clause, therefore, is the removal of the government’s right to unilaterally alter the investor’s rights by changing its municipal law or promulgating new implementing regulations subsequent to contract execution.\textsuperscript{231}

International arbitrators have construed the Stabilization Clause more narrowly: the clause is the nation state’s specific and express promise not to unilaterally change the contract.\textsuperscript{232} As such, the Clause safeguards the IOGC’s investment in the politically unstable developing economies, especially in nation-states that do not follow Western legal traditions.\textsuperscript{233} At the same time, the Clause has been considered in the larger context: it is viewed as evidence of a sovereign nation’s right to waive its sovereign law-making authority.\textsuperscript{234} For example, the arbitration tribunal in \textit{Texaco v. Libyan Arab Republic}\textsuperscript{235} stated that "[n]othing can prevent a State, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to

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\textsuperscript{232} See Notes 214, 222-224, supra.
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\textsuperscript{233} \textit{Id.} The Vietnam Deal offers an opportunity to illustrate discordance between Western legal traditions and other legal traditions premised upon a different cultural heritage. An Eastern culture such as Vietnam views contractual execution as the \textit{beginning} of a business and legal relationship, rather than the conclusion of a finite set of legal obligations. The tendency of Eastern parties and their legal regulators, therefore, is to favor more amendments than their Western counterparts, because of the Eastern cultural view that the business relationship should amply be adjusted as it progresses. \textit{See, e.g., VIETNAM’S ORDINANCE ON ECONOMIC CONTRACTS, Art. 21 (allowing for right to amend after contract execution to “give details” and “make concrete” provisions of an economic contract); VIETNAM’S ORDINANCE ON CIVIL CONTRACTS, Art. 26 (acknowledging right to amend, open to negotiation). Accord, Wendy Duong, “Overview of the Institutional and Legal Framework, The Petroleum Law, and Relevant Legal Matters in the Socialist Republic of Vietnam,” unpublished manuscript prepared for Mobil Eastern Exploration and Development, INC. (November 1994) (\textit{cited with client’s permission}). Compare Dennis Unkovic, “Doing Business in China and the Pacific Rim,” Int’l Quarterly Vol. 15-2, 189-219, 205 (2003) (commenting on flexibility of China’s Economic Contract Law: contract may be changed or cancelled if impossible to fulfill, or if breached by a party; contrasting this flexibility against rigidity in specific performance and strong emphasis on penalty for economic discipline, rather than respecting parties’ freedom of contract).
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Further, in a culture with a hybrid legal history such as Vietnam, frequent legislative changes to meet the need of the transitional economy are viewed with more tolerance by (and, in fact, are expected of) country leaders. Custom has higher societal precedential value than the written law in the “relational” cultures of Asia, Africa, and Latin America (as opposed to the “individualistic” cultures of the West).

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\textsuperscript{234} \textit{Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic}, 53 I.L.R. at 474.
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\textsuperscript{235}53 I.L.R. at 474. Dispute resolution in international business transactions has traditionally been handled via final and binding arbitration, as may be recognized by state-signatories to the 1958 U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “\textit{New York Convention}”), Convention on Recognition and Enforcement of Arbitral Awards, June 10, 1958, Art. V, 21 U.S.T. 2517, 330 U.N.T.S. 3 [hereinafter NY Convention]. Accordingly, there has been no court case addressing the validity of the Stabilization Clause in the international context.
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the concessionaire irretractable rights.” According to the tribunal, in granting concessions to IOGCs, the Libyan State did not alienate but, instead, “fully exercised its sovereign power to contract.” To the extent international arbitral decisions constitute modern lex mercatoria, it can be said that stabilization clauses are valid under international law. In various forms, the Clause has increasingly become a standard practice in most PSCs executed with “Third World” countries.

When carefully drafted and broadly applied, the Stabilization Clause can shield the investment from new taxes, new legislation, new regulation, decrees of nationalization or expropriation, or any other form of a “materially adverse governmental action” (MAGA) that may make the investment less economically whole. For example, if a country’s petroleum law (which may include environmental and safety standards) effective at the time of contract execution later needs to be changed, the Stabilization Clause can estop the host government from applying the new law and new standards to the IOGC’s long-term project, in the absence of the IOGC’s consent or some other renegotiated, mutually acceptable conditions. In other words, while the rest of the country may be governed by a newer version of the law, the IOGC’s investment, secured by the Stabilization Clause, will be governed by an outdated version. This is in practice a much more pervasive application and interpretation of the Stabilization Clause than mere prevention of the retroactive application of a new legislation.

The Stabilization Clause’s validity and effectiveness may be questioned based on six conceptual premises, as explained below.

236 53 I.I.R. at 482.


238 James L. McCulloch & Christina Maria Abascal Deboben, Tulane Latin American Law Institute Symposium: “The Foreign Corrupt Practices Act and Other Legal Considerations Relevant to the Oil and Gas Industry in Latin America,” 77 Tul. L. Rev. 1075 (March 2003) (recognizing the popularity and necessity of stabilization clauses in Latin America’s foreign investment contracts, noting that in “traditional stabilization clauses, a government is contractually prohibited from enacting legislation that is inconsistent with the original contract”).

239 If sovereignty rights over natural resources and territory can be waived in private transactions with “outsiders” and, hence, are not “permanent,” then a government’s sovereign power to proscribe conduct of its citizens by way of inhumane regulatory measures affecting the people’s liberty interests should likewise be less than “permanent” and, hence, can similarly be circumvented by acts of outsiders premised upon international humanitarian laws. These sources of law should suffice to curtail a government’s power to proscribe conduct of its own citizens, if such power is exercised in a way that offends universal liberty interests. Yet, in Doe v. Unocal Corp., 2002 U.S. App. LEXIS 19263 (9th Cir. 2002), the court barred Burmese villagers’ claims against the military government of Myanmar (and an U.S. oil company) under the “Sovereign Immunity Doctrine” codified in U.S. statutory law. Foreign Sovereign Immunities Act, 28 U.S.C. § § 1602-1607 (2000). See also the analysis under The Fifth Premise discussed in this Part. The Doe case has been set for an en banc rehearing before the Ninth Circuit. 2003 U.S. App. LEXIS 2716 (February 14, 2003).
• Challenging and Reexamining the Popular Stabilization Clause – the Six Premises

■ The First Premise

The rationale of Texaco v. Libyan Arab Republic and similar decisions upholding the Stabilization Clause can be challenged. The sovereignty may have entered into a contract via its commercial arm or in its commercial capacity, but not in its capacity as the law-making body charged with the responsibility to safeguard the country’s public interest.240 This is the gist of permanent sovereignty. In fact, this sovereign power constitutes the type of macro- and micro-economic oversight critical to nation-building as well as to the building of an effective world economy. U.S. courts have recognized permanent sovereignty as an “inalienable right” uniquely applicable to a nation-state’s control power over its natural resources and economic activities, and, hence, cannot be waived.241 If the reverse scenario had been presented to the American public and its court system – that a non-U.S. investor wants a political subdivision or branch of the U.S. government to waive the U.S.’s rights to enact new legislation or promulgate new regulations affecting the investor’s project, the public outcry in response to such request (from the steps of Capitol Hill to the average American household’s television set) would have killed the Stabilization Clause much quicker than the time it takes the investor to table it for discussion.

■ The Second Premise

Popularized as a risk-management device, the Stabilization Clause, nonetheless, is not an effective tool for the management of Political Risks. As a practical matter, the Stabilization Clause does not protect the investment contract against a change in regime. If a government is toppled or denounced as illegitimate, one of the three elements of statehood (territory; people; government)242 becomes missing. Therefore, a contract executed by a defunct or illegitimate government, which never has the recognition of the “people,” is not binding upon a nation.243 If this notion falls short of the dignity of an international legal theory, it at least reflects the undeniable reality of the global political economy – what keeps governmental contractual obligations intact after a change of regime is the new regime’s voluntary compliance, instigated by


242 See Notes 55 and 229, supra (discussing elements of statehood).

243 “If a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress the population that fights against it, this debt is odious for the population of the State...” Alexander Sack, Russian law professor, 1927.
the military and international pressure from the community of nations at large, rather than by any aspirational goals of the international rule of law. Accordingly, a commercial transaction negotiated and executed with a foreign government always carries a risk of being dishonored or renegotiated after a *coup d’etat* or revolution uprooting the current political or legal foundation. But even if the new regime is amenable to establish itself as part of the international investment community, and hence is willing to honor existing contracts, the state authority once in charge of the investment project may have been restructured or repealed entirely, presenting practical problems in contract enforcement and performance. This point, again, demonstrates the intimate correlation between (i) the IOGC’s commercial relationship with an incumbent regime, and (ii) the IGOC’s incentive to support the incumbent regime long-term, in an effort to control and minimize Political Risks.

### The Third Premise

The host government or their successors may view the Stabilization Clause as an expression of the foreign investor’s skepticism toward the country or the regime’s legitimacy and reliability. Here lies the paradox: if the foreign investor is already haunted by such skepticism, such that it has to insist on a Stabilization Clause, why is it entering into a binding contract recognizing the legitimacy or stability of such a political regime in the first place? What, then, has happened to the foreign investor’s sound business judgment and careful assessment of Political Risks – an element that should, at all times, be part of its accountability to the home country’s shareholder public?

By its very nature, the Stabilization Clause acknowledges that a sovereignty may wear two hats: (i) as contracting party to a commercial transaction, and, (ii) as sovereign regulator of economic behaviors, exercising its “jurisdiction to prescribe.” By conducting itself in the second capacity, the sovereignty in effect breaches the contract it enters into in the first capacity. The Stabilization Clause thus becomes a tool of anticipating, minimizing, or eliminating risks of investment loss due to foreseeable breach. The irony remains: If the sanctity and freedom of contract is the principle governing the parties’ transaction (as both parties will want to argue), one party – the more

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244 See, e.g., American Bell Int’l Inc. v. Islamic Republic of Iran, 474 F. Supp. 420 (S.D. N.Y. 1979); Harris Corp. v. National Iranian Radio & Television, 691 F.2d 1344 (11th Cir. 1982) (new Iranian government dishonoring contracts with U.S. companies in the 1970s following the Iranian revolution). See also M. Sorharajah, The International Law on Foreign Investment (1994). An example of this situation is the contract for the construction of nuclear electricity-generating plants in the Philippines, to be operated on islands with active volcanoes. The contract was allegedly obtained through improper means under the Marcos government and subsequently was rescinded by the incoming government. See Patricia Adams, “Philippine Government to Dismantle Marcos Nuclear Plant” (Probe International February 28, 000), [found at](http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=content&ContentID=9); Maristella Cardenas, “ECAs in the Philippine Power Sector and the Continuing Debt Problem,” (Freedom from Debt Coalition Dec. 12, 2003), [found at](http://www.jubileesouth.org/news/EpZyVyuAVISMReFuL.shtml). Likewise, the validity of contracts made in Namiba under regimes controlled by South Africa has also been questioned.
economically powerful -- is also anticipating and trying to render predictable the possibility of breach by the economically weaker party. If the Stabilization Clause is an enforceable promise (as the MNC will try to argue), it is also a signal of lack of trust, demonstrating the need for additional safeguards against potential breach or default.245 It in itself is proof of the high Political Risks inherent in the investment environment. Investor skepticism may have negative impact on negotiations, or may even be found offensive to the host culture. Yet, perhaps due to lack of leverage, or otherwise prompted by the need to please its wealthy business ally, the host government must live with the Clause. Aware of this subtle erosion of trust or cultural clash, if the IOGC decides to forego the Clause in exchange for goodwill, from a corporate policy standpoint, this omission in itself may indicate that the negotiation team has not buffered the contract effectively against Political Risks. For an IOGC's lawyer, such an omission may arguably raise a claim of professional malpractice.

**The Fourth Premise**

Principles respecting the sanctity of contract are part of international law, starting with the law of treaties.246 Likewise, among those principles of contract law that should constitute the “general principles common to the major legal systems”247 (as a source of customary international law) is another legal concept called voluntary assumption of risk.248 Where the legal and political environment of the host country is extremely volatile, the IOGC

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245 Compare Menachem Mautner, “Contract, Culture, Compulsion, or: What is so Problematic in the Application of Objective Standards in Contract Law?” 3 Theoretical Inquiries in Law 545 (2002) (questioning objective approach such as “the economic man” to contract interpretation; analyzing role of culture in contract formation; arguing that contract-making is functional equivalent of “trust” – actual knowledge of whether a promissor can keep his word will render either contract-making or trust unnecessary; viewing contract as either “professional” script or “lay” script, and lawyers as translators of such script).


248 See, e.g, See, e.g, Restatement 2d of Torts, § 496C (1965) ((1) Except as stated in Subsection (2), a plaintiff who fully understands a risk of harm to himself or his things caused by the defendant's conduct or by the condition of the defendant's land or chattels, and who nevertheless voluntarily chooses to enter or remain, or to permit his things to enter or remain within the area of that risk, under circumstances that manifest his willingness to accept it, is not entitled to recover for harm within that risk; (2) The rule stated in Subsection (1) does not apply in any situation in which an express agreement to accept the risk would be invalid as contrary to public policy); See also Deena B. Bothello , “An Unequal Balance: Repudiation and Restitution in Mobil Oil Exploration & Producing Southeast Inc., v. United States,” 80 Oregon L.R. 1469 (2001).
willingly assumes such risk when it makes a decision to invest there. Apparently, its profit incentive to do business in such a volatile environment outweighs its pre-investment Political Risk assessment. If that is the case, why should the IOGC benefit from a negotiated Stabilization Clause that in effect erodes the host country’s sovereignty, due clearly to the IOGC’s enormous leverage power exercised during the contracting process?

The next logical inquiry is whether the Stabilization Clause will apply if and when the host nation’s new legislative or policy measures improve, rather than jeopardizes, the investor’s bargained-for position under the contract. As a practical solution, the clever IOGC’s lawyer will then carefully draft the Clause such that it will shield her client only from the negative effect – and not the positive effect -- of future legislation or sovereign action. Again, this selective enforcement is clear evidence of the IOGC’s exercise of its powerful negotiation leverage.

The sliding scale reflecting this leverage varies from deal to deal, depending on the country, the government, and the project. Within this sliding scale, three scenarios may arise when a host government must consider a proposed Stabilization Clause:

1) Other investors will insist upon a similar Stabilization Clause for each and every foreign investment project in the country. The more economically powerful and better-known investors will get their way; the smaller or medium-sized entrepreneurs will have a lesser chance of getting their way, or no chance at all. The MNCs who join forces to propose the broadest Stabilization Clause as a group effort, *vis a vis* the host government, will get the broadest protection from such standardized Stabilization Clause as jointly negotiated and coordinated. The smaller investor who is not part of any “joined forces” or “de facto cartels” will not get such broadest protection;

2) If the government is desperate for foreign investments, it may just allow a commercial instrumentality to waive the essence of governmental existence – the ability of a sovereignty to legislate. This may occur for only one project, for many projects, for only a particular kind of investor or certain tier of investors, or only for a particular kind of industry; or

3) Where the disparity of bargaining power is not too severe, a compromised Stabilization Clause may *(i)* require the host government to make its best efforts to maintain or restore the foreign investor’s economic position in the event of a subsequent legislative change, no more no less; or, *(ii)* impose only a mutual obligation upon the parties to renegotiate the contract, in good faith, in the event of new legislation or regulations. 249

249 The “*Renegotiation Clause*” may be considered a species of the Stabilization Clause, or it can be a broader clause that serves purposes other than just stabilizing the contractual environment. For example, a “*Gas Clause*” in a petroleum contract is usually a Renegotiation Clause, whereupon the parties agree to
The Fifth Premise is the natural result of the first four Premises. As a legal concept, the Stabilization Clause is inherently problematic. The incoherent and self-conflicting nature of the Stabilization Clause can further be illustrated by examining

(i) the **contracting capacity** of the host government or its agent in the deal-making process; and

(ii) the **negotiation objective** of a U.S.-based IOGC in structuring the host government’s warranty or representation of its legal capacity to contract with the IOGC.

(i) **Host Government’s Capacity to Contract.** Of critical importance in the contracting process is the issue of who can bind the nation-state. The dual-hat nature of the government’s role as a contracting party – **either** as statehood or in its commercial capacity **or both** – can be very delicate and complex. Under the “statehood” analysis, several issues arise as to which entity or agency can legitimately represent and bind the government. (Very seldom will a private investment contract be entered into in the name of the nation itself, as in the case of a treaty, although such practice may perhaps be the ultimate goal of the foreign investor, seeking to eliminate all kinds of ambiguous legal issues regarding capacity to contract, as explained below.)

Since international cooperation and foreign investments often are among the most lucrative areas of the national economy (and a substantial, if not the only, source of foreign currency revenues), various state instrumentalities will compete against one another to occupy some role in these “glamorous” areas. (Of course, the more economically powerful the MNC is, the more chance it will further negotiate fiscal terms in the event of a commercial gas discovery. Since gas development projects are full of uncertainty, the parties cannot define contractual obligations unless and until the gas discovery is evaluated, and economic benefits ascertained based on the characteristics of the gas found. A “**Review Clause,**” on the other hand, imposes an obligation upon the parties to review contractual terms in the event of change in circumstances, or to meet and formulate a new fiscal system to return the IOGC to its original economic position. See, generally, Andrew B. Derman, International Oil and Gas Joint Ventures: A Discussion with Associated Form Agreements, Monograph Series No. 16 at p. 70 (Section of Natural Resources, Energy, and Environmental Law Section, American Bar Association and the National Energy Law & Policy Institute, the University of Tulsa College of Law) (1992). See also James L. McCulloch & Christina Maria Abascal Deboe, Tulane Latin American Law Institute Symposium: “The Foreign Corrupt Practices Act and Other Legal Considerations Relevant to the Oil and Gas Industry in Latin America,” 77 Tul. L. Rev. 1075 (March 2003) (recognizing the renegotiation clause as a hybrid stabilization clause); Gaetan Verhoosel, “Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking A “Reasonable” Balance between Stability and Change,” 29 L. & Policy Int’l Bus, 451 (Summer 1998) (noting modern contractual practice to move from traditional stabilization clauses to preferred renegotiation clauses).

250 In the Vietnam Deal, PetroVietnam wore two hats: first as representative of the sovereignty, and, second, as an SOE/commercial entity doing business for the government and of which the government is the sole owner.
have in getting to negotiate with the very top echelon of the government, thereby avoiding the headache of being caught in the lower echelon’s competition.)

In addition, if the host country is a federation, a number of additional complications may arise under *lex loci*, whether or not notions of federalism are clear or well-developed in the country’s laws. The division of authority between the federation and constituent units may be ambiguous. The constituency may, within its authority, introduce specific regulations affecting the project, and provincial authorities may insist on enforcing local regulations that are inconsistent with federal regulations. Accordingly, it is not unusual in a developing nation for various government instrumentalities or constituencies to claim the same authority over an investment project, resulting in internal political fights that can discourage or even immobilize the foreign investor, at least during the period of political in-fighting. Likewise, it is not unheard of if the actual practice may differ from the written rules.  

Within its commercial capacity, the nation-state may also have many faces. It may exercise choices in selecting an instrumentality through which the state can do business -- either through one of its agencies, ministries, provinces, or through an SOE (which is akin to a corporation in which the government is the sole or controlling shareholder). The crucial difference attached to any of these choices is the degree of the host government’s liability for the obligations assumed by its instrumentality or SOE under the country’s law or prevailing custom. (Again, *lex loci* or *lex situs* may be ambiguous or nonexistent on these critical legal issues.)

Where the host government has designated an SOE to serve as contracting party (as with the role of PetroVietnam in the Vietnam Deal), both the SOE’s capacity to represent the state and the SOE’s own commercial capacity must be ascertained. For example, under the local law, an SOE may or may not have a “corporate veil.” It may, or may not have corporate assets, or if it does, its rights to corporate assets may be limited, and asset disposition may require higher state approval. In any event, the IOGC-contractor will want to establish the SOE as an instrumentality or agency of the state, with the capacity both to bind the government and to execute business transactions for itself, as well as on behalf of the state, all at the same time. In summary, the

251 *See, e.g.,* Note 106, *supra* (discussing the unwritten “Operation Code” of the transitional economies).

252 Such is the case in the Russian Federation. If a “corporate veil” is granted, the state is not liable for the obligations of the SOE. If, however, the SOE has no "corporate veil," the state is fully liable for the obligations of the enterprise it owns, especially when the assets operated by such enterprise are not sufficient to satisfy all claims. *See Civil Code of the Russian Federation, Arts. 114, 115. On the other hand, SOEs in the Federation may have limited rights to corporate assets. Quasi-ownership rights such as economic and operational management rights may, or may not allow SOEs to encumber or dispose of corporate assets without the prior consent of the state. Failure to obtain such consent may render the transaction invalid. *See Civil Code of the Russian Federation, Arts. 294, 296.*

253 *Id.*
IOGC wants the best of all worlds. If applicable *lex loci* or *lex situs* is neither clear nor in existence, the clever IOGC lawyer will use her client’s enormous economic power to write these advantageous “legal capacity representation and warranty” provisions into the investment contract, at least as a starter point.

But that is not all. As the ultimate risk control measure, MNCs may attempt to get parliament approval of the contract, including the Stabilization Clause aided by all those “legal capacity” provisions discussed above. In some legal systems, an agreement of the executive branch or its agency to “freeze” the applicable law may not be effective without legislative approval of such agreement. In such a case, legislative approval of the investment contract is mandatory. Where parliament approval is not mandatory, it still provides additional assurance at the highest level, and bolsters the validity of all those contractual mechanisms. This is often done when the developing country’s law governing a sector or an industry has not been enacted or is in an embryonic state.

In reality, this measure may carry its own drawbacks. The process can delay the project and increase bureaucratic hurdles, subjecting the investment to more local political pressure. Or, for the following reasons, the process may serve only psychological and goodwill purposes, rather than creating legal precedents. *First*, a right granted by the legislature can be taken away by the legislature. *Second*, legislative approval of the contract only serves to demonstrate the commitment of the current legislature, not any future regime or a newly elected body. *Third*, legislative approval of a contract does not necessarily change such contract into law, since an agreement is not a statute. *Fourth*, if the contract becomes law, then implicitly any amendment of the contract may have the effect of law as well, thereby changing private contractual negotiations into a legislative process. *Fifth*, even where the contract becomes or has the effect of law, conflicts may arise between the contract and any other existing or subsequent laws that have effect beyond the specific industry to which the investment project belongs. *Finally*, a question may equally arise as to whether provisions of the contract may be binding on regulatory authorities other than the authority represented by the governmental instrumentality or SOE (for example, whether PetroVietnam in the Vietnam Deal had the authority to bind the Ministry of Finance or the Central Bank). The PSC often addresses other matters such as customs, export-import of goods and services, labor, taxes, environmental and workforce safety, many of which are beyond the regulatory power of the petroleum authorities. Legislative approval of the PSC may affirm the petroleum authorities’ power, but not necessarily other divisions of the government.

In practical terms, legislative approval of an investment contract that contains a Stabilization Clause may reinforce the contract’s validity as a binding obligation of the nation-state. As such, the Clause can deterrently make it more difficult for the host government to breach, repudiate, or otherwise disregard contractual obligations. However, under traditional notions of sovereignty, it is inconceivable that the nation-state’s Parliament or Congress, its taxing, Treasury, or Central Bank authorities will turn their law-making and rule-making authority over to an SOE or any other governmental
instrumentality, allowing such agency or instrumentality, in the conduct of commerce, to waive the legislative or regulatory power of the nation. Yet, practically, that may be the most far-reaching effect of the Stabilization Clause. When upheld as binding upon the nation-state, the Clause amounts to tacit admission that the SOE who enters into the contract has more authority than the country’s legislators, or at least has the authority to speak for them. Consequently, the enforcement of the Stabilization Clause may have great political implication upon a nation well past the four corners of the investment contract.

In the past decades, MNCs have tried, and have succeeded, in obtaining parliament approval of their investment contracts executed by a host country’s executive branch. This success demonstrates once more the vast clout, powerful leverage, and superior bargaining power of the MNC-investor in a developing economy.\footnote{See, e.g., Assessing Investment Opportunities in Economies in Transition, OECD, Paris 1994, at 11.} Either the country is so poorly situated that it has to waive its sovereign power for the sake of attracting investment, or, because of the tight glove-fitting nature of the MNC’s partnership with the government, the government is willing to forego its supreme power to proscribe conduct and abandon its responsibility to act in the national interest, simply to support a long-term business partner. In such a case, the MNC’s interests can dilute or replace the national interests. The Stabilization Clause illustrates not only the host government’s willingness to bend and accommodate, but also the enormous political power and negotiation leverage that cloaks a particular IOGC, or a consortium of IOGCs, as the desired partner of the host government.

\textbf{(ii) The paradoxical negotiating objective of the IOGC investor.} It follows from the discussion above that the MNC-IOGC’s objective is two-fold: to bind the host government \textbf{both} in its sovereign capacity \textbf{and} in its commercial capacity \textbf{in the same contract}. Such a posture may be viewed by legal scholars as inherently paradoxical; yet it has been done \textbf{(i)} as a practical matter to facilitate “Third World” economic development, and \textbf{(ii)} with respect to U.S.-based MNC-IOGCs, as a necessary strategic measure to accommodate the current status of U.S. law, to be explained below. Again, the success of MNC-IOGCs in accomplishing such a paradoxical negotiating objective illustrates, once more, the willingness to accommodate, as well as the inferior bargaining power of today’s poor or lesser-developed “monarchs.” \footnote{At least one commentator has noted that in these partnerships, governments are often fearful of angering MNCs, lest they leave and take their capital investments away. Baker, 20 Wis Int’l L.J. at 103.}

To serve its purpose, the Stabilization Clause must be interpreted as a \textit{sovereign} promise not to alter the legal environment governing the investment contract. At the same time and in the same contract, the IOGC must establish the host government’s \textit{commercial} capacity, since the “monarch” is also acting as a private party contracting for profit in the deal. If the “monarch” fails to abide by these commercial obligations, it may be committing, and, hence, may be sued for, breach of contract, the same way a private party can be held liable for breach. One capacity may undermine or undercut the other, and this
becomes the challenge of the international business lawyer representing MNC-IOGCs.

This paradoxical negotiating objective is necessitated by the current state of U.S. laws or similar legal theories recognized in other developed jurisdictions. In a dispute resolution proceeding arising out of the investment contract (whether arbitral or judicial, or both, as when an arbitral award must be enforced in the U.S.), the host government or the SOE acting on the government’s behalf may attempt to assert two defenses:

1) the jurisdictional defense of Sovereign Immunity, now codified in the U.S. Foreign Sovereign Immunity Act (FSIA),\(^\text{256}\) (the “Sovereign Immunity Doctrine”); and/or

2) an affirmative defense that the government’s act challenged by the IOGC is an “Act of State” not subject to review by the U.S. judiciary (the “Act-of-State Doctrine”).\(^\text{257}\)

Both the Sovereign Immunity and Act-of-State doctrines have firm roots in U.S. laws. The Sovereign Immunity doctrine compels the federal court to relinquish subject matter jurisdiction over an action against a foreign state, in due respect for principles of comity rooted in customary international law,\(^\text{258}\) unless certain statutory exceptions under U.S. law are met.\(^\text{259}\) The Act-of-State doctrine, on the other hand, is the exercise of judicial restraint or abstention based on principles of “separation of power” or the “political question” doctrine in U.S. constitutional law.\(^\text{260}\) Under the Act-of-State doctrine, a U.S. court would not “sit in judgment” of another country’s sovereign act “within its own territory,”\(^\text{261}\) because the substitution of judgment would infringe upon an executive function, causing sovereign embarrassment or discordance to international relations, and undermining the “separation-of-power” bedrock of


\(^{258}\) Schooner v. McFaddon, 11 U.S.116, 3 L.Ed. 287 (1812).


\(^{261}\) Underhill v. Hernandez, 168 U.S. 250, 252 (1897) (“Every sovereign state is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory.”).
the U.S. governmental structure. The Act-of-State doctrine has been applied by U.S. courts to accord validity to the expropriation of U.S. investors' property, even though the doctrine caused detriment to an aggrieved U.S.-investor.\footnote{Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398(1964).} The doctrine has developed slowly, partly due to the scarcity of caselaw on such a complex and antiquated doctrine rooted in, according to the U.S. Supreme Court, "constitutional underpinnings."\footnote{In Sabbatino, the Court rejected the notion that the Act of State doctrine may have its roots in principles of sovereign immunity. Instead, the Court held that, although it is not constitutionally required, the doctrine has "constitutional underpinnings" rooted in the "basic relationships among branches of government in a system of separation of powers." 376 U.S. at 428.} These “constitutional underpinnings” conceptually distinguish the Act-of-State doctrine from Sovereign Immunity, rendering “Act of State” a domestic rule part of \textit{lex fori}, rather than a rule of international law. Similar doctrines have been recognized and applied in many countries besides the U.S.\footnote{See, e.g., A.M. Luther v James Sagor & Co, 3 K.B. 532, 548 (1921) (England); Sociedad Minera El Teniente S.A. v. A.G. Norddeutsche Affinerie, 12 I.L.M. 251 (Super Ct. Hamburg 1973); Donald T. Kramer, Annotation, Modern Status of the Act of State Doctrine, 12 A.L.R. 707, 715 (1972). \textit{But see} F.A. Mann, \textit{Studies in International Law}, 374 n. 7 (1973) (noting that outside Anglo-American and Dutch law, the Act of State doctrine has no support in the judicial system of other countries). In comparison, civil law countries employ the private international law concept of \textit{ordre publique}, which, in effect, favors the application of \textit{lex fori}. Under the civil law’s notion of \textit{ordre publique}, a national court may refuse to give effect to a law or act of a foreign state if doing otherwise will offend the \textit{public policy} or \textit{basic values} of the forum state. \textit{See, e.g.} Convention on the Law Applicable to Contractual Obligations (EEC) Art. 16 (1980). \textit{See also} Chifor, “Caveat Emptor: Developing International Disciplines for Deterring Third Party Investment in Unlawfully Expropriated Property,” 33 Law & Policy in International Business at 254.} Commentators, however, have noted the decline in the use and invocation of the doctrine in past decades.\footnote{See, e.g., Paul N. Filzer, \textit{The Continued Viability of the Act of State Doctrine in Foreign Branch Bank Expropriation Cases}, 3 Am. U. J. Int’l L. & Policy, 99, 108 (1988). \textit{See also} Chifor, “Caveat Emptor: Developing International Disciplines for Deterring Third Party Investment in Unlawfully Expropriated Property,” 33 Law & Policy in International Business 179, 254, 262 (2002). \textit{See also} W.S. Kirkpatrick& Co., Inc. v. Environmental Tectonics Corp., Int’l, 493 U.S. 400 (1990).}

In practical terms, the Act-of-State doctrine functions as a conflict-of-law principle and, in this regard, does \textit{not} advance the interest of the MNC-IOGC. The doctrine establishes that the law of the forum (\textit{lex fori}), as in the case of the United States, creates a presumption of validity accorded a sovereign act, thereby shielding it from scrutiny by the courts of the forum applying the conflict-of-law rule of \textit{lex fori}. The doctrine’s practical impact lies in the consequence of its application: only \textit{lex loci} or \textit{lex situs} provides the source of law under which the validity of a sovereign action can be assessed. This is precisely the kind of localized anomaly that the “internationalization” doctrine purports to eradicate.

Under U.S. laws, \textbf{two} exceptions to the Sovereign Immunity and Act-of-State defenses have been carved out by either statute or caselaw, or both. In general, either doctrine can be defeated and the host government, or parties acting on its behalf, can still be sued if \textbf{(i)} the sovereign act constitutes a
“taking” of investor’s property “in violation of international law” (the ‘International Law Exception’);266 and/or if (ii) the sovereign act in question constitutes a “commercial activity” (the “Commercial Activity Exception”)]267

**The International Law Exception.** To qualify for this exception, the IOGC will have to establish that in breaching the Stabilization Clause, the host government has committed an illegal taking of the IOGC’s property in violation of international law. Such an action by the government must be a sovereign act. This explains why, *inter alia*, it is crucially important that the investment contract binds the host government in its sovereign capacity. It is predicted that the International Law Exception will gradually gain more vitality and popularity, as U.S. courts will increasingly come to face international law principles as a result of globalization. This prospect, however, is not without challenge. The preliminary inquiry of whether the sovereign “taking” violates international law already raises complex and unresolved legal issues, because the standards of what constitutes an “illegal taking” under international law are unresolved, representing a serious split of viewpoints in the ongoing North-South dialogue since the day of the Cuba Revolution and throughout the 1970s and 1980s.268

Further, with respect to the Sovereign Immunity defense, assuming that the IOGC could successfully persuade a court that an illegal taking of its property had taken place in violation of international law, the petroleum investment and assets – all located in the host country – or the activities of the SOE or governmental instrumentality that served as the contracting party must somehow be traceable to U.S. territory to order to justify federal court subject matter jurisdiction.269 Under the FSIA, without such territorial nexus to the U.S., the International Law Exception does not apply.270

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269 Foreign Sovereign Immunities Act 28 U.S.C. § § 1602(a)(3) (2000) (“A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case...in which rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the united states in connection with a commercial activity carried on in the United States by the foreign state; or that property...is owned or operated by an agency or instrumentality
The International Law Exception remains an ineffective safeguard against host governments’ bad acts, unless and until the divergence of viewpoints in the North-South dialogue is resolved, if ever, at all. So long as the divergence of opinion persists, any proposed rule of law falls short of the status of customary international law because the disagreement defeats the notion of consensus accorded to universally accepted custom.271 If a court cannot determine whether the foreign sovereign act in question constitutes a violation of international law because it is unsure as to what the standards under international law are, it cannot apply the exception with certainty and intellectual comfort.

♦ The Commercial Activity Exception. In contrast, no such territorial nexus to the U.S. is needed for the Commercial Activity Exception to apply in order to defeat the host government’s claim of Sovereign Immunity. Thus, compared to the statutory International Law Exception, for U.S. investors, the Commercial Activity Exception is an easier test to meet under the FSIA, one that involves less legal uncertainty and requires a lesser degree of exposure to
international law on the part of the U.S. domestic forum that must interpret and apply the FSIA.

The Commercial Activity Exception illustrates the “defensive” application of the U.S.’s “extraterritorial jurisdiction to prescribe.” Instead of reaching out extraterritorially to regulate foreign conduct beyond its border, the U.S. is “fencing off” the sanctity of a foreign sovereign act when it is made applicable to U.S. nationals appearing in an U.S. court, based on their conduct outside the U.S. To support this “fencing off” posture, the FSIA resorts to the “effect” test to justify jurisdiction for the federal court. Under this “effect” principle, the IOGC can sue the host government in the U.S. if the cause of action is based on “an act outside the territory of the U.S. in connection with a commercial activity of the foreign state elsewhere (including its own territory), and such act causes a direct effect in the U.S.”272 (emphasis added).

“Commercial activity” is statutorily defined as “either a regular course of commercial conduct or a particular commercial transaction or act.”273 The FSIA clarifies that the commercial character of an activity shall be determined by reference to the “nature” of the transaction or act, rather than by its “purpose.”274 If the host government’s violation of the Stabilization Clause is its breach of the investment contract, the “nature” of such breach may make the sovereign act “commercial,” even though the breach was occasioned by enactment of a legislation whose “purpose” is to regulate an industry across the board. Thus, by carefully drafting and phrasing the Stabilization Clause as well as various “legal capacity” provisions, the IOGC stands a good chance of making a strong case for the application of the Commercial Activity Exception, using the contractual language and the investment contract itself to characterize the government’s breach as a commercial act. Where a host government breaches an investment contract that generates a Profit Split and a Participating Interest held by the sovereignty in addition to tax and royalty, the sovereign act begins to take on the nature of a commercial dealing, rather than a legislative act of a sovereignty. By statutory definition, it is the nature of the act (the displacement of a business partner’s economic rights), and not its purpose (the enactment of law regulating the industry) that determines the act’s “commercial” character.

In summary, the Commercial Activity exception to Sovereign Immunity is statutorily pronounced and defined in the FSIA. This Exception exists to the advantage of the MNC-IOGC. In contrast, the existence, extent or elements of a Commercial Activity exception is not yet clear under U.S. caselaw interpreting the judge-made Act-of-State doctrine, including Supreme Court jurisprudence.275 The ambiguity haunting over the availability and vitality of

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274 Id.
this exception under the Act-of-State doctrine makes it more difficult for the IOGC’s lawyer to draft and negotiate express contractual language establishing the host government’s commercial capacity in the investment. Further, compared to Sovereign Immunity, which must be applied based on the FSIA’s statutory elements, the judge-made Act-of-State doctrine is not a rule of decision, but rather the result of judicial balancing of factors that may warrant abstention. Accordingly, from a risk-management standpoint, the probability of success or positive outcome of an “Act-of-State doctrine” litigation is much harder to assess. The doctrine carries more risk and less certainty, and hence, poses graver concern to the IOGC and its lawyers.

In any event, both the Sovereign Immunity and Act-of-State doctrines confirm the privilege of monarchy -- the queen will judge herself! Her sovereign neighbors should stay at bay and play “hands off” in all due respect to her! If permanent sovereignty attaches to the queen’s “Act of State,” as it should, the queen will change her law as she sees fit at any point in time into the indefinite future, even though she might have transacted business with traveling merchants in the past, and has made all kinds of commercial promises to them! All these principles are well and good if the queen watches out for her subjects, but not if the queen is “pawning” her subjects for the benefit of the throne! When served as a permanent shield for the “bad acts” of a corrupt, incompetent, and recalcitrant government, both Sovereign Immunity and the Act-of-State doctrine can become an accomplice to a pattern that obstructs, instead of furthering, the social goals underlying “Third World” economic development.

From a policy perspective, Sovereign Immunity and Act-of-State are legal theories that restrict economic globalization. At least one commentator has opined that traditional concepts of “sovereignty” central to international relations and international law are outdated and should be reassessed and modernized to accommodate today’s reality of economic interdependence. Nonetheless, these doctrines have evolved and have sustained their viability in a common-law system such as the U.S., as certain aspects of sovereign powers

\[275\] See Dunhill v. Republic of Cuba, 425 U.S. XXX at 682 (1976) (plurality opinion) (pure commercial obligations of foreign government were not within Act-of-State protection). The part of the opinion outlining the commercial exception was agreed to by only four of the nine justices and hence continues to be of doubtful or less significant precedential value. Compare Banco Nacional de Cuba v. Sabbatino, 649 F. 2d 1354 (9th Cir. 1981) CHECK (deciding in favor of judicial abstinence due to foreign policy considerations; avoiding detailed analysis of Act-of-State doctrine); But see Hunt v. Mobil Oil, 550 F.2d 68 (2d Cir. 1977) (recognizing commercial exception to Act of State doctrine as viable law). See also W.S. Kirkpatrick& Co., Inc. v. Environmental Tectonics Corp., Int'l, 493 U.S. 400 (1990) (holding Act of State doctrine did not apply where there was no issue of validity of sovereign action before the court; instead the act in question involved foreign officials’ corruption pattern).

\[276\] Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 428 (1964) (“[R]ather than laying down [an] all-encompassing rule in this case, we decide only that the Judicial Branch will not examine the validity of a taking property within its own territory by a foreign sovereign government...”).

essential to nationalism and internationalism must remain intact in order for concepts of statehood to endure. In international “breach of contract” disputes, these doctrines create unnecessary hurdles that undermine the sanctity of international contracts and render tools such as the Stabilization Clause or other risk-allocation mechanism less effective and less predictable. If the Stabilization Clause is here to stay, it should be allowed to function as a true risk management technique, free from obstacles arising out of antiquated legal theories. Further, in commercial deals, governments should be held ultimately liable to their peoples, and in the appropriate case should be made to bear an accountable share of the global market based on their contractual obligations. This accountability should serve as a deterrent against governmental “bad acts.” Even if governmental actors may care little about the “people,” they should worry about going bankrupt because of monetary judgments rendered against them. Private judgments, therefore, carry their own weight in facilitating policy choices.

In summary, from the perspective of the IOGC, not only does the Stabilization Clause achieve relative predictability for an environment of political instability, but it also boosts a case for the Commercial Activity Exception under the FSIA, if and when the IOGC must bring the host government or its SOE to a U.S. forum applying lex fori to (i) the resolution of the IOGC’s breach of contract claim, or (ii) the IGOC’s request for the enforcement of a favorable arbitral award. The Stabilization Clause, bolstered by various “sovereign capacity” vis a vis paradoxical “commercial capacity” warranty and representation provisions in the investment contract, can become a pivotal part of the MNC-IOGC’s risk management and anticipatory litigation management strategies.

The Sixth Premise

Finally, under my last premise, I pose the question of remedy for a breach of the Stabilization Clause. If the host government violates the Clause, and such violation falls under a Commercial Activity Exception to any national law doctrine protecting the sovereign action, what is the foreign investor’s damage or remedy? This issue strikes at the core of the Stabilization Clause and reveals its pitfall when it is enforced as part of a petroleum exploration contract.

As already discussed, the IOGC typically assumes all Appraisal Risks associated with exploration. If no petroleum is found, the IOGC will have done

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work free. Consequently, if, during the exploration program, subsequent legislation substantially changes the terms of the contract or renders them uneconomic, a remedy such as restitution will give a virtual windfall to the IOGC-contractor. Restitution will make the company whole notwithstanding the potential losses it may have to endure due entirely to Appraisal Risks. Restitution will also rescue the company from financial losses resulting from entering into an imprudent commercial deal in which the IOGC has apparently misvalued Political Risks. Restitution operates as a punishment to the host country (as the repudiating party) and its people for having enacted new legislation and implementing it. When used to claim restitution, the Stabilization Clause not only redistributes wealth among contractual parties who already do not have equal bargaining power, but it also alters the nature of sovereignty. “Third World” governments can exercise and enforce their sovereign power against the entire “Third World” population, but if it wants to enforce the same law against a particular foreign investor, the nation-state must pay for the enforcement, at a price that assumes the investment has no Appraisal Risks. If upheld as a method of seeking restitution for the benefit of the IOGC, the Stabilization Clause will become more and more a “pro-corporate/pro MNC” device, and not simply a means of Political Risk balancing aimed to facilitate and foster global economic development.

Unfortunately, illustrative of this “pro-corporate” tendency, U.S. domestic caselaw has shown an increasingly pronounced preference for the protection of large-scaled corporate financial interests. In Mobil Oil Exploration & Producing Southeast Inc. v. United States, 530 U.S. 604 (2000), the U.S. Supreme Court granted the equitable remedy of restitution to the oil company and restored its status quo prior to the execution of a domestic petroleum exploration contract. In order to secure a mineral lease to explore for oil in North Carolina, Mobil had paid a front cash bonus of $158 million in addition to annual rentals. Analogous to a Signature Bonus in an international petroleum deal, the $158 million bonus was part of the company’s investment in the Contract Area, whereupon the company spent front money in order to secure the right to explore for oil. The chance for success would depend on Mobil’s evaluation of geological Appraisal Risks. If, during the term of the contract, the company did not find any commercial reserve, it would have to abandon drilling, and the cash bonus would be a lost investment. Likewise, if new legislation rendered the project futile, the company would also lose the investment.

When the Department of Interior refused to approve the project based on new regulation, the lower court ordered restitution, allowing the company to recoup its investment. The Supreme Court held that because the government repudiated the contract and impaired its economic value, the refund of the cash bonus to the company to make it whole was appropriate, whether or not the contract would have ultimately proved to be profitable to the company. Where the government was a contracting party, the enactment of new legislation impairing the project constituted a “statement” from the promissor to the promissee unequivocally repudiating the promissor’s obligations to uphold the economic value of the contract. Such a statement is the government’s

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280 530 U.S. at XXX.
“individualized speech” in the commercial context, and not just an exercise of sovereign power. The court analogized the refund of the cash bonus to a refund given to the purchaser of a lottery ticket not received, even if the ticket might have been a losing one.

At least one commentator has severely criticized the Mobil decision as overbroadly redefining contractual relationships and expanding contract law for the benefit of big businesses simply because the United States is a contracting party. The decision increases the risk the government must bear in an otherwise arms-length, fully informed business transaction, allowing the costs of Political Risks to be shifted from the contractor to the government, since the government was in the best position to control or eliminate Political Risks. The commentator also criticized the court’s “lottery ticket” analogy as inappropriate, because the purchase of a lottery ticket for a chance to win was strikingly different from the right for access to mineral resources. A Stabilization Clause, in the commentator’s view, penalizes the government for exercising its legitimate sovereign power and hence creates disconcerting implications regarding the role of the government. When legislation is regarded as “individualized speech,” the nature of law changes from that of a function of order and justice to a means of facilitating transactions and commercial ends. Public governance as a governmental function thus becomes a financially motivated bargaining tool, with the balance of power shifting to the cash-rich party.

It is saddening to realize that these policy concerns, vigorously expressed by the commentator in the context of a domestic deal, have long been the tenor of international petroleum transactions and “Third World” economic development for decades preceding the Mobil decision. It is obvious, then, that issues surrounding the Stabilization Clause in the international arena prove once more the following disconcerting fact: For the MNC-IOGC, much of project or investment risks can be lessened or avoided by contractual planning and negotiation, taking full advantage of (i) the developing economies’ needs for foreign investment and technologies; and (ii) the host government’s desire to form and nurture a self-interest structure that encompasses the two sources of power: the ruling power of poverty-stricken societies, and the deep-pocket power of the affluent world. In such a system, the strong bargaining chip is in the hand of the economically and politically advantaged.

My purpose of presenting the above six premises is neither to condemn nor defend the Stabilization Clause. I neither wish to advocate for its utility, nor its abolition. In fact, I believe that the Clause supplies the psychological comfort needed for the closure of high-risk international deals. Without it, corporate


282 Id.

283 Id.
actors and their employees will be incapacitated by the fear and anxiety often associated with risk assessment and profit/loss projection in dealing with the indeterminate future in an alien investment environment. In multi-million-dollar MNC/IOGC-"Third World" government partnerships, the Stabilization Clause has constituted a legal norm and standard business practice, such that, in the absence of extraordinary and peculiar circumstances, a lawyer’s failure to propose or include the Clause in a large-scaled investment contract may arguably subject him or her to professional malpractice exposure, or at a minimum, severe criticism by management, due to the foreseeable political instability of the “Third World.” For the cautious IOGC lawyer, the Stabilization Clause is like the American Express card – don’t leave home without it!

My **six** premises serve only to call to the legal community at large the inherent imperfection of the Clause as a legal tool. Yet, such an imperfect legal tool has gained the type of popularity and widespread use that constitutes the force behind the formation of modern *lex mercatoria* for such an important industry and sector of the global economy. As such, the Clause’s popularity should cause the prudent legal scholar a frown or, at a minimum, a sense of ambivalence. The six premises I analyzed above are intended to expose the dynamics, intricacy, intensity, and at times disturbing nature of MNC-government confidential partnership negotiation. Considering the imbalance of economic powers, as well as the pattern of feeding self-interests, these partnerships can turn into fruits laden with a juice that potentially can be poisonous to the “people” invisible at the negotiation table. Invisible as they are, they will be tasting those fruits because, from a policy-making standpoint, those fruits are supposedly planted for them! Yet, one should not make the overbroad generalization that all such fruits are poisonous, in the absence of concrete evidence or empirical data specifically relevant to a decipherable trend within an industry, a government, a country, or a region. In fact, I do believe that any such unproven generalization may constitute the type of corporate and government “bashing” that will undermine the critic’s credibility. But this is not to say that we should ignore the chance that the poison may exist.

All I am pointing out is that the potential for the poisonous juice is latently there in those partnerships by virtue of “Third World” realities and the negotiation process itself. The chance for the poison to cumulate may exist in the roots of the fruit-tree and, hence, it may taint the tree’s newly grown buds, especially when the process of pruning the fruit is completely outside the check-and-balance arm of a public interest watchdog representing a concerned international humanitarian community. As the trend for the globalization and

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285 *Id.* Doctrinal polemics on stabilization clauses have centered around their validity under international law. See Thomas W. Walde & George Ndi, “Stabilizing International Investment Commitments: International Law versus Contract Interpretation,” 31 Tex. Int’t L.J. 215, 230 (1996); Wolfgang Peter, Arbitration and Renegotiation of International Investment Agreements 136-137 (1986). The issue has not been confronted by, or resolved by a national court in the context of an international transaction.
internationalization of law is calling various transnational work groups to sit
down together and look at the foundation for modern *lex mercatoria*, new
procedures and method to install this check-and-balance watchdog function
should be a priority for modern international jurists. No mutually acceptable
solution can emerge overnight, let alone a perfect one, but the deliberative
efforts and the thinking process must commence now. Some imperfect solution,
no matter how drastic it may seem, is better than no solution at all.

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II. CASE NO. 2: THE “MID-STREAM” TRANSACTION.

Suppose that in the Vietnam Deal, the IOGC had discovered *Natural
Gas* (rather than *Crude Oil*) in the Contract Area. The IOGC would then have
evaluate the discovery and renegotiate the PSC for more specific gas terms,
because typically, a Producing Sharing Contract leaves contractual terms
governing natural gas for future negotiation. This is as much a necessity as
a norm, since gas terms cannot be projected or particularized ahead of time
without a technical evaluation of the type of gas discovered and the availability
of a long-term gas sale market in the region. (Crude Oil, on the other hand, can
be shipped all over the world. Natural gas transportation by ship is only
economically feasible if the natural gas is liquified – the process of cooling and
compression needed to “shrink” the gas from its original volume).

Gas discoveries are often non-commercial unless they are very large in
quantity, are quite rich in liquids (this description refers to the density or
percentage of liquid in gas), and there exists a market for gas sale or use.

286 In a typical petroleum agreement, “*Crude Oil*” may be defined “solid and liquid hydrocarbons in their
natural state and also includes any liquid hydrocarbons extracted from Natural Gas except for methane.
See “Model Contract for Subject Area of the People’s Republic of China” (China National Oil
“*Natural Gas*” may be defined as both “Associated” and “Non-Associated” natural gas under natural
conditions. It can be wet if it contains condensates, or dry if it does not contain them.” See “License
Agreement for the Exploration and Exploitation of Hydrocarbons Entered into by and between PeruPetro
SA and Great Western Ltd. Sucursal Del Peru Area No. 68,” printed in James Barnes, “Granting
Instruments” (Supp. to Part 7). See also Model Contract, “Oil and Gas Concession Agreement for
Exploration and Production (Budapest December 1994) (“Gas” [means] natural gas consisting of gaseous
hydrocarbons and all non-hydrocarbons gaseous substances produced in the concession area regardless of
whether such gaseous substances exist in liquid or gaseous form in the reservoir or in solution with crude
oil, but excluding liquid condensate which by normal field method is separated from natural gas.”).

287 See Note 249, supra (discussing “Renegotiation Clause” and gas terms).

288 A Kaplan & Graham Marshall, “World LNG Trade Responding to Increased Natural Gas Demand,”
Oil & Gas Journal (November 24, 2003).

289 The construction and operation of a Liquefied Natural Gas (LNG) liquefaction plant involves
significant capital costs, thereby requiring very large deposits of easily extractable natural gas to supply
feedstock to the plant, and most of the projected output must be committed in long-term sales contracts
before a project can receive third-party financing. Today’s new LNG facility will require certified natural
Quite often, gas development in the developing nations is a large-scaled and long-term proposition, involving complex planning and technical gas processing. Accordingly, many gas fields discovered in the “Third World” are still “waiting on pipe,” sitting idle for years awaiting development, due primarily to two reasons. First, many exploration acreages are located a long distance from the kind of gas markets that would make gas sales profitable. Second, if the gas is rich enough, liquid extraction is a development option, but liquefaction facilities are extremely expensive and take a long time to build (as long as two years or more). For example, the Arun liquefaction complex built by Mobil Oil Indonesia (now ExxonMobil) cost approximately $3 billion. 290

However, if gas is discovered in sufficient quality and quantity, and if adequate infrastructure for the transport of gas exists or can readily be contemplated, the gas discovered can become the fuel supply for power-generation plants, built to meet electricity needs of the host country, nearby nations, and the region as a whole. In the energy chain, the conversion of natural gas discovered at the wellhead into electricity can be classified as the “midstream” progression of an “upstream” exploration project such as the Vietnam Deal. 291 Accordingly, as a continuation of the Vietnam Deal, this Article will next dissect a typical independent power project (IPP) in which gas discovered upstream is used as fuel to generate electricity as a commodity for sale (the “IPP or Midstream Transaction”). 292 The IPP Transaction is selected because it is typically financed via Project Financing, a legal and business concept crucial to “Third World” economic development.

A. Anatomy of an IPP Transaction. The IPP Transaction is an integrated, multi-deal energy transaction consisting of several related agreements, concurrently negotiated and coordinated. At the heart of the transaction is the Power Developer (or Power Supplier, or at times called the Independent Power Producer), which is the entity responsible for developing the Power-Generation Facility (“Facility”) and supplying electricity to buyers. The agreements constituting the IPP Transaction consist of the following:

—gas reserves of more than 4 tcf in order to be considered for non-recourse financing supported by long-term gas sales contracts. Id. Although the technology was developed in the U.K., the business of gas liquefaction really took off in Asia. Japan, which had no gas production of its own, adopted the technology and was quickly followed by South Korea and Taiwan. Steve Robertson, “LNG Spending Will Reach #39 billion by 2007,” Oil & Gas Journal (Jan. 12, 2004).


292 The terms “Midstream Transaction” and “IPP Transaction” are used herein synonymously.
(i) an agreement between the Power Developer and an expert contractor for the “Engineering, Procurement, and Construction” (the “EPC Function”) of the Facility (the “EPC Contract”);

(ii) an agreement between the Power Developer and an expert operator for the “Operation and Maintenance” (the “O&M Function”) of the Facility (the “O&M Contract”);

(iii) an agreement between a gas supplier and the Power Developer, who agrees to buy gas from the gas supplier as fuel for the Facility (the “Gas Sales Agreement” or “Fuel Supply Agreement”); 293

(iv) a long-term electricity sale-purchase arrangement (called “Power Purchase Agreement” or “PPA”) executed by the Power Developer and buyers of electricity. The PPA (or a cluster of PPAs) constitutes the core economics of the IPP Transaction because the PPA provides the income stream used to pay off the costs of Facility construction and operation, as well as the costs of gas fuel. 294 The income stream can last for decades, and is used to pay off loan proceeds over the years. According to a joint study by the World Bank and USAID, PPA terms in Asia and Latin America may range from 14 to 40 years. 295

(v) an optional “Implementation Agreement” executed by the Power Developer with the host government. This agreement sets the regulatory framework and standards for the project, based on, or in addition to, the applicable local law. The Implementation Agreement may act as the

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293 Various transportation arrangements may be necessary to enable the delivery of gas Fuel to the plants. These transportation agreements will also be part of the Project Documents submitted for bankers’ review. Accordingly, an IPP transaction may occasion infrastructure building projects such as pipeline construction and operation. For example, British Petroleum was instrumental in the development of an approximately $1.3 billion pipeline project purported to transport gas from the South China Sea to various fuel power stations onshore in Vietnam. Associated Press, “Pipeline from Vietnam’s Offshore Gas Fields Reaches Land,” (Alexander’s Gas & Oil Connections Sept. 17,2002), found at http://www.gasandoil.com/goc/news/nts22852.htm; Agence France Presse,”BP’s Vietnam Gas Project Completed After a Decade” (Nov. 25,2002), found at http://perso.wanadoo.fr.patrick/guenin/cantho/vnnews/bpvn.htm. Minh Ngoc, , “BP Reaching Target” (Vietnam Investment Review news, Jan. 3, 2004) (discussing Gas Supply Agreement executed by PetroVietnam as buyer of gas from BP’s gas field to supply fuel to power-generation plant). Accord AsiaPluse via COMPTEX, “Nam Con Son production set to skyrocket late this year,” (Alexander’s Gas & Oil Production, June 25, 2003).


295 See, e.g., Laura Onofri, 16 European Jnl Law & Econ., at pp. 23-28. The Power Purchase Agreement may cover a period of 15 to 30 years. Id. at p. 24. See also David Baughman & Matthew Buresch, Mobilizing Private Capital for the Power Scene: Experience in Asia and Latin America (Joint World Bank-USAID Discussion Paper, 1994) (PPA terms examined for study ranged from 14 years to 40 years, with the average being about 20-25 years).
broader regulatory overlay, infusing its effect into all other agreements that constitute the IPP Transaction.

All of the agreements described above constitute “Project Documents,” which must be reviewed not only by the parties, but also by financing institutions contemplating commitments to finance the project. Parties to these Project Documents constitute principal “Project Participants” in the IPP Transaction, each providing a critical function as described below:

(i) The **Power Developer** undertakes to develop and own the Facility. The Power Developer can be a single company, a consortium, or a joint venture, either incorporated or unincorporated. Where the joint venture is incorporated under the law of the host country, the result is a **Project Entity** bearing the juridical status of the host country. All Project Participants who contribute capital and hold equity interests in the project are functionally shareholders of the Project Entity.

(ii) The **EPC Contractor** undertakes the EPC Function and executes the EPC Contract with the Power Developer for the construction of the Facility.

(iii) The **O&M Contractor or Plant Operator** is responsible for the O&M Function and executes the O&M Contract with the Power Developer for the maintenance and operation of the Facility.

(iv) The **Fuel Supplier** is responsible for the supply, transportation, and delivery of fuel to the Facility. (Where gas from the upstream discovery becomes the source of fuel for a gas-fired facility as in the Vietnam Deal, fuel supply is provided by the IOGC that has discovered gas upstream. The IOGC may decide to act as the Power Developer, thereby wearing a “double hat”).

(v) The **Power Purchaser** executes the PPA with the Power Developer, and hence provides the income stream for the project. The Power Purchaser can be governments, municipal authorities, or public utility companies in the region.

(vi) The **host government** or its designated entity can be a Power Purchaser, or it can simply act as the overseeing regulatory authority who controls the utility sector or the project. The host government may also execute an optional Implementation Agreement with the Power Developer.

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296 This configuration of transactions does not include various financing agreements to secure funding for the project.
B. IPP Transactions, Project Financing, and “Off-Balance-Sheet Accounting

Because of its self-sufficient nature, the IPP Transaction is the classic international business transaction typically funded via Project Financing. The structure of an IPP Transaction can best be explained in connection with Project Financing as a legal and business concept.

For several decades, Project Financing (sometimes called “Segregated Financing”) has enabled billions of dollars of funding for economic development projects in the “Third World.” The term, therefore, is also used to refer to a specialty banking practice within the practice of law, focusing exclusively on this type of financing transactions. Simply stated, Project Financing is a financing method based solely on the merits of the project, rather than on the creditworthiness of the project sponsor. In the classic, purest form of Project Financing, all parties to the integrated deal (including bankers or financiers) look to (i) future revenues generated by the project as the source of funds from which project loans will be paid; and (ii) the assets of the projects, whether physical or as contractual rights, as security or collateral for the loans. In traditional corporate financing, lenders typically have recourse to all of the project sponsor’s assets and revenues. The structure of a Project-Financed transaction limits the lender’s security to the assets and cash flow of the project itself, typically under the rubric of a project company formed specifically to construct, own, and operate the project facility.297 The loan is either with limited recourse or completely no recourse to the project sponsor, resulting in no encumbrance on the sponsor’s balance sheet. Hence, the sponsor can maintain its general creditworthiness despite the high debt-equity leverage ratio that may have been incurred by virtue of its sponsorship of international Project Financed transactions. The sponsor may contribute about 20 to 40 percent of the investment as equity, with the remainder infused strictly as project debts.298 (For its equity contribution, the sponsor may use its earnings, raise money on the international or domestic capital markets, either as debt securities or equity securities, or otherwise obtain funding or loans via commercial sources and/or via the Multilateral Institutions. The sponsor can also spread risks by sharing equity contribution with other companies). Overall, Project Financing enables the sponsor to limit its risk exposure to its own equity investment in the project.

From the lender’s perspective, under Project Finance principles, where it is contractually established that the project can pay for itself over an extended period of time, bankers may be persuaded to make loans based on demonstration of the project’s long-term self-sustaining capabilities and economic viability. Such demonstration of viability and assurances of an

uninterrupted income stream are evidenced in the contractual arrangements among the Project Participants. Accordingly, in order to determine whether Project Financing is appropriate, commercial lenders will closely scrutinize Project Documents for any risks of disruption to the income stream or impairment of project assets. Lenders will examine the contractual language of all Project Documents to decipher whether these risks of loss have been adequately treated via transfer to the third party, or assumed by an economically able Project Participant. If the lender or financier sees any untreated or uncovered risk of loss, it will either turn down the request for Project Financing, or ask for additional guarantees or other credit enhancement tools. These tools may alter the nature of financing from the classic form of Project Financing to a more hybrid form bearing more resemblance to other traditional methods of financing. The lawyering and business skills lie in the prospective prediction and mitigation of risks via tightly negotiated contractual language, as well as in the financial and legal engineering that give lenders the necessary comfort in not seeking recourse beyond the project itself. The documentation for an international “Project Financed” investment is among the most complex and voluminous of any financing transactions, and will encompass all kinds of debt and equity arrangements, credit support facilities, as well as credit enhancement tools to give lenders the assurances needed.

The purest, classic form of IPP Project Financing is also described as “Non-Recourse Financing” because loans proceeds will be paid solely from the future income stream or cash flow generated by the project, “without recourse” to the assets, or as individual obligations of the Power Developer or other Project Participants. In such pure Non-Recourse Financing method, the existing assets of a corporate sponsor are unencumbered by the debts. (In contrast, in hybrid (rather than classic) Project Financing, lenders may still have “limited recourse” directly or indirectly to the assets of the corporate sponsor or equivalent. For example, the sponsor’s parent company may have issued a corporate guarantee to secure the sponsor’s performance or to guard against financial losses suffered by others resulting from the sponsor’s non-performance. Such guarantee may provide lenders recourse to the parent company’s corporate assets in case of loan defaults. As another example, bankers may require the sponsor to obtain a surety bond, or a Standby Letter of Credit issued by the sponsor’s bank to guard against the sponsor’s default.


(In the case of a Standby Letter of Credit, the issuing bank granting the credit will make good the financial loss occasioned by the sponsor’s default, but ultimately the issuing bank will look to the corporate accounts or assets of the sponsor – the issuing bank’s customer – via an indemnity or reimbursement agreement executed separately between the issuing bank and the sponsor as a condition precedent to the bank’s issuance of the Standby Letter of Credit.)\(^{302}\)

For decades, the corporate sponsor has enjoyed the single most important benefit of pure or classic Non-Recourse Project Financing: the “off-balance sheet” accounting treatment, whereupon the liabilities incurred by the project are not reported on the corporate sponsor’s balance sheet (The sponsor may still disclose the transaction under the textual Management Disclosure and Analysis or footnotes to the financial statements, depending on whether the sponsor and its auditors deem the project to be material to the financial picture represented).\(^{303}\) Off-balance sheet treatment is appropriate because there has been no encumbrance of corporate assets and the debt had produced no effect on the balance sheet of the corporate sponsor. Corporate sponsors prefer pure or classic Non-Recourse Project Financing, and will bend backward to obtain or structure funding as such. The end result is evident -- the high-risk “Third World” development project in question will leave no effect on their assets, credit, or balance sheet.\(^{304}\)

To a limited and highly technical extent, the post-Enron legislation, the Sarbanes-Oxley Act of 2002, has taken away this “safety-net” from the corporate sponsor. Section 401(a) of the Act added a new Section 13(j) to the Securities Exchange Act of 1934 by requiring public companies to disclose in their 10K Annual Report and 10Q Quarterly Report all “material off-balance sheet transactions, arrangements, obligations, and other relationships of the issuer with unconsolidated entities.”\(^{305}\) The SEC has interpreted “off-balance-sheet arrangements” to include “Variable Interest Entities,” defined by FASB

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\(^{303}\) In the latest Interpretive Release issued by the Securities & Exchange Commission (SEC), the SEC opined that Item 303 of Regulation S-K, Management’s Discussion & Analysis of Financial Condition and Results of Operation, should enhance the overall financial disclosure and provide the context within which financial information should be analyzed, so that investors can ascertain the likelihood that past performance is indicative of future performance. The MD&A disclosure should reveal, inter alia, known material trends and uncertainties. See Corporate Counsel Weekly, “SEC Issues Interpretive RElease Giving Guidance on MD&A Disclosure” (BNA Dec. 31, 2003), found at http://sec.gov/rules/interp/33-8350.htm.


Interpretation No. 46 (FIN 46), as contractual, ownership or other pecuniary interests in an entity that change with changes in the entity’s net asset value.\textsuperscript{306} Simply stated, “Variable Interests” are investments or interests that will absorb a portion of the entity’s expected losses if they occur, or receive portions of the entity’s expected residual returns if they occur.\textsuperscript{307} FIN 46 describes Variable Interests Entities to include Project-Financed investments and certain lease-back financing techniques. So, depending on how an IPP Transaction is structured (for example, which entity owns which interest, and receives income or absorbs losses in what manner or through what legal structure), nowadays, under the widely cast net of Sarbanes-Oxley and in the SEC’s view, an IPP Transaction may have to be disclosed in corporate public filings if it qualifies as a “Variable Interest” under FIN 46.

Hence, with Sarbanes-Oxley, management and its auditors may no longer have the discretion whether to disclose off-balance-sheet Project Financed transactions that may arguably meet the definition of FIN 46. It should be noted, however, that Sarbanes-Oxley was not designed to address the structures of foreign direct investment (FDI) transactions and their Non- or Limited-Recourse Project Financing methods, which have been conducted by U.S.-based public companies for decades, all over the world. Instead, the legislation was specifically designed to deter the recurrence of the “Enron-type” of fraudulent practice aimed to dodge tax and accounting scrutiny via the use of “Special Purpose Entities” (SPE) such as subsidiaries or limited partnerships set up solely for a special project. The “Enron” ills addressed by Sarbanes-Oxley are the hiding of debts, hiding of poor-performing assets, and quick execution of related-party transactions at prices that are inherently suspicious, via the use of SPEs. For example, a company may try to shift liabilities and assets to an SPE owned by it in order to manipulate and evade accounting and reporting requirements -- the SPE may borrow funds, yet the debts are not shown in the books of the sponsoring parent; the company may transfer poor-performing investments to the SPE so that declining value will not have to be recognized by the sponsoring parent; or, the company may execute related-party transactions without regard to arms-length negotiated prices.\textsuperscript{308} These situations are completely distinguishable from legitimate SPEs set up in accordance with a host country’s legal requirements for the specific purpose of conducting a foreign direct investment overseas, which, by virtue of its non-recourse financing structure, may enjoy legitimate “off-balance sheet” accounting treatment.


\textsuperscript{307} Id.

\textsuperscript{308} Testimony of Bala G. Dharan, \textit{Enron’s Accounting Rules: What Can We Learn to Prevent Future Enrons} (U.S. House Energy and Commerce Committee, Feb. 6, 2002), \textit{printed in} Nancy B. Rappoport & Bala G. Dahran, Enron Corporate Fiascos and Their Implications (Foundation Press 2004).
Overall, the new “off-balance sheet” disclosure requirement of Sarbanes-Oxley is to promote transparent financial reporting in the interest of the American investing public, rather than to address corporate FDI transactions or “Third World” beneficiaries of those transactions. At the same time, the “catch-all” safeguard of federal securities law's anti-fraud provision in connection with the purchase or sale of securities, Section 10b of the Exchange Act and SEC Rule 10b-5,309 will continue to safeguard the American trading public against fraudulent disclosure or non-disclosure of corporate transactions in all relevant aspects.

C. Risk Allocation as Core Principle for Project Financing and IPP Transactions, and the Dynamics of Lawyering.

Even though “off-balance-sheet” accounting may inherently be suspect, it cannot be generalized that FDI Non-Recourse Project Financed transactions are per se indicia of any allegedly fraudulent intent on the part of the sponsor. Instead, these transactions typically involve the sponsor’s “good faith” risk assessment analysis in the course of its business judgment. Unless Non-Recourse, Off-Balance-Sheet Project Financing is available, the corporate investor is reluctant to take on high-risk FDI transactions in faraway land, on foreign territories with political and legal concepts alien to the U.S-trained business executive or lawyer. To ban or invalidate all such financing methods is not what the post-Enron legislation purports to do, as the Act only imposes a more intricate and more complete financing reporting requirement aimed to protect the U.S. investing public. Without the type of financing structure that helps buffer the corporate sponsor against investment risks, the corporate sponsor may not invest in a foreign country unless the profit margin is extremely high, which quite often is attributed to drastically cheaper labor and raw materials – the same type of consideration facing the colonists of the 19th and early 20th centuries. (In the colonist model, all Political Risks were eliminated because the colonist government simply took over the territory and became the “Third World” monarch!).

At the onset, therefore, it must be noted that international Project Financing and risk-allocation principles go hand in hand and should not be segregated as unrelated concepts. Although I have previously discussed project risks in upstream petroleum projects in Case No. 1, to provide a thorough understanding of the dynamics of deal negotiation, a more in-depth focus on risk assessment is necessary at this point in the context of IPP Transactions and their enabling funding device, Project Financing.

From the owner-developer's perspective, risk allocation involves more than merely obtaining financing or purchasing insurance. Risk allocation principles seek to control and quantify potential losses for purposes of financial planning. Overall, risk management techniques may typically include the following considerations: 1) risk avoidance (for example: foregoing the project);

2) loss prevention (for example: taking steps to reduce loss frequency such as providing drivers’ defensive driving training and imposing drug-testing procedures to prevent automobile accidents); 3) risk retention (for example: setting up reserves to pay for future losses); 4) risk transfer (for example: spreading risks through joint ventures, indemnification agreements, or assignments of interest); and 5) simply purchasing insurance or a surety bond (payment of premium for a third party to assume all quantifiable future risks of loss). When the costs of all these risk management steps exceed the anticipated profit, the first step – risk avoidance – may become the conservative business decision not to invest or engage in the project.

Under these risk management concepts, even the highly volatile Political Risks inherent in “Third World” environments can scientifically be managed like any other project risks. Economists, lawyers, and business executives have long argued that even the most “slippery” and speculative Political Risks can be quantified and estimated for purposes of economic calculations, and can be treated via loss prevention plans or contractual means. For example, the following loss prevention measures may be appropriate to avoid the risk of expropriation in an international project: 1) the investor should keep a low profile in the host country and designate government relations personnel to develop rapport with the local authorities; 2) the investor should utilize local industries and employ native personnel in order to build local support and alliance and to develop worker loyalty in the host country; 3) the investor should avoid geographical over-concentration and should locationally diversify its international investment portfolio; and 4) last but not least, the investor should involve the government in equity sharing, in order to get governmental long-term support.

Risk allocation principles are supported primarily by two economic theories: 1) the fundamental theory of exchange, and 2) the general theory of competitive equilibrium. Under the “exchange” theory, parties to an economic transaction are better off if each produces the type of goods or services for which the party has comparative cost advantage, and hence risks should be shifted to the party best equipped to prevent its causation. Under the “competitive equilibrium” theory, optimum production is reached when the cost to the provider equals the benefit to the receiver of products. Accordingly, a risk
should be shifted until the cost of the risk equals the benefit of shifting it elsewhere.\(^{313}\)

A risk, in simplified business or economic frame of reference, is a possibility of financial loss. Certain commercial or business risks center around business relationships and may not be insurable because those risks may involve the speculative loss of the chance to make a profit, rather than physical and tangible losses that can be transferred to an insurance company at a premium.\(^{314}\) (Most insurance contracts will exclude speculative losses from coverage.) Nonetheless, in an IPP Transaction, the costs of risks that are not insurable must still be absorbed or assumed by a responsible party in order for the project to sustain its economic health. When a risk is shifted or allocated to a party, it means that such party agrees to bear the costs of such risk because the party is most equipped to prevent or control the risk. This is where risk management principles and the practice of Project Financing coincide and overlap.

To bring home the risk-assessment philosophy underlying Project Financing, there is a need to re-examine the overall risk-allocation patterns of energy projects. Upstream” petroleum exploration projects such as the Vietnam Deal are typically not funded by Project Financing. It is not unusual for an IOGC holding a Participating Interest in an oil and gas exploration project abroad to rely on its own assets (rather than borrowed funds) to finance the exploration venture,\(^{315}\) although the reputation and technological power of the IOGC may attract additional investors to share capital, as illustrated by the Vietnam Deal. (In the Vietnam Deal, the IOGC successfully brought in Russian and Japanese partners to share risks.)\(^{316}\) The unavailability of Project Financing in upstream projects is obviously due to the high and speculative appraisal risks involved in exploration activities.\(^{317}\) However, once the IOGC has discovered petroleum in commercial quantities such that projected investment return or an income stream is readily ascertainable, the IOGC may be able to borrow funds to take the project through the expensive Development and Production phases. Project Financing may be available at that time.\(^{318}\)

\(^{313}\) Id.


\(^{315}\) Horrigan, “Foreign Natural Resource Investment,” supra.


In contrast, an IPP investment, as the midstream progression of a commercial gas discovery, may ideally be suitable for Project Financing. In an IPP Transaction, prospective revenues from the sale of electricity secured by long-term contracts are used to discharge loan payment obligations. To satisfy the Project Financier, any risk of disruption to the revenue stream must sufficiently be buffered and covered via appropriate contractual risk transfers. Such contractual risk transfers may include express indemnification, warranty, or other remedy provisions, or otherwise be explicit or implicit in the delineation of rights and obligations among the Project Participants. The contractual risk-allocation mechanism is contained in a complex set of legal agreements, with each Project Participant assuming a special function and contributing a different expertise. All Project Documents must be tightly negotiated and drafted, such that all risks of loss will have been treated or shifted to the entities most suited to assume the risks. Such party will either absorb the risk as part of its bargained-for benefit of the deal, or it will charge other Project Participants a premium for assuming such risk, ultimately raising the price of the contract in question. Business sense dictates that no risk will be allocated or reallocated among the Project Participants without a premium. Accordingly, when risks are contractually shifted, identifying the party who should assume the risk and affixing a premium pay for the cost of risk-taking become crucial matters in IPP negotiation. While each project carries its own basket of risks, there may be risks common to all projects in the same industry. Risks involved in IPP Transactions are particularly exacerbated by high capital outlays, long construction and operation periods, and potentially unstable gas and electricity markets. The importance of the energy and utility sectors further reinforces the impact IPP Transactions may produce on the national and regional economy and, ultimately, upon “Third World” debts.

The job of the lawyer as planner, drafter, negotiator and reviewer of all such contractual transfers is undoubtedly essential. Depending on the corporate culture, quite often lawyers team up with business and technical personnel in the identification of project risks, even though the task at hand may not purely be legal. In that sense, the lawyer has a unique opportunity not only to represent the interest of her client as a Project Participant and in the allocation of risks, but also to oversee and observe the macro-economic impact of balancing contractual risk allocation patterns, in order to achieve certain level playing field and fairness. In fact, the risk allocation mechanism behind a project is what drives the legal issues, shapes the legal structure of the deal, and hence in turn creates legal norms via the formation of lex contractus. I will


illustrate the interdependence between legal issues and risk allocation by examining, as an example, the treatment of Facility construction and operation risks in an IPP investment.

D. **Relationship between Risk Management and Legal Structure – An Example of Contractual Risk Allocation in the Construction Phase of an IPP Investment.**

The IPP Transaction consists of two principal phases: (i) the shorter-term construction of the Power-Generation Facility, and (ii) the longer-term distribution and sale of electricity to buyers and end-users. All risk allocation principles in general construction contracting apply to the first phase of an IPP investment.

As I already stated, risk-allocation techniques determine the legal structure of the construction deal. This can be illustrated via four distinct legal issues in construction contract negotiation:

1. **Type of contractor compensation:** whether the EPC Contract should be structured as fixed price or cost plus;

2. **Type of contract delivery method:** whether the contract should be single-sourced or multiple-sourced;

3. **Type of remedies or damages:** for example, whether liquidated damages should be imposed upon a party for certain types of event; and most importantly,

4. **Type of equity structure, which dictates the legal organization of the Project Entity that serves as the Power Developer:** whether the project should be structured to include Vendor Equity or Government Participation.

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321 On the average, the construction of a power-generation plant takes approximately two years.

322 See Note 295, supra (the term of an international Power Purchase Agreement may range from 14 to 40 years).

323 These legal issues, and hence the risk allocation mechanism from which they derive, are addressed typically in the EPC Contract and the PPA. See, e.g., *Federation Internationale Des Ingenieurs-Conseils, Guide to the Use of FIDIC Conditions of Contracts for Electrical and Mechanical Works* 132 (3d Ed. 1988).
be in a better position to control or absorb the risks, and a “cost-plus” type of contract will better serve such goal. On the other hand, a cost overrun caused by a political force majeure is typically within the control of the host government, which may act as a Power Purchaser in the project. In such a case, the Power Purchase Agreement (PPA) is the proper place and means to allocate the risk of construction cost variations ultimately to the host government. The PPA may also revert the risk of such cost variations back to the Power Developer, who, in such a case, will undoubtedly charge the host government a higher “Monthly Capacity Payment” (the cost of consuming electricity to certain level of capacity)\textsuperscript{324} to compensate for the Power Developer’s assumption of risks. Or, the host government may be asked to financially guarantee the obligations of their affiliated Power Purchasers. Such sovereign guarantee is the legal tool that serves to allocate risks of cost overruns ultimately to the buyers of the commodity and the host country.\textsuperscript{325}

2. Type of Contract Delivery Method: In construction contracting, “Contract Delivery Method” refers to the organizational structure that governs the relationships among Project Participants such as architect, engineer, owner, construction contractor, and service or supply subcontractors.\textsuperscript{326} As illustrated below, the Contract Delivery Method – a legal issue -- can become, and has been used as a risk-allocation technique.

In the “Traditional Contract Delivery Method,” the owner hires, first, an architect and/or an engineer to design the project, and, second, a general contractor to build the design.\textsuperscript{327} Construction performance risks are thus transferred to two sources: the design professional, and the construction professional. The owner will consequently be isolated from design issues, depending on the specific contractual risk-allocation language negotiated with each of the two contractors. This method of risk transfer is sometimes called “Multiprime Contracting” (as opposed to “Single-Source or Single-Point Contracting”).\textsuperscript{328}

The construction phase of an IPP investment typically is modeled after a different Contract Delivery Method called “Design-Build,” suitable for projects

\textsuperscript{324} Capacity is defined as the “load,” or “demand” for which a power-generating unit or station is rated either by the user or by the manufacturer. “Demand” means the rate at which electricity is delivered to or by a system. See, e.g., Glossary of Electric Utility Terms, prepared by the Statistical Committee of Edison Electric Institute (1991).


\textsuperscript{327} Id.

in which the owner must require that the facility meet specific performance such as output or air quality standards. Because the Power-Generation Facility must meet quantitative electricity output as well as qualitative performance requirements, it is better off being constructed via the Design-Build method. The importance of output or standardized performance criteria necessitates the transfer of all performance risks to one single source, accomplished in one “turn-key” operation. More importantly, because most IPP investments are “Non-Recourse Project Financed,” the Power Developer must select a construction contracting method that minimizes the risks to the financial and technical integrity of the project. The Design-Built approach utilizing the technical expertise of one single source for all technical fronts minimizes the chance of fragmented disputes and, hence, serves the “Project Financing” purpose well.329

Specifically, Facility construction is typically handled via the execution and implementation of an Engineering, Procurement, and Construction (EPC) Contract, also known as “Turnkey” or “Single-Point” contract. The owner holds only one party, the “EPC Contractor” (often an international engineering and construction firm) responsible for the entire Facility, its output and “Commercial Operation.”330 Only one contractor (as opposed to multiple contractors) will handle all functions – from engineering and design to procurement of supplies and parts, and ultimately construction of the Facility. Upon timely completion and successful performance testing, the EPC contractor will “turn the key” over to the owner and limit its risk exposure to the honoring of warranty obligations. This single-source method of contracting reduces management time, streamlines negotiation, lowers overall costs, enhances accountability, and enables faster completion in satisfaction of specific performance and output standards.

3. Type of Remedies or Damages: From the owner-developer’s perspective, the risk-allocation pattern in the Design-Build method, however, is not diversified. If things go wrong, the owner must rely on only one source for recovery or compensation. Accordingly, the owner must be protected by pre-determined, well-calculated contractual remedies. If the EPC Contractor fails any of its obligations (whether it be Facility output, Commercial Operation, or a target completion date), the owner-developer must impose very high and precisely calculated liquidated damages as a means of remedying risks of loss. Pure legal issues such as the imposition of liquidated damages thus become the primary mechanism to allocate the risk of delay in Facility completion or the contractor’s failure to achieve target performance. Such delay or failure will interfere with the pre-determined income stream to be expected from scheduled electricity sales. The party who occasions the delay or failure, or is in the best


330 The EPC Contractor may obtain the services of subcontractors, although it remains primarily liable to the owner-developer regarding all aspects of the EPC Contract. See also Note 143 for a definition and discussion of “Commercial Operation.”
position to prevent such delay or failure, must therefore be responsible for paying liquidated damages, or otherwise making good all financial losses, in amounts sufficient for the owner-developer to ultimately cover loan proceeds and for the project to continue without interruption. That party may be (i) the EPC Contractor, if the delay or failure occurs with respect to the completion or performance of the Facility; or (ii) the O&M Contractor (the Plant Operator), if the delay or failure occurs in connection with the ongoing operation and maintenance of the Facility. However, if the delay or failure of performance is attributed to political force majeure events, the host government, or the Power Purchasers, may ultimately be made to bear the costs by way of an increase in the “Monthly Capacity Payments,” payable to the Power Developer.

4. Type of Equity Structure -- Variation of Financing Structure and Legal Organization to Accomplish Risk-Spreading Objectives. At least three variations in the equity structure and legal organization of an IPP investment have been devised by Project Participants in order to accomplish risk-spreading objectives:

(i) The Power Developer may seek equity participation from the EPC Contractor, O&M Contractor, or Fuel Supplier as a means of enhancing proper project performance (“Vendor Equity Financing”).

(ii) The Power Developer may seek equity participation from the host government in order to reduce Political Risks (“Government Participation”); and

(iii) IPP investments may also be structured as the Build-Operate-Transfer (BOT) or Build-Own-Operate-Transfer (BOOT) model, which, for decades, has enabled several large-scaled infrastructure development projects in the “Third World.” This model spreads project risks to the international public sector, via Multilateral Financing such as World Bank funding, or funding by the Regional Development Banks.331

These risk-spreading mechanisms, however, may occasion new vices, which can be examined by scrutinizing the special legal issues raised by the afore-mentioned financing and structural variations.

a. Vendor Equity Financing. Within the Design-Build model, the EPC Contractor may opt to be included in the owner-developer consortium or Project Entity. This is called the “Vendor Equity” structure of financing.

referring to the inclusion of services or good providers or suppliers ("Vendors") in project ownership. In IPP investments, Vendor Equity typically includes equity interest held by the EPC Contractor, the O&M Contractor, or the Fuel Supplier. (For example, in the Vietnam Deal, the IOGC who found gas upstream might decide to undertake the development of IPP midstream as a Power Developer. In that case, the IOGC would own both the fuel and the Power-Generation Facility, meaning it would be selling fuel to itself in a Vendor Equity structure.)

Overall, inclusion of Vendor Equity in the Project Entity increases expertise base in the owner group, helps diversify capabilities, secures loyalty from vendor-suppliers, improves accountability by making them an integral part of the project and, quite often, also increases the owner group’s chance of success in international competitive bidding (via the joining of forces that form a de facto cartel). But the benefits gained are also the potential source of vice: the Vendor Equity structure concentrates a number of major international corporate players into one owner group, typifying the often-taken-for-granted monopolistic characteristic of “Third World” economic development. A group of allied companies – a self-selected group of dominant players – controls the energy and utility sector and, hence, a substantial portion of the economic landscape of a country or region.

Concerns raised by Vendor Equity goes beyond the monopolistic pattern it may illustrate. An inherent conflict exists in Vendor Equity analogous to conflicts-of-interest issues raised by “related-party transactions” in U.S. financial disclosure law. A vendor may have dual objectives – to participate in profit-sharing as a part owner of the Project Entity, and, at the same time, to profit from selling and supplying goods and services to the Project Entity of which he/she is a part. Negotiation for services or supply contracts between the Project Entity and the vendor will inherently include aspects of self-dealing, raising issues as to whether such negotiation is truly at arm’s length. Yet, the


deal and its related-party transactions may or may not be disclosed, depending on the financial disclosure requirements under the law of either the home or host jurisdiction. (Naturally, the legal systems of host jurisdictions are often under-developed). If self-dealing results in high costs, such costs are ultimately passed on to the inhabitants of the “Third World,” which eventually may lead to more austerity or even more international debts incurred by the “Third World” nation.

b. **Government Participation.** The same inherent conflict of interest exists in a Government Participation structure, when the host government or its designated SOE is included as equity owner of the Project Entity. The Project Entity, partly owned by the host government, may negotiate a Power-Purchase Agreement under which electricity will be sold to the host government or its political subdivisions as Power Purchasers. The government may be acting in a dual capacity: as seller and buyer both. The Project Entity will negotiate price, terms, and conditions of the electricity sale with the government as one of its shareholders, who also serves as the market regulator. Expectations of arms-length dealing are thus less linear and less clear. The chance exists for a corrupt or inefficient governmental apparatus (if that is the case) to be enriched at the ultimate expense of “Third World” inhabitants, as well as the shareholder public back in the foreign investor’s home base.

It is evident, therefore, that in both Vendor Equity and Government Participation, contractual measures are needed to eliminate or minimize the risk of less-than-arms’-length negotiation, and to help delineate functions and capacities in order to prevent self-dealing and price manipulation. (This is the reason why in World-Bank-funded IPP Transactions, the Multilateral Agency will assist the host government, supposedly in designing (i) a workable utility rate-making or regulatory framework, and (ii) a model Power Purchase Agreement based on sound economic principles.) Preventive contractual measures may include procedures to assure arms’ length terms; setting parameters for contractual capacities of the parties; defining terms and conditions for withdrawal in the event of conflicts of interest, and/or similar safeguards to assure both quality services and fair and equitable dealings. In off-balance-sheet, unregulated “Third World” deals, these contractual safeguards may result from the parties’ own will, rather than a matter of mandatory protection for the larger public good. (The only regulation may rest in the hand of a self-interested “monarch,” whose lack of experience and capital may also be coupled with a corrupt and inefficient bureaucracy.)

Private-sector Project Participants, nonetheless, may view Government Participation as a necessity, as it brings to the IPP investment **two** principal risk-allocating advantages: (i) Government Participation can qualify the project for Multilateral Financing, since the Multilateral Agencies will only lend money to nation-states or their SOEs and not to private parties; and (ii) Government Participation can reduce Political Risks. The involvement of the host government as equity partner in the IPP investment helps reduce the risks of

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materially adverse governmental action or governmental interference – why interfere if the government owns a stake in the project itself, since adverse or intervening sovereign action may cut against the government’s own commercial interest? For example, in facility construction, Government Participation alleviates such political risks as government-imposed changes in site conditions. (In the Design-Build model, the owner-developer often takes the entire responsibilities over information and condition regarding project sites, including land, access, right of way, existing core facilities, as well as support infrastructure typically owned or controlled by today’s “monarchs.” It is therefore beneficial, efficient and desirable for the project if the host government occupies the owner-developer role.) Now that the “monarch” has entered the deal as a shareholder-investor, it will have all the incentive needed to support the project long-term and to protect its foreign partner, who happens to control the technology needed for the construction and operation of the Facility.

c. The Build-Operate-Transfer or Build-Own-Operate-Transfer (BOT/BOOT) Legal Model for Infrastructure Building. To further the risk-allocation goal of a Government Participation structure, a separate legal model has been devised and made applicable to the development of “Third World” infrastructure, called Build-Own-Transfer (BOT) or Build-Own-Operate-Transfer (BOOT). The terms are self-explanatory: In the BOT/BOOT structure, the developer builds, owns and operates the Facility for a definite term. After a period of time (long enough for the developer to recoup its investment and earn the desired profit), the developer is contractually obligated to transfer the facility to the host government or its designated SOE, which will then own and operate the infrastructure from that point forward. This transfer of ownership and operation satisfies the host country’s national interest, and enables the infrastructure to become a public operation. Initially, the developing nation has no technology or managerial know-how to construct and operate infrastructure systems, and must therefore invite foreign participation in those projects. Eventually, the government would want infrastructure to be part of the political economy free from foreign control.

Because of the importance of infrastructure, many developing nations have enacted law or promulgated regulations establishing the legal framework for the BOT/BOOT model, thereby elevating the model into legal mandates. The local law mandating the BOT/BOOT form for infrastructure investment projects may require the incorporation of a BOT Company or BOT Entity to serve as the developer of a particular infrastructure project. The BOT/BOOT structure

336 The principles behind the BOT/BOOT date back to colonial days. In the past, incoming colonists had to construct infrastructure and educate a small class of native collaborators before economic exploitation of the native land and labor could take place. In that sense, the colonized territories and population incidentally benefited from these “good deeds” of the new rulers. After decolonization at the end of World War II, the developing nations inherited the infrastructures and facilities previously built and operated by colonist governments.

337 For example, in 1995, Vietnam promulgated its first BOT Regulations, requiring the establishment of a BOT Company in which the government holds an equity interest. See Wendy N. Duong, “Legal Framework for IPP Projects in Vietnam” (February 1995) (unpublished paper prepared for Mobil Power
may also involve both Vendor Equity and Government Participation, in which case both vendor-supplier group and the host government functionally become shareholders of the BOT Entity.

For decades, the BOT/BOOT structure has channeled billions of dollars of both private and public funding into “Third World” economic development, and has become quite popular in Asia and Latin America. Its popularity in Africa, central Asia, and certain parts of central or Eastern Europe will undoubtedly be forthcoming, if not already in existence. If the BOT Entity involves Government Participation, the BOT Entity may qualify for Multilateral Financing, since the Multilateral Agencies will only loan money to member states, but not to the private sector (with the exception of the International Finance Corporation (IFC), the commercial arm of the World Bank.)

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See Note 22, supra, for definition of Multilateral Financing. For example, the World Bank lends money to member states for specific reconstruction and development projects. See Articles of Agreement of the International Bank for Reconstruction and Development, Dec. 27, 1945, art. I, 60 Stat. 1440, 2 U.N.T.S. 134. The IRBD also aims to promote foreign capital by means of guarantees, loan participation in investment projects sponsored by the private sector, and to conduct business “with due regard to the effect of international investment on business conditions in the territories of members.” Id. In practice, this goal has been translated into IRBD funding of typically infrastructure-building projects.

The Regional Development Banks (RDB) share similar functions and goals as the World Bank Group. The African, Asian and Inter-American Development Banks all have similar mandates as the IBRD.

To the contrary, the IMF is not a “development” institution, although its governance is similar to that of the development banks. The IMF is a fiscal and monetary monitoring organization to help member states with funding to address macroeconomic issues. See Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, art. 1, 60 Stat. 1401, 2 U.N.T.S. 39, as amended July 28, 1969, 20 U.S.T. 2775, 726 U.N.T.S. 266, April 1, 1978, 29 U.S.T. 2203.

The IFC provides both equity investment under its own name, as well as debt financing for the private sector. As a multilateral lender, it may serve as the lender of record for a commercial bank syndication, thereby boosting the private sector’s confidence in the project. Typically, the IFC will fund up to 25 percent of a greenfield project, and under its own guidelines, may take an equity interest in the project up to 5-10 percent. See International Finance Corporation, World Bank Group, Basic Facts About Ifc, at http://www.ifc.org/about/basiefacts/basiefacts.html (as of May 1, 2002). As a matter of policy, the IFC will not take a controlling interest or majority position in a project. In addition, the IFC’s Global
The application of the BOT/BOOT legal norm to an IPP Transaction begins with the prerequisite finding that the Power Generation Facility, as well as any gas processing, liquefaction, and transportation facilities (such as gas pipelines), be part of national infrastructure building. This can be a legal conclusion either clearly stated in the local law, or otherwise accepted as a norm of practice by the business, legal, financial, or Multilateral community. Without electricity as a critical infrastructure or pipeline systems to deliver energy sources to the market, the national economy and natural resources foreign investment can be retarded or incapacitated. Once the IPP investment and all support facilities have qualified as infrastructure building, with Government Participation, the IPP Transaction and related deals may receive World Bank or Regional Development Bank funding and assistance, in addition to private Project Financing. The BOT/BOOT structure that encompasses Government Participation and combines both private Project Financing and Multilateral Financing enables the Power Developer to accomplish two risk-allocation objectives: (i) to reduce Political Risks by according the host government a direct long-term financial interest in the project, and (ii) to spread investment risks to inhabitants of the developed nations. If the project fails, the corporate sponsor can be risk-free, except for its chance to make a profit, or any equity contribution it may have made out of its own pocket.

In summary, the midstream segment of the Vietnam Deal is a classic scenario for the structuring of a BOT/BOOT legal model that involves both Vendor Equity and Government Participation. Such a structure leaves much room and opportunity for related-party transactions tainted with classic conflicts of interest and potential self-dealing – one Project Participant may have its foot in several functions in the project. The structure evidences a close-knit, long-term, and interdependent relationship among private Project Participants, the Multilateral Institutions, and the “monarch.” In masterminding and

341 See George Shultz, “Ten Commandments for Evaluating Risk on Private Infrastructure Projects,” Bechtel Power International Private Power Forum (Amelia Island, Florida November 9, 1995) (written copy of the speech was made available as of November 27, 1995) (Mr. Shultz was formerly President of Bechtel engineering and construction firm):

“My third commandment is: We have to keep forcing ourselves to think creatively to make agreements work. ...look at the different risks and try to figure out who is going to bear what risk in a careful way. It may be things like production sharing with host governments, as a way to deal with these issues...If you are going to buy a plant, make sure the government gets the subsidy out and raises the price of the product before you buy. If you are going to build a plant and electricity is priced way low...if you can get the government to get that price change before you enter the field, it is going to be a tremendous advantage because we all know that, if you are the guy that is raising the price of electricity by a lot, and that is what privatization means, then you are in deep trouble! Again, we are talking politics at least as much as economics...Be greedy, but not too greedy...”
implementing such a structure, the IOGC that has discovered gas as fuel supply for a gas-fired Power-Generation Facility will tend to look to dominant industry players that share its corporate philosophy and investment style, especially those who have established track records of successful partnerships with the IOGC and the same “monarch.” This means that the selected Project Participants may have participated in joint operatorship or may have held joint interests with the IOGC elsewhere in the global economy, and/or may have successfully partnered with the host government in other national projects. In fact, typically all dominant players must have the approval and blessings of the host government. Close-knit partnerships with “monarchs” by a group of self-selected players continue to be the undeniable and inescapable profit-making pattern for the international petroleum and energy sector in “Third World” economic development.

Needless to say, cloaking an allegedly corrupt government as the project sponsor and equity owner in order to guarantee payment and profit for the private sector via Multilateral or Bilateral financing can be a dangerous proposition. This danger is amply illustrated in the scandal involving the outrageously costly and hazardous Bataan Nuclear Power Project in the Philippines.\textsuperscript{342} Bataan was the biggest independent power project undertaken in the history of the Philippines, constructed in 1977 and completed in 1984. Activists allege that the project was the means for the corrupt Marcos government to enrich itself. By sponsoring the project and partnering with US-based Westinghouse, the Marcos were able to obtain public funding via the U.S. Export-Import Bank (\textit{ExIm})\textsuperscript{343} Such public money was used to pay, among others, Westinghouse (including, naturally, its desired profit for constructing and outfitting the nuclear plant), and to benefit the Marcos allegedly by way of illicit commissions payable to their alleged “cronies”\textsuperscript{344}. According to activists, international inspectors considered Bataan a health, safety and environmental hazard, and the Philippines ended up experiencing severe outages leading to a national power crisis, since Bataan never produced the expected volume of electricity. Notwithstanding the plant’s hazardous and inoperational status, the “beneficiaries” of Bataan, the “consumers, taxpayers, and host communities” of the Philippines, and not the ousted Marcos, ended up having to pay the ExIm debts (a total of direct loans and guarantees estimated at $900 million), which

\textit{“You probably want to think about international partners. The IFC is a leading candidate, and the World Bank group generally, because obviously it gives you a certain kind of insurance policy, because countries do not want to alienate this potential source of future finance...”} (emphasis added).

\textsuperscript{342} See Note 244, \textit{supra} (discussing new government dishonoring onerous contracts entered into by previous regimes not recognized by the people).

\textsuperscript{343} See Notes 22 and 213, \textit{supra}.

\textsuperscript{344} Maristella Cardenas, “ECAs in the Philippine Power Sector and the Continuing Debt Problem,” (Freedom from Debt Coalition Dec. 12, 2003), found at http://www.jubileesouth.org/news/EpZyVyuAVISMRrFluL.shtml
contributed substantially to the Philippines’ impoverished conditions and debt crisis.\textsuperscript{345}


Despite its utility, the BOT/BOOT structure illustrates at least three windfalls created in the current funding patterns for “Third World” development projects:

(i) The interdependence between Multilateral Financing and Project Financing, and the stimulating effect the former produces upon the latter;

(ii) The triple benefits enjoyed by corporate sponsors whose projects qualify for Project Financing; and

(iii) The real-life influence that name-brand corporate identities may have on the risk assessment process that determines eligibility for Project Financing, thereby confirming the monopolistic and exclusive nature of large-scaled “Third World” development project sponsorship.

These three windfalls are discussed below.

(i) The interdependence between Multilateral Financing and Project Financing.

Among the most profound impacts of the BOT/BOOT structure is the effect that such a structure may produce upon project risk assessment in the determination of Project Financing eligibility. Not only does the BOT/BOOT structure enable public funding such as World Bank or Regional Development Bank loans, but it may also increase the success chance for qualifying related projects for private Project Financing, thereby stimulating the involvement of the private sector. In that sense, Multilateral Financing and Project Financing are interdependent. The availability of Multilateral Financing in BOT/BOOT and other infrastructure projects motivates the corporate sector to seek partnerships with the Multilateral Agencies in nation-building, even if the corporate goals are purely profit-seeking and not nation-building. Such a partnership can generate more foreign direct investments for the host country, not only because private investors will benefit from the availability of infrastructure, but also because Multilateral Financing acts as assurance for private lenders and financiers, and hence can practically become a risk management device to mitigate against the host environment’s Political Risks. In simple terms, Multilateral Financing has the same effect as the corporate

\textsuperscript{345} Id.
The presence of Multilateral Financing and their credit support facilities in a developing nation helps ease the private sector’s anxiety, constituting the type of backing by the developed nations that make private investors feel safe.

Consequently, not only is the private sector more likely to invest, but it will actively assist the host government in meeting Multilateral Funding qualifications. Specifically, although the World Bank does not fund upstream energy projects, it generally supports privatization of certain segments of the energy chain that may be considered part of nations’ infrastructure building, and hence will finance and/or guarantee projects that fall within its funding criteria. As of the end of the millennium, a commentator reported that out of the $17-20 billion of World Bank’s annual funding, approximately $2-3 billion goes to IPP and approximately $1 billion goes to oil and gas midstream projects annually. The pipeline project in the Republic of Chad is an example of World Bank support available to the oil and gas industry in its partnership with the Republic. The gas development project offshore Vietnam sponsored by British Petroleum (BP), BP’s accompanying pipeline project to transport its gas onshore, and the construction of gas-fired power-generation plants in Vietnam using offshore gas as fuel, supported by Asian Development Bank and MIGA, are all evidence of an integrated IPP Transaction benefiting from the combination of Multilateral Financing, BOT financing, and private sector investment. IOGCs, Power Developers, their multinational contractors and suppliers, as well as their private bank syndicates will readily cooperate and

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346 Regarding one example of corporate strategies in partnerships with governments and the Multilaterals, see comments by George Shultz, Id.

347 The criteria for Multilateral Funding of reconstruction and economic development projects should be revisited. For example, “infrastructure” development criteria should include the provision of informational technology and the outfitting of educational projects. In today’s modern world, informational technology and education should qualify as infrastructure, just as roads, bridges, dams, electricity, and telecommunications have qualified as infrastructure in the past. An educated workforce with access to informational technology is the key to economic development as well as the promotion of democratic principles against authoritarianism or isolationism. (In that sense, informational technology represents a threat to dictatorial governments.) Liberalizing the definition of “infrastructure” will also enable participation by smaller and medium-sized entrepreneurships in “Third World” economic development, both from the foreign investor community as well as from the native community.

348 See Blumental, 16 Berkeley J. Int’l L. 267, 276.

349 See Note 16, supra (discussing the Republic of Chad).

assist host governments in the application for Multilateral Funding and credit support.

The same stimulating effect has amply been observed with respect to loan conditions established by the International Monetary Fund (IMF) for the developing economies. Although the IMF has no direct role in the financing of international energy projects, its goal as a global economic and monetary monitoring institution greatly impacts the risk assessment process performed by private lenders, at least in two separate aspects:

- **First**, payment for energy as a commodity in a host country may be made in the local “soft” currency and must be converted into a “hard” currency such as the U.S. dollar or the Euro to service project debts and to be repatriated as investor returns. IMF policies and rules for its member states, articulated in its Articles of Agreement, purportedly help stabilize and prevent local currency collapses, as well as reduce the risk of currency fluctuations in the local economy. Thus, a host country’s membership in the IMF can serve as a bedrock to ease private lenders’ anxiety.

- **Second**, as a Bretton Woods institution, the IMF lends money to member states to help correct these countries’ fiscal problems. IMF loan conditions, reflective of its economic policies, are purportedly designed to assure repayment of “Third World” debts. Accordingly, private bankers lending money to “Third World” projects have looked to IMF loan conditions as “risk management” tools, and IMF loan conditions have typically been incorporated into private loan agreements, serving as “risk assurances” to stimulate private banks’ funding of “Third World” development projects. Syndicates of private lenders have “ridden on the coat-tails” of not only the IMF but also other “development” Multilateral Agencies, at times creating de facto “creditors’ cartels.”

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Some scholars have used the experience of Tanzania in Africa as an example to criticize the effectiveness of IMF global economic goals and strategies, viewing both the World Bank and the IMF as agents for the restriction of the welfare state. Tanzania was a stable democracy who could not continue to afford social programs that had produced the highest literacy rates in Africa and a tolerable life for Tanzanians. After 15 years of IMF funding, half of the population allegedly live in poverty, although the country’s
When pushed to the limit, this stimulating effect and over-reliance on the presence of the Multilateral Agencies in a host country can easily result in risk assessment errors committed by the private banking industry. Risk assessment errors can even be made by the Multilateral and Bilateral Agencies themselves, since one may undoubtedly be influenced by the activities of the others within the same country or region, let alone the fact that these institutions typically share nation-state memberships. Principles of risk management are not an exact science capable of mathematical precision at all times. Many subjective factors come into play. The ultimate inquiry rests in whether or not the financier or lender feels assured and comfortable with the prospect of recouping its funds together with the desired interest. In reality, especially in an international IPP Transaction, this level of assurance can be obtained in several ways, some of which may have little to do with the mathematical calculation of probability or risks. In fact, it is possible that the more substantial the financial stake is, the more the assurance is stimulated by psychological comfort or the totality of circumstances. The interdependence between Multilateral Financing and private Project Financing illustrates this point. What’s more, the interdependent, stimulating effect described above also leads to the undeniable fact that all Multilateral Agencies, and not just the IMF, become the sheriff, regulator, insurer, and rescuer of both public and private “Third World” debts, even if some of them are not officially in the business of providing Political Risk insurance – a function and specialty exclusively reserved for agencies such as MIGA, Ex-Im, or OPIC. Further, when private and public loans are defaulted, debt or loan work-out solutions, often proposed by the Multilateral Agencies and/or major nation-contributors such as the U.S. to prevent global economic crises, may lead to more severe loan conditions, which in turn will cause more austerity and negative social and economic impact on “Third World” population.

macroeconomic picture brightened with reduced inflation and growing GDP. Eric Pooley, “The IMF: Dr. Death?” (Time, April 24, 2000), cited in Tony McAdams, 19 J. Legal Studies Education at 253, n. 94. Case studies such as this need empirical data support, rather than just editorialized conclusions. See also IMF Press Release No. 04/18,”Statement by IMF Deputy Managing Director Augstin Carstens at the Conclusion of a Visit to Tanzania” (Feb. 3, 2004) (“In the past few years, Tanzania has made substantial progress in establishing the macroeconomic stability and deepening structural reform...Despite these achievements, much remains to be done if Tanzania is to increase growth and raise living standards...Participants emphasized the need for the IMF to be more flexible in its policy advice...”).

354 See Notes 22 and 213, supra (identifying and describing the Multilateral and Bilateral Institutions).


There has been no established international legal framework for sovereign bankruptcy. As one of the largest contributors to the IMF and World Bank systems, and in the interest of major U.S. banking syndicates who financed international projects, the United States has undertaken to structure “Third World” debt “workout” solutions. In the “Baker Plan” – named after the then Secretary of State – new loans were made to help developing nations pay interests, thus preserving the “book value” of defaulted loans. The
(ii) The triple benefits enjoyed by the corporate sponsor whose infrastructure projects qualify for Project Financing.

From the discussion above, the following scenario becomes highly likely: If the IPP Transaction (and all related projects that may qualify as infrastructure building such as gas processing, gas liquefaction, and pipeline construction) are structured as the BOT/BOOT model eligible for both Multilateral Financing and Project Financing, corporate sponsors that partner with “monarchs” and the Multilateral Institutions may enjoy at least three benefits.

The first benefit results from the fact that foreign investors need the country’s infrastructure in order to conduct their profit-making enterprises. The same infrastructure may even benefit the foreign investors’ various projects in the region and not just in a single country. One can argue that under normal circumstances, the cost of the infrastructure needed to support the investor’s various projects should be considered business expenses to be borne by the investor out of its own pocket (no more no less than overhead costs any business enterprise may have to outfit, or no more no less than the costs of hiring workers for production). Yet, if the corporate investor chooses to sponsor the infrastructure project, it can even make profit from the infrastructure that supports its other profit-making enterprises. In other words, the private investor can take two bites of the same apple – to benefit from the infrastructure and, at the same time, profit from the construction of the infrastructure as a project sponsor. Further, by partnering with the “monarch” and co-sponsoring the infrastructure project, via Multilateral Financing,


Recognizing this incidental benefit to the foreign investor, member states have imposed or negotiated for “infrastructure payments” as part of funding advances required of the IOGC in petroleum joint venture contracts between the IOGC and the state. See, e.g., Peter Goodwin, “Mobil’s Joint Venture Experience with State-Owned Companies: Kazakhstan,” paper presented at Conference on Model Petroleum Contract, Vung Tau, Vietnam (Feb. 12-13 1998) (cited with client permission). However, this practice may not be universal.
corporate sponsors can spread investment risks and transfer the costs of the very infrastructure that serves them to other nation-states. Since the host country that borrows Multilateral Funding will have to pay back those loans out of its treasury, the risks are ultimately borne by the poor citizenry of the “Third World.”

**Second,** although eligibility for Project Financing in principle is supposed to rest solely on the evaluation of the project’s economic viability, in reality, private bankers may be influenced by the availability of Multilateral Financing in the project. Hence, corporate investors seeking Project Financing stand to gain from this relaxed risk assessment process. Where Multilateral Funding has been made available to a project, corporate investors may stand a much greater chance of receiving favorable private Project Financing in the same project, or in related ventures, including the construction of all other support facilities necessary for their investment.

**Third,** classic Project Financing acts as an effective risk transfer mechanism for corporate investors because of its “non-recourse” nature, thereby constituting another layer of benefit. If the project fails, the corporate sponsor is practically risk-free (other than any “down payment” or out-of-pocket equity that it may have advanced, depending on the project).

On one hand, the utility of, and justification for, Project Financing in “Third World” economic development are evident. Project Financing as a concept stimulates private investment in the “Third World,” especially in projects crucial to nation building. Without Project Financing, the undeveloped areas of the world will remain undeveloped, since foreign aids among nations and even Multilateral Financing cannot adequately supply the necessary funding and carry the financial weight. Private bankers should be encouraged to count on the ascertainable income stream evidenced by contractual rights in order to pour more funding into the “Third World.” Without Project Financing, developers may hesitate to initiate costly development projects on the unfamiliar territories of the “Third World.”

On the other hand, Project Financing can create an anomaly. If the high investment risks do not fall upon the corporate sponsor, under established risk management principles, these risks do not just disappear. They are simply shifted elsewhere, ultimately to the group of people who are the least equipped and ill-prepared to bear the loss. In that sense, the economic theories behind risk management philosophies discussed earlier have indeed been betrayed! The accuracy of risk assessment methods depends on whether the information taken into consideration is reliable and accurate. Imperfect information makes imperfect risk assessment and, therefore, results in flawed risk treatment. If, for any reason, the project fails, or the Power Developer goes under and fails to perform (as in the case of Enron), bankers will hurriedly foreclose on the project’s physical assets or will take over the stream of income. If there is no income stream or the physical assets are inadequate or otherwise not salvable to satisfy the debts (as in the case of the Bataan project in the Philippines discussed earlier), bankers will have to face and absorb their risk-assessment errors, **without recourse** to the developer’s corporate assets in the home
jurisdiction or elsewhere. In the end, two groups of inhabitants ultimately bear the risk of loss: 1) the inhabitants and taxpayers of the capital-exporting countries will bear the financial impact of bank syndicates’ risk assessment mistakes when loans are defaulted; and 2) the inhabitants of the “Third World,” or the capital-importing countries, end up having no electricity yet still have to pay project debts. Ultimately, the poor citizenry gets poorer and poorer, having less and less economic means or disposable income because governments will seek to levy and make good the financial losses from their citizenry. In the worst scenario, since an IPP investment, viewed as an infrastructure development project, is typically funded both by private money (through Project Financing) and quasi-public money (through Multilateral Financing), the default of the private sector sponsor may also cause the “Third World” nation--a sovereign sponsor--to default on its international financial obligations, and a transnational insolvency problem may arise leading to global economic crises.

The use of Project Financing as the corporate sponsor’s risk-allocation mechanism fatally flaws because it ultimately protects the corporate sponsor, the party who is in the best position to assess future risks of loss, and who benefits the most from the financial reward of the project, all to the detriment of those beneficiaries whom the project is supposed to serve. Under scientific risk management principles, those beneficiaries occupy the least advantageous and the least equipped position to prevent or control the loss. In fact, they have no control at all. The ultimate noble goal of “Third World” economic development in the name of free market, in the worst case, will work to the severe disadvantage of the poor and the weak.

(iii) The Monopolistic, Exclusive, and “Brand-Name” Nature of Large-Scaled Project-Financed Transactions in Real-World Application.

If a giant corporate sponsor is suffering financially or its management is deteriorating due to inefficiency or misconduct, the signs of financial ills and troubled corporate operation will manifest themselves and trickle down all operating units, and ultimately to those international projects funded via Project Finance an ocean away. Yet, because of pre-Sarbanes-Oxley “off-balance sheet” accounting treatment, coupled with the illusory psychological comfort created by brand-name glory, the significance of potential financial and management ills manifested in international projects easily escaped the immediate attention of the investing and analyst community, making the prospect of financial disasters appear further removed or remote. As an incidental benefit of the Enron scandal, the prophylactic Sarbanes-Oxley arguably helps prevent this misleading appearance by requiring disclosures of certain “off-balance sheet” arrangements, but Sarbanes-Oxley does not change


a Non-Recourse financing transaction into a Full-Recourse financing transaction and, hence, does not help the lending community and the public it serves. Nor does Sarbanes-Oxley help prevent or correct the lending community’s risk management errors, committed at the time the project is being contemplated, not at the subsequent time of disclosure in public filings or reports, after the deal has been finalized. The Enron scandal illustrates the danger of how brand-name corporate identities can psychologically distort and imbalance private bankers’ risk assessment process.\footnote{All allegations and facts discussed in this Article are based on public press reports and public filings available in the SEC’s Edgar system.}

The Enron Corporation (Enron)’s 1999 10K Annual Report discussed the Dabhol gas-fired power plant in the Maharashtra State of India (India’s industrial heartland south of Bombay), developed by the Dabhol Power Company (“Dabhol”), majority-owned by Enron.\footnote{Enron Corporation’s 10K annual report, page 14. http://www.sec.gov/archives/edgar/data/1024401/0001024401-00-000002-index.html.} Dabhol was allegedly India’s largest FDI project, valued at $2.9 billion.\footnote{Saritha Rai, “New Doubts on Enron’s India Investment” (New York Times November 21, 2001).} Dabhol’s revenues were counted as part of the bigger business segment, Enron Wholesales Energy Services (“Wholesales”), and reported collectively in Enron’s Financial Statements as part of Wholesales business unit.\footnote{Enron Corporation’s 10K annual report (December 31, 1999). http://www.sec.gov/archives/edgar/data/1024401/0001024401-00-000002-index.html.} Overall, by fiscal year 2000 – the year preceding the scandal, Enron’s Wholesales Energy Operations and Services, including power development and infrastructure projects in the developing markets, were reported as Enron’s largest business segment, with sustained growth rate of 48% annually over a five-year period,\footnote{Id.} both domestically and internationally. Yet, by the end of 2001, when the scandal was first uncovered, the 2,184-megawatt plant had been shut down allegedly as a result of an ongoing dispute between Dabhol and its only customer (the state utility authority of Maharashtra) over non-payment of power supply.\footnote{Saritha Rai, “World Briefing/Asia: India: Dabhol Seeks Payment (New York Times, September 19, 2001), "New Delhi to Intervene in Dispute with Enron,” (New York Times, September 8, 2001).} Around this same period of time, Dabhol also served notice of terminating its sale of power to the state utility authority. This meant that the income stream from which loan proceeds were serviced would not be forthcoming.

Enron’s financial meltdown threw the Dabhol project into more uncertainty. In the middle of the power purchase payment dispute, news from America arrived that Jeffrey Skilling, the CEO who was instrumental in Enron’s transformation from a power development and pipeline business to an energy trading company,\footnote{Id.} had resigned only after 6 months on the job, forewarning
the corporate giant’s subsequent financial collapse. At some point, Dabhol’s core physical assets were allegedly listed on the high priority sale by either the financially distressed Enron or its prospective buyer, Dynegy of Houston, Texas, who eventually rescinded the acquisition after conducting a due diligence review of Enron’s operations and records. The press reported that a consortium of Indian lenders led by the Industrial Development Bank of India, who apparently were once impressed by the mighty brand-name Enron, and whose exposure in the form of loans and guarantees amounted to approximately $1.5 billion, unsuccessfully attempted to stop the transfer of the Dabhol assets during Enron’s financial meltdown. Assuming that the transfer actually occurred arguably pursuant to U.S. bankruptcy law, who but the poor people of India and its industrial heartland will bear the consequence of this asset loss and the stand-still of the Maharashtra power-generation system?

The Dabhol power purchase dispute originated long prior to the Enron financial scandal, presenting peculiar facts and allegations, yet receiving relatively modest attention, if any at all, from the U.S. investing or analyst community, perhaps due to the fact that the dispute was couched as an incident of a nation-state buyer’s default in a developing economy so far away, with cultural and business practices so alien to the American mindset. Or, perhaps it is widely known to the investing public and its analyst community that such a project was non-recourse to Enron. The peculiar dispute was reported by the international press as early as February 2001, when Dabhol sought to invoke a $50 million sovereign guarantee provided by the Indian government, allegedly because Maharashtra had refused to pay for Enron’s power supply. Both the local and central governments refused to honor the guarantee, citing as reasons Enron’s technical failures in meeting contractual terms. The local utility buyer, in particular, complained about Enron’s exceedingly high prices (often calculated in accordance with long-term mathematical formula provided in the PPA). The dispute also halted the

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construction of Phase II of the power plant project. U.S. diplomats, at that time, reportedly stood behind Enron, warning that India’s default on the sovereign guarantee might endanger future FDI projects in the country. Apparently, the mighty name Enron, at that time, stood parallel to the American interest.

The circumstances surrounding the Dabhol dispute might have suggested not only Enron’s internal ills, but also a pattern of difficulties in the relationship between the foreign power developer and Maharashtra’s government buyer in the implementation of the relevant Power Purchase Agreement. This problem could certainly be characterized and foreseen as a materialized Political Risk. The risk, however, was not completely without warning, yet the lenders involved did not seem to be affected by any such warnings, judging from the scarcity of press reports relating any public reaction by the relevant lending community. The Dabhol project had experienced difficulty caused by the relationship between Enron and the local provincial government right at the inception and during the early phases of the project. The early signs of ills had generated a volume of rather scandalous publicity. As of 1994, Dabhol was reported as the high-profiled power project that received India’s full sovereign attention and promise of “fast-tracked approvals,” evidenced ultimately by the 12-year guarantee provided by the central government to make good any defaults on bills unpaid by the individual power buyer-provincial state. Perhaps this sovereign support was all justified, since the $2.6 billion project was conceived and made feasible by two brand-name U.S. corporate giants – Enron Power Development Corp. of Houston, Texas, and General Electric Co. of Fairfield, Connecticut (General Electric is the known manufacturer-supplier of turbines and generators for power-generation facilities). (The U.S.-based international engineering and construction firm, Bechtel, was also allegedly involved in Dabhol as a contractor.)

The Dabhol investment contract had been negotiated by Enron with a previous state government headed by the then ruling political party, as part of India’s national movement for economic reform commenced in 1991. The reform movement allegedly replaced former socialist policies with more rigorous free-enterprise implementation to attract more foreign investment from the West. Subsequently, there was a change of guards in local government leadership, and, well into the fall of 1995, the new local officials in Maharashtra decided to


372 Id.


cancel Dabhol, viewing it as “against the interest of the locale and its people.”

Local officials claimed that the previous negotiation was one-sided and whatever Enron wanted was granted to it. Likewise, the president of the opposition party in India reportedly claimed that Enron executives took advantage of economic reforms, and were doling out bribes and kickbacks to Maharashtra state politicians in order to secure the power project.\footnote{Id.} Notwithstanding the controversy, by 1996, Dabhol was reported as “back on track,”\footnote{John F. Burns, “Second Thoughts on India; Enron Project on Track, but Policy Doubts Remain” (New York Times Jan. 9, 1996).} and Enron resumed construction, after reducing the costs charged for electricity in response to nationalist objections,\footnote{Allen R. Meyerson, “Enron Agrees to Resume Work at Project in India” (New York Times Jan. 22, 1996).} and after receiving the Maharashtra state’s formal offer to revive the cancelled project.\footnote{AP, “Enron Says India State Offers to Revive Big Power Project” (New York Times Jan. 17, 1996).} In July of 1996, Dabhol received final approval and blessings from the Indian central government.\footnote{AP, “Enron Can Resume Big Indian Power Project” (New York Times July 10, 1996).} By 2001, the Dabhol project was shut down, and the heatedly disputed income stream come to a definite stop.\footnote{Enron’s 10K Annual Reports filed for fiscal years 1997 and 1998 disclosed that Enron was developing Phase II of the Dabhol power project, which consisted of a 1,624MW combined cycle power plant, together with the development of liquefied natural gas (LNG) station and harbor to supply fuel to Dabhol. Enron’s 10Ks also disclosed that financing for the Phase II project would commence in late 1999 (as per 1998 10K) or 2000 (as per 1999 10K), with commercial operation for the facilities to commence in 2001. \textit{See http://www.sec.gov/Archives/edgar/data/1024401/0001024401-00-000002-index.html; http://www.sec.gov/Archives/edgar/data/1024401/0001024402021500010/0001024401-01-40010.txt}. For fiscal year 1999, Enron reported that “earnings from Enron Wholesale’s energy-related assets increased, reflecting the operation of the Dabhol Power Plant in India.” \textit{10K Annual Report of Enron Corporation (December 31, 1999).} However, in Enron’s 10K Annual report for fiscal year 2000, the completion date for Dabhol Phase II was reportedly delayed to late 2001, and the LNG component’s completion date was further delayed to mid 2002. \textit{10K Annual Report of Enron Corporation (December 31, 2000).}}

The “brand-name” pitfall of Project Financing goes beyond the type of risk assessment errors that might have contributed to Dabhol’s depressing story. The substantial size and impact of large-scaled Project-Financed transactions make them a natural fit for sponsors that are major energy MNCs who bring with them to the Third World their bankers, hotel chains, international law firms, international accounting firms, international
engineering firms, as well as other brand-name international contractors. In fact, quite often, the banks, law firms, accounting firms, and other service industries (the “Service Providers”) will go “Third World” first, in order to lay out the support structure for their wealthy clients, who will then “go” second, only after their comfort level has been satisfied via the work of the Service Providers. The Service Providers will send to the “Third World” those employees who uniquely can demonstrate cultural and linguistic abilities, as well as the flexibility and courage to operate in “sub-standard” living and working conditions of a transitional economy – those individuals that America’s “diversity project” helps recruit. Quite often, when the Fortune 500 business executive’s flight hits the “Third World” runway, their lawyers and accountants are already lining up to greet him/her with their billable hours and timesheets. The network of all these players works such that the players feed business to one another to the exclusion of smaller entrepreneurs, except for those local “privileged few” who are selected or recommended by the government due to their close-knit connections with government officials, a suspect link that may lead to the Fortune 500’s derivative liability under the U.S. Foreign Corrupt Practices Act (assuming that corporate “knowledge” of their local agents’ bad acts can be established).382

Following is a specific example of how this close-knit network may work to the great disadvantage of talents from the local community, using the law practice as an illustration. In Vietnam (as the investment environment for our 1994 Vietnam Deal), except for a couple of small boutique international law firms with established track record in the country prior to the Communist takeover of 1975, small local law firms had no chance to compete with MNCs’ Service Providers. This was extremely ironic because the task of advising MNCs involved the interpretation of esoteric Vietnamese law (often appearing on yellow paper in types coming from a manual typewriter), which quite often looked alien to lawyer trained in a developed jurisdiction. Yet in the early 1990s, the timeframe for our Vietnam Deal, the international law and accounting firms, either U.S. or U.K. based, dominated the legal and business advisory scenery in the country. The excuse used by the foreign investor community was that either local law did not exist, was not enforced, did not work for or apply to foreigners, or corporate clients had no comfort in using local lawyers due to these lawyers’ Communist indoctrination and deficiency in the Anglo-American capital market. These stereotypical assumptions were made, even though (i) the local tort and criminal law of the host jurisdiction had little to do with any Anglo-American capital market model,383 and even

382 See Notes 187, 189-191, supra (discussing “knowing” element under Foreign Corrupt Practices Act). Under the FCPA, local, non-U.S. agents can also be prosecuted and can implicate the MNC and its employees, provided that the element of “knowledge” on the part of the MNC and its employees is proven. This linkage is distinguishable from a scenario where the MNC works with an agent of the host government. If the government requires dealing with the host government’s agent as an in-between contact, the MNC will want to comply in order to gain support from the government. One such example is the recent scandal involving the President of Kazakhstan. U.S. prosecutors filed a criminal action against Kazakhstan’s agent, a U.S. citizen, for FCPA violations. See Jeff Gerth, “U.S. Businessman Is Accused of Oil Bribes to Kazakhstan” (New York Times April 1, 2003).
The assumption that the developing nation has no or little law is not always correct. In a lesser developed and authoritarian country, law and order purposely become ways for the ruling elites to “flex their muscles” and to exhibit the oppressive regime’s supreme authority to administer the “written law.” Leaders will use or formulate written laws to justify their action post-facto. (For example, in prosperous Singapore’s model of “Asian-styled modified democracy,” written laws (interpreted by common law precedents) were enacted to restrict freedom of speech and access to information, and to impose government licensing upon private acts.) See Scott L. GoodRoad, “The Challenge of Free Speech: Asian Values v. Unfettered Free Speech, an Analysis of Singapore and Malaysia in the New Global Order,” 9 Ind. Int’l & Comp. L. Rev. 259 (1998) (discussing, inter alia, Singapore’s and Malaysia’s Internal Securities Acts restricting freedom of speech, and the interpreting case of Jeyaretnam Joshua Benjamin v. Lee Kuan Yeu, 2 SLR 310 (Sing. 1992), 1992 SLR LEXIS 412).

The problem with the “rule of law” in many “Third World” nations is not whether laws exist, or whether laws exist in abundance. For example, in Vietnam, according to the private international bar, from the inception of Vietnam’s “open door” economic policy to 1994, Vietnam passed 120 “Laws” (enactments by the National Assembly) and more than 1000 decrees, circulars, ordinances, and interpretative decisions (constituting what U.S. legal scholars know as public law or administrative law). See THE ECONOMIST CONFERENCES, OPERATING IN VIETNAM; A MANAGEMENT FORUM at 16 (1994) (Conclusions Paper of Conference in Ho Chi Minh City, April 11-12, 1994 (statement by Nguyen Tan Hai, then Baker & McKenzie Representative based in Hanoi). Instead, the challenges are whether law is fairly and equitably formed, whether law is enforced to effectively achieve both substantive and procedural due process, and whether the system of law is workable.

In general, in their “country report”-style of providing advisory services, international legal advisors to foreign investors in the developing nations tend to focus on the countries’ civil and commercial law systems (or lack thereof), as well as these countries’ memberships in the Multilateral and Bilateral Institutions, rather than looking into the civil tort and criminal justice systems of the host countries. This decision tends to reinforce Fortune 500 management and general counsel’s notion that what is important to them is a country’s aspirations to invite foreign commercial interests. Hence, the Fortune 500’s focus is on the investment climate and the country’s foreign investment and natural resource laws. These “commercial interest” types of law receive General Counsels’ priority consideration, and are artificially segregated from the country’s human rights and civil liberty records, or the relationship between a government and its own citizens.

For the following two reasons, I seriously question the soundness and wisdom of this segregation. In my view, the civil tort and criminal justice systems of a host country should be the first thing the international counsel needs to look at, and this task requires the full cooperation and utilization of the native legal scholars, regardless of differences in training or backgrounds.

• First, criminal justice and civil tort systems, whether viewed as legally simplistic or complex and sophisticated from the perspective of the U.S-trained lawyer, would provide the most direct and most profound insight into a society and its curve of development, as these foundational systems speak for human relations in society, the interaction between citizens and the State, and the role occupied by the sovereign state in private lives.

• Second, foreign investors and their employees do travel, live, work, and engage in economic and commercial activities in the host nation. How can they then ignore the civil tort and criminal justice systems that govern the general population, unless there is an implicit understanding that the foreign investors are privileged or supreme citizens who are above the law?

In summary, I think that the “country report” accompanying the foreign investor to a foreign land should begin with the country’s constitutional and political frameworks, as well as the country’s civil tort and criminal justice systems. These topics require and demand the intimate involvement of, and constant consultation with, the native lawyers during the client advisory process, right from the start of any FDI projects.
though (ii) both HaNoi and Ho Chi Minh City (the former capitalistic, entrepreneurial Saigon, once fully exposed to America’s legal system and constitutional framework) were inundated with middle-aged or senior-citizen former lawyers well-trained in French civil and commercial law and/or Soviet legal principles, which made up the then legal system of Vietnam. (Any capital market model, in the hay days of Vietnam’s economic development, was being drafted by government cadres in consultation with Western lawyers sent by the new-coming investors, leaving the well-trained civil law and Soviet law scholars of Vietnam as second-class citizens performing interpreter and translator roles, at a minuscule fraction of the cost of an expatriate Western lawyer practicing international business on Vietnam’s soil. Those Western IBT lawyers worked in collaboration with their privileged few “local counsel” who were often high-ranking party members selected and recommended by the host government.)

The foregoing esoteric example involving the private international law practice typifies the close-knit alliance of corporate brand-names that disadvantages local talents. The same pattern of monopoly exists when “brand-name” corporate players are involved in Project-Financed IPP Transactions -- the forming of a self-feeding network that dominates the natural gas and utility sector in the “Third World.” A couple of law-school hypotheticals can help demonstrate how the tendency to favor brand-name corporate identities will inescapably and undoubtedly influence bankers’ risk assessment process.

**Hypothetical #1:** Suppose that my students, Reid and Megan, want to open a restaurant chain in the new Afghanistan. They would like to have a Project-Financed loan from J.P. Morgan Chase (which, at the time this Article was finalized, was contemplating acquisition of Banc One). Having learned principles of Project Financing, Reid and Megan have managed to secure several catering contracts from business offices in the new Afghanistan. Under each contract, Reid & Megan, LLC, will provide hamburger lunches to all U.S. expatriates craving for American food, and those native employees who want a “taste” of the American fast good culture. Reid & Megan will also handle banquets for all these offices at each and every American holidays celebrated by U.S. expatriates in Afghanistan. Under the terms of these catering contracts, for the next five years, these businesses will pay for a minimum number of meals all year round regardless of whether or not those meals are actually consumed by their employees – a “Take or Pay” concept analogous to gas sales terms in the energy sector: a gas buyer will pay for the supply, whether or not it actually


takes delivery of the gas. These “Take or Pay” terms are to secure and stabilize long-term supplies of a scarce and unpredictable commodity in a seller’s market. These “Take or Pay” terms are possible because Reid & Megan is the only supplier of hamburgers and American food in Afghanistan. The income stream produced by these catering contracts is sufficient to pay for debt services for the next five years.

Applying classic Project Financing principles, J.P. Morgan Chase should have no problem financing the Reid & Megan deal, judging solely on the economic viability of its restaurant and catering project (as evidenced by tightly secured contractual rights producing a steady future income stream for five years). Nonetheless, J.P. Morgan Chase bankers may inescapably be influenced by the two youthful and non-famous project sponsors, who have not demonstrated any experience in the food industry, in international business, or in the country of Afghanistan. In classic Project Financing, none of those factors should matter, since only the income-producing certainty of the project should drive the risk assessment process. Nonetheless, there is a great chance that the bank will still require Reid’s and Megan’s parents to guarantee the debt, or an examination of at least two years’ financials by Reid & Megan showing its prior income in the food service business, which my two entrepreneurial students do not have. Reid & Megan LLC has no “brand-name” appeal or corporate reputational identity, which apparently Enron of Houston had with respect to its Dabhol project, prior to its scandalous collapse. The classic principles of Project Financing might have been applied full force and favorably to Enron’s Dabhol, but not to Reid & Megan. Yet, J.P. Morgan Chase may feel differently when the name of Reid & Megan LLC is replaced with McDonald’s Corporation, even if the project and its supporting catering contracts remain exactly the same. Although corporate brand-name is undoubtedly a factor in any kind of business judgment, here, in the context of Project Financing, it has diluted the very principle underlying the funding concept – it is the project, not the project sponsor, that should provide the basis for lending or collateralization.

Hypothetical No. 2: Assume further that Reid and Megan had been able to pull together a group of petroleum engineers trained by the prestigious School of Mines in Colorado. Together they formed a company to participate in “Third World” natural gas and IPP investments via the procurement of finders’ fees or technical consulting contracts in exchange for a minimal equity interest of approximately 0.1%. Suppose that they were able to procure such an interest in a contemplated pipeline construction in the new Iraq. Again, my two students went to J.P. Morgan Chase. The same dubious concerns might still characterize the loan application process because of Reid & Megan, LLC.’s lack of “brand-name” appeal and track record, even though under Project Financing principles, bankers should be looking at the project, and not the project sponsors. Suppose further that Reid & Megan switched their investment and substituted Iraq with the Republic of Chad. The bankers might still be reluctant. Suppose, finally, that Reid & Megan showed the bankers contracts

between it and Exxon-Mobil, guaranteeing Reid & Megan’s finder’s fee in the pipeline and oil production project currently undergoing in Chad, which already received Multilateral Funding, and was co-sponsored by Exxon-Mobil, Chevron-Texaco, and Shell.\(^{387}\) The bankers might just change their view about Reid & Megan’s Project Finance eligibility at that time, having been influenced by (i) the “brand-name” appeal, credibility and glory of Exxon-Mobil as a Fortune 5 entity, (ii) the mighty strength of the de facto “oil cartel” behind the Chad project; and (iii) the added assurances of Multilateral Financing already accorded to the overall project and the host country.

I have taken the liberty of speculating on what J.P.Morgan Chase bankers might have done with my two students and their Limited Liability Company, only to illustrate my point: Project Financing can operate as an exclusive privilege for corporate giants and sponsors of large-scaled projects. To fully realize the goals of free enterprise and to maximize the best utility of Project Financing as a stimulant for “Third World” economic development, the concept must apply with rigor and fairness to the smaller entrepreneurs who take a chance with a “Third World” investment environment. The Multilateral Institutions, in their free-enterprise economic mission, should provide the fullest support to these small foreign or native entrepreneurships. This can only be done if the Multilaterals regard economic development projects and related infrastructure building in a broader and more flexible light. Without such multilateral support and a breakthrough in real-world application of Project Financing, very few small or medium-sized entrepreneurs can afford to compete against, for instance, the consortium of Exxon-Mobil, Shell/Dutch Royal Group, Bp-Amoco, and Chevron-Texaco in poverty-stricken Chad. Nor could any entrepreneurships formed by returning East Indian Americans have competed successfully against mighty Enron executives in the mid-1990s in a project like Dabhol, which turned out to be a sour experience for India. When these smaller entrepreneurs could successfully raise funding, or pull together their lifetime savings to pursue their “American dream” in the “Third World,” they would most likely become the easy targets for bribery requests, or selective adverse material governmental action (MAGA), since typically they had no “brand-name” corporate clout to protect them, unless they somehow could tap into an existing network of governmental connections and benefits, which in all likelihood might carry grave FCPA implications. The smaller, independent entrepreneurs taking a chance with the “Third World” would operate in the worst risk scenarios.

In the experience of Vietnam, a good number of disappointed and bankrupt Vietnamese American entrepreneurs (or returning Vietnamese expatriates from other developed nations such as France or Canada) have become witness to the failed American dream. For example, on May 15, 2003, the Wall Street Journal reported the sad story of two young Vietnamese who returned to their former home from their adopted home overseas in order to successfully operate a telecommunications business, after helping Nokia and Samsung obtain an 80% share of the local market.\(^{388}\) (The popularity and high

\(^{387}\) See Note 16, supra (discussing the Republic of Chad).
usage of cellular phone in developing nations may surprise the American public, but the high usage may also include volumes of international, long-distance, and business calls made by the business and expatriate community.\footnote{According to the Wall Street Journal, the brothers’ newly formed company allegedly surged to $40 million in sale in 2002, but their success story did not last long. The Vietnamese government recently arrested both young entrepreneurs, accusing them of tax invasion and confiscating their business and inventory – something that it would probably not have done to Fortune 500 executives who might legitimately have got paid offshore for services rendered in the country. Countless similar stories never made it to the Wall Street Journal for the benefit of the observing public. They became part of the continuing untold sad stories of exiled Vietnamese after half a century of war and bloodshed that had sent them away from their former home. Neither the allure of the “American Dream” nor the ennobled economic development of their root culture has saved these daring entrepreneurs from heartaches and bankruptcies.}

In summary, the instigation of small business involvement in “Third World” economic development must be the joint project for the multilateral community, the private lending community, as well as governmental agencies of the home jurisdiction (entities such as the Small Business Administration or various state authorities and Chambers of Commerce in the U.S). In the new global age, new visions and new roles for the smaller or medium-sized entrepreneurship must be born. In its purest form as an economic development stimulant, Non-Recourse Project Financing, after all, should not be just a benefit and risk transfer mechanism for conglomerates of the powerful and the rich.

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**PART C
REFLECTION, RECOMMENDATIONS, AND CONCLUSION:
THE ROAD TO TRAVEL**

- **The Need for Reflection**

\footnote{Barry Wain, “Two Vietnamese Brothers Fall Victim to Their Success” (Wall Street Journal, May 15, 2003). The news story also referenced the arrest of the Vietnamese Australian owner of Peregrine Capital Vietnam in the 1990s.}

In 2000, the Vietnamese government also sentenced a Vietnamese Canadian woman to death, having convicted her of drug trafficking and holding her in captivity (together with her aging mother), notwithstanding the Canadian government’s plea for due process procedural justice and clemency. \textit{See Nguyen Nam Phuong, “Southeast Asia: Vietnam Debates Capital Punishment, Again,” (online Asia Times May 31, 2000); Agence France Press, “Le Vietnam, Aujourd’hui: Vietnam Executes Canadian Trafficker”.(AFP April 28, 2000). Both articles raise the question of whether the Vietnamese-Canadian woman might have been innocent).}

I have by now unveiled before you certain transactional legal issues that may contribute to the pattern of “Third World” economic development projects in the petroleum and energy sector. The lawyer plays a pivotal role in the forming of such pattern. This role deserves some reassessment.

The prospect of an equitable global economy was envisioned half a century ago when the Bretton Woods Multilateral Institutions were created in the aftermath of World War Two and the global depression. The World Bank has since proclaimed, as its motto, that its “Dream is A World Free of Poverty.” The new millennium calls for an examination, empirically and conceptually, of this mission’s progress, not as a critique of the World Bank, but rather as a suggested focus for researchers of the global economy.

Recent events have afforded the American public an opportunity to reassess the role played by corporate America in foreign relations and “Third World” economic development. I recall seeing an interview of school children on national TV during the September 11 crisis. One schoolgirl asked the interviewer: “Why do those people hate us so much?”

The program ended there without an answer.

I am not sure there can ever be a comfortable or exhaustive answer to the child’s question. On network television back then, in the heart of the September 11 national wound and the peak of patriotism, it was not the kind of question we wanted to face. But the innocent question brought to our consciousness the perplexing root causes of anti-American sentiments that fertilized extremists’ atrocious behaviors, in an era where supposedly all worlds should become one. In searching for an answer to the child’s question, it is natural to focus our attention on U.S. foreign policies. What can easily be overlooked is the role of that “Quiet American” who, outside the political arena, has long contributed to the image of Americans abroad.

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391 But see Dansher (ed.) 50 Years is Enough: The Case Against the World Bank and the International Monetary Fund (1994).


Among these “Quiet Americans” are the corporate executive and his/her corporate lawyer, both of whom jointly map global development for profit. They travel to remote locations of distinctive ancient cultures to strike deals. In the discrete ways that often characterize economic confidential negotiation, they become de facto ambassadors of the American way of life and the showcase of its influence abroad. Quite often, and acceptably so, cultural sensitivity is overshadowed by economic goals. But it goes without saying that in order to participate in the global economy, it is no longer adequate for an international executive and his/her lawyer just to surround themselves with their international “Service Providers.” Nor is it adequate for the pair to arm themselves with a manual, “Doing Business in XYZ jurisdiction,” or a nicely compiled “country report” on a nation’s foreign investment legal framework and governmental structure, often curiously described in American legal jargon.

If this is not enough, what will, then? The gravity of contemporary geopolitical issues and the complexity of today’s world necessitate a reorientation of perspectives and outlook.

Five Suggestions:

I advocate the following five points, as part of what I consider an overall, systematic “public interest” approach to international deal-making.

1) Systematic Training on Multiculturalism for the International Business Executive or Legal Practitioner, and Rewriting the Agenda of MNC Corporate Counsel

Both the IBT executive and his/her lawyer should be trained on multiculturalism, and made cognizant of their “de facto ambassador” role. This training should be similar to the training of foreign service officers without the political overtone. I think of the traveling corporate executive and lawyer specializing in “Third World” projects as those who have taken the “road less traveled” envisioned by Robert Frost. On such road less traveled, the traveler

394 See Daphne Eviatar, “Wildcat Lawyering,” The American Lawyer Vol. XXIV, No. 11 (November 2002) (discussing phenomenon of big-firm lawyers following the trail of oil and pipelines, expending their practices to deals made in remote countries and locations such as Baku, Azerbaijan, and Turkey).

395 See, e.g., Jeffrey K. Walker, Symposium Luncheon, “Law and International Relations,” 51 U.Kan.L.Rev. 297 (February 2003) (“The world did not change on September 11…Rather, the United States suddenly noticed how the world actually is…Although I refuse to blame Americans and American culture for the atrocities of September 11, we need to do a better job of reaching out in tolerance to other peoples.”)

396 The global workforce of MNCs include executives and lawyers from all cultures. In its ultimate objective, the training on multicultural sensitivity and awareness of geopolitical issues should apply to the global workforce, and not just U.S. professionals.

encounters burdens as well as benefits. More exotic life opportunities present unconventional responsibilities. The “de facto ambassador” role goes with the job, regardless of choice, because our world is getting extremely complex from all fronts, and all actors have become interdependent.

Likewise, the agenda of corporate counsel should be reevaluated and rewritten. It is no longer sufficient to devise minimal legal compliance. The artificial division between non-economic human rights concerns and private economic law is already blurred and should be alleviated, because, at the end of the day, for the transnational corporation, both platforms can be translated into contingent or actual liabilities and monetary losses.

Many strata of the international community see the aspirational rule of law, whether it be public or private international law, as the rule that serves humanity. A “post-industrial sensibility” throughout the developed countries is being called to the center stage of policy-making, toward the search for some sort of a moral consensus in a world of differences and in the aftermath of several corporate scandals and tragic world events. Part of the challenge is the articulation of a “corporate morality” attached to a legal fiction such as the corporation. As an English jurist once declared, “corporations have neither bodies to be punished, nor souls to be condemned. They therefore do as they like.”

But even if such moral consensus may be far from reality, undoubtedly and justifiably, issues such as international human rights, cultural property, and environmental issues should be part of the corporate counsel’s agenda, considering, inter alia, the recent spur of class action lawsuits against U.S.-based corporations by foreign workers, and recent United Nations’ renewed human rights initiatives. Specifically, companies in the extractive industry


399 Edward, 1st Baron Thurlow, English Jurist and Lord Chancellor (1731-1806).

400 Jenna Greene, “Gathering Storm: Suits that Claim Overseas Abuse Are Putting U.S. Executives on Alert and Their Lawyers on Call; ‘Plaintiffs Using 18th Century Law Against Companies’ (Legal Times July 21, 2003) (discussing foreign plaintiffs’ suits against MNCs based on Alien Tort Claims Act: ExxonMobil was sued over the hiring of Indonesian soldiers as security guards; Unocal was sued over Burma pipeline; IBM was charged with supplying computers that enabled South African government to create devices to control black population; Ford Motor, General Motor, and Daimler Chrysler were named for providing armored vehicles to patrol townships; Citigroup, J.P. Morgan Chase, and Credit Suisse were sued for providing funding to South Africa to expand its police apparatus). See also Sub-Commission on the Promotion and Protection of Human Rights, Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, UN Doc. E/CN.4/Sub.2/2003/12/Rev.2 (2002), available at http://www.unhchr.ch/html/menu2/2/55sub.htm.
have recently become the renewed target of scrutiny due to lawsuits brought under the Alien Tort Claims Act. It is incongruent to have U.S. public interest lawyers and workers of INGOs and NGOs running around a developing country advocating and monitoring human rights compliance, while U.S. corporate executives are ignoring that aspect of reality, and, instead, concentrate solely on negotiating, outwitting, and partnering with the “monarch.” A short-term profit focus or the rush toward deal closings, without considering the real party-in-interest—the inhabitants of the developing economies—is the shortsighting of ultimate corporate goals and accountability. Corporations are citizens of every market and community in which they operate. In the U.S., the same message has been spoken through the doctrine of social responsibility, made applicable to the corporation’s role by state incorporation statutes as well as by caselaw. Similarly, aspirational international law also recognizes the doctrine of corporate social responsibility via the “social contract” theory—that the multinational corporation, by doing business, enters into a “social contract” between it and the host society.

2) Expanded Ethical Concepts Governing Lawyers to Accommodate A Legal Transnational Practice

To date, the role of the international business transactional (IBT) lawyer in “Third World” economic development remains at best an elusive mystique. Her job involves an undecipherable, esoteric specialty in the eye of the international legal community. Two reasons explain the myth about the IBT practice: First, the number of truly full-time IBT lawyers is relatively small compared to the legal community at large. Second, what they actually do can be as imprecise and incomprehensibly exotic as the flexible nature of the curriculum of IBT courses in accredited law schools, quite often shaped by the


Id. See also Notes 70 and 239, supra (inventorying lawsuits brought by foreign workers and inhabitants against MNCs).

See Notes 38, 197, 208, supra (discussing doctrine of corporate social responsibility). The scholarly debate regarding effective remedies for the implementation of the corporate social responsibility doctrine is ongoing. See, e.g., Eric Engle, “Corporate Social Responsibility: Market-Based Remedies for International Human Rights Violations?” 40 Williamette L.Rev. 103 (Winter 2004).


For example, as of 1996, out of the corporate in-house staff of Mobil Corporation (now Exxon-Mobil), only 25 lawyers were classified as major transactional lawyers responsible for the negotiation and implementation of deals worldwide. This number did not include the headcounts of lawyers assigned to the daily servicing of producing subsidiaries or affiliates overseas (note on file with author).
individual view and previous work or research experience of the professor who teaches the course. The mystique is not clarified any better by the generally vague and non-standardized publicity material of law firms that hold themselves out as having an “international practice.” While the practice or teaching of torts, contracts or criminal law can definitively be contoured, IBT can be anything that involves a cross-border touch or emphasis: the highly structured administrative practice of international trade concentrated in Washington, D.C., the mammoth documentation of bank financing performed at a lawyer’s desk in New York City, the “quickie” finalization of an international sale on a form invoice and purchase order anywhere in the U.S., the intensive, nerve-wrecking negotiation of oil and gas interests in remote locations of the earth, or simply the routine handling of a business immigration visa by a small-town practitioner.

U.S. courts as well as the Federal Rules of Civil Procedure have recognized licensed practitioners as “officers of the court,” owing responsibilities not only to clients, but also to the integrity of the profession and the justice system symbolized by the bench and the courthouse. The concept of lawyers as “officers of the court” should have its counterpart in a transnational practice. Although there is a gap in mandatory rules of conduct for transnational practitioners, who are typically regulated by the licensing home jurisdiction, several voluntary codes or guidelines have come into existence, thereby focusing the attention of the international legal community on issues involving a transnational practice. See, e.g., The International Lawyer’s Creed (Texas-Mexico Bar Association); The International Bar Association (IBA) International Code of Ethics; The ABA Section of International Law and Practice’s Model Rules for the Licensing of Legal Consultants; statements by the ABA Commission on Multi-Jurisdictional Practice MJP); the ABA’s Evaluation of the Model Rules of Professional Conduct and MJP Issues; Code of Conduct for Lawyers in the European Community (adopted by 18 nations); NAFTA Model rule on Legal Services; Statement on Standards for International Legal Practice, Union Internationale des Avocats (UIA); Restatement (Third) on the Law Governing Lawyers (2000). Cf. Detlev F Vagts, “The International Legal Profession: A Need for More Governance,” 90 Am. J. Int’l L. 250 (1996) (recognizing that national legal systems almost always become watchdogs for international lawyer’s conduct, and that issues of professional behavior for transnational lawyers are plagued with problems and


407 Although there is a gap in mandatory rules of conduct for transnational practitioners, who are typically regulated by the licensing home jurisdiction, several voluntary codes or guidelines have come into existence, thereby focusing the attention of the international legal community on issues involving a transnational practice. See, e.g., The International Lawyer’s Creed (Texas-Mexico Bar Association); The International Bar Association (IBA) International Code of Ethics; The ABA Section of International Law and Practice’s Model Rules for the Licensing of Legal Consultants; statements by the ABA Commission on Multi-Jurisdictional Practice MJP); the ABA’s Evaluation of the Model Rules of Professional Conduct and MJP Issues; Code of Conduct for Lawyers in the European Community (adopted by 18 nations); NAFTA Model rule on Legal Services; Statement on Standards for International Legal Practice, Union Internationale des Avocats (UIA); Restatement (Third) on the Law Governing Lawyers (2000). Cf. Detlev F Vagts, “The International Legal Profession: A Need for More Governance,” 90 Am. J. Int’l L. 250 (1996) (recognizing that national legal systems almost always become watchdogs for international lawyer’s conduct, and that issues of professional behavior for transnational lawyers are plagued with problems and
zealously advance the cause of her client, but also to make a contribution to the
goals of harmonizing national laws, toward the building of a “rule of law”
system accepted by the “civilized nations.” Whether or not IBT lawyers go to
court, they should be made cognizant of their role as “officers” or “members” of
such an international legal community working toward and sharing the “rule of
law” common to all civilized systems of national laws. The public interest
(concepts of ordre publique in civil law) should not just be used to defend
national sovereignty. Ordre publique should underlie the continued development
of the “internationalization” and “legalization” trends, but only toward
acceptance of a nucleus of universal legal concepts constituting modern
international law, whether economic or humanitarian.

At the negotiation table, notwithstanding the IBT lawyer’s role as zealous
advocate for her investor-client, she is, and should be in the best position to
strike the balance between private profit incentives and the public interest. In
the effective representation of her client, she should also be mindful of the
overall ethical duty to advance the public good. This “double hat” function is
implicit in the role of any lawyer, domestic or international. The notion,
however, should eventually be expressed or incorporated explicitly in modern
Codes of Professional Responsibilities all around the nation, as well as by the
various voluntary bars, in order to accurately reflect the realities of today’s
global economy.

3) **Use of Voluntary Corporate Compliance Programs as a Means to
Police MNCs’ Conduct, under a “Management-Based/Enforced Self-
Regulation” Model.**

The enforceability of a “Universal Code of Multinational Corporate
Conduct” project has been talked about for years, among U.N. work groups as
well as among institutions and legal academia. Still, the project has not

uncertainties). For a comparative analysis of the international legal practice, see Peter Roorda, “The
Internationalization of the Practice of Law,” 28 Wake Forest L.Rev. 141 (1993). See also Lauren Frank,


With respect to ethical issues involving corporate counsel, see, generally, Ralph Nader & Wesley J. Smith,
No Contest – Corporate Lawyers and the Perversion of Justice in America, xxiv-xv (1996); Cf. George A.
Riemer, “Zealous Lawyers: Saints or Sinners, 59 Ore. St. Bar Bull. 32, 32 (1998); Lawrence J. Fox,
“Lawyers’ Ethics According to Nader: Let the Corporate Clients Beware,” 12 Geo. J. Legal Ethics 367,
business lawyers, the familiar response is that they ‘protect’ their clients, that they get their clients the
‘best’ deal.”).

(incorporating concept of “Ordre Publique” in convention’s language).

410 See The Global Compact, [http://www.unglobalcompact.org/Portal/](http://www.unglobalcompact.org/Portal/): The Global Compact is a voluntary
corporate citizenship initiative seeking to support nine labor, human rights, and environmental principles.
Proposed by U.N. Secretary-General Kofi Annan and launched at U.N. Headquarters in New York on July
become a reality. If we cannot come to an enforceable consensus of how to govern the conduct of MNCs, then we must let them govern themselves, and oversee that self-imposed process.411

I suggest that the overseeing function start with the MNC’s home jurisdiction, and that a “management-based,” “enforced self-regulation,” or “mandated self-regulation” model be utilized as the legal framework to address this perplexing challenge.412 Such a “management-based” regulatory model, to be administered by the MNC’s home jurisdiction,413 should utilize the MNC’s voluntary “corporate compliance policies and programs” (already in existence in most, if not all, U.S.-based publicly traded companies) as the tool to achieve regulatory social goals.414 The end result I hope for is the “double dosage” of public scrutiny so that MNCs will impose upon themselves a “public interest” approach to international deal-making. (My hope is built, first, on the common-sense philosophy that humans’ desire to “look good” before a scrutinizing audience is just as strong as their desire to become powerful and rich; and, second, on the more sophisticated philosophy underlying U.S. corporate securities “disclosure” law – that full and accurate “disclosure” results in the


414 I will save the precise or detailed construct of the model for another day.
best balancing of market forces toward the self-correction of inefficiencies and defects.)

The “management-based” model of “enforced self-regulation” has been presented and debated in both management and legal academic literatures, in connection with different issues such as environmental or product safety concerns. Also called “mandated self-regulation,” the model allows regulators to intervene at management’s planning stage (rather than at the output stage). The model aims to achieve regulatory social goals by allowing management to exercise its creativity in performing a “self-critical analysis and evaluation” of the organization’s internal programs. Whether regulators will approve, ratify, or review management plans, or otherwise require subsequent auditors’ certification of compliance will distinguish a “management-based” approach from a traditional “information disclosure” approach, although both models seek to provide greater availability of information to a concerned public. The “management-based” approach places the responsibility for decision-making and program design with those who possess the most information on risks and the control of risks. This model can be less costly and more effective than traditional government-imposed standards, and can improve employee morale and cooperation, since workers will tend to look at their own organization’s rules as being more “reasonable” than onerous government-imposed rules. The model also helps mitigate problems associated with limited government resources and creates incentives for firms to seek innovative solutions.

The term “management-based” distinguishes the model from specific government regulations directed at firms’ output performances. In its most flexible form, management-based regulation need not be regulation at all, but rather serves as a voluntary option for firms. Market forces will cause firms to voluntarily devise, create, and comply. Because the model shifts the focus of policy-making from governments to private parties, it should be viewed as a voluntary approach.

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415 For a detailed capture of federal and state implementation of the disclosure philosophy, see J. Robert Brown, The Regulation of Corporate Disclosure (3d Ed. Aspen 2002), in particular Section 2.01, at p. 2-3 (regulatory environment and historical perspective).

416 The notion of “self-critical analysis” has been implemented in the securities industry’s self compliance programs in order to help the securities broker-dealer firms satisfy their legal duty to supervise and to police their own staff. Broker-dealers’ self-compliance programs serve regulatory preventive purposes, create effective compliance means by placing compliance functions within the firm’s normal operations, accommodate the particular needs and circumstances of the firm, incorporate businessmen and women’s creativity by cloaking them with regulatory power, and hence constitute a better means to monitor and achieve compliance goals. See, e.g., John Walsh, “Right the First Time: Regulation, Quality, and Preventive Compliance in the Securities Industry,” 1997 Col. Bus. L. Rev. 165.


418 Colgianese & Lazer, 37 Law & Society Rev. No. 4 at p. 696.
regulating strategy, rather than a body of statutory or regulatory criteria. This type of strategic governmental intervention is often needed to address some of more intractable public policy concerns, for which governments have not been able to design uniform standards. The down side of the model lies in the fact that it does not necessarily guarantee optimal result – firms may just go through the motions or “game,” or simply consider the new law an additional nuisance, turning the “regulator” into a business “risk.”

The inherently adversarial nature of the relationship between businesses and their government in the U.S. has prompted a small number of authors to suggest an alternative “cooperative approach” to the interaction between the regulator and the regulated -- a model more typically observed in Europe and Japan. These authors urge policymakers and the academy to utilize a comparative method to the study of regulatory models across borders, although the jury is still out concerning the efficacy of cooperative methods of legal enforcement. Other authors have urged, overall, a “consultative and cooperative” preferred approach to the development and implementation of international standards for the global community, as part of the “legalization” movement.

An effective management-based model will depend on the types of mandates regulators choose for various purposes, as well as the extent of government involvement or oversight included in the model. Such mandates must aim to create incentives for a “cooperative” model of enforcement that improves the regulated entity’s public image, client base, and business goodwill, rather than the traditional adversarialism in which businesses view regulators as “nuisances,” “risks,” or “threats” to their existence, or simply an impediment to their thriving economic growth. To be effective, the mandates chosen must be aimed at the areas of overlap between firms’ private interests and the public interest in order for maximize the model’s benefit.

419 In the most recent survey of some 1,394 CEOs globally during the fourth quarter of 2003, “over-regulation” was rated as the number one risk by CEOs (the biggest threat to their business). Global terrorism was rated as the fifth risk factor. See Marc Champion, “CEO’s Worst Nightmares: An Old Bogeyman Replaces Terrorists Atop the List: Regulators” (Wall Street Journal Jan 21, 2004).

420 See, e.g., Regulatory Encounters: Multinational Corporations and American Legal Adversarialism, Ed. By Robert A. Kagan and Lee Axelrad. (University of California Press: Berkeley, Los Angeles and London (2000), reviewed by Sidney A. Shapiro, 50 Amer. J. Comp. L. 229 (2002). See also Sanford M. Jacoby, “Corporate Governance in Comparative Perspective: Prospects for Convergence,” 22 Comp. Labor L. & Policy J. 5 (2000) (comparing models of corporate governance between the U.S., Japan, and western Europe in order to assess trends of convergence). It should be noted, however, that the strong U.S. economy in sharp contrast to the more mediocre Japanese and European economies in the last decade may tend to imply the superiority of the U.S. model, if efficiency and wealth optimization are the standards for evaluating governance models. Overall, more concise studies and better empirical data are needed to render meaningful conclusions to the comparative analysis. Id. at 25-32.

One such area of overlap can be inferred from the fact that U.S.-based MNCs have long voluntarily devised corporate compliance policies and programs to curtail and police employee conduct, as well as to ensure compliance with existing U.S. laws and foreign laws where MNCs do business.\textsuperscript{422} (The same self-compliance trend and practice have long been established in the broker-dealer securities industry).\textsuperscript{423} These policies and programs are part of MNCs' legal defenses in litigation or in the event a government investigation is initiated. Where legal liability is found, these policies and programs can be taken into consideration by the judicial officer under the Federal Sentencing Guidelines.\textsuperscript{424}

Continuous emphasis on compliance training has already dominated the lives of international business executives and lawyers, considering the complex regulatory framework of U.S. laws with extraterritorial effects, among which are the Department of Commerce's export control, Department of Treasury's foreign asset control, Department of State's munition control, and the joint effort of the Department of Justice and the Securities & Exchange Commission over foreign corrupt practices.\textsuperscript{425} This emphasis has amply been evidenced by the wide range of corporate compliance programs in place in today's MNCs' internal regulations,\textsuperscript{426} as well as by the myriad of widely advertised continuing education programs organized by the American Practicing Law Institute (PLI).\textsuperscript{427}


\textsuperscript{425} See, e.g., Michael Deal, “Tactical and Practical Considerations in Defending Export Control Enforcement Actions,” 15 Int’l Q. No. 2, 163-188 (April 2003); Peter Fitzgerald, “Hidden Dangers in the E-Commerce Data Mine: Governmental Customer and Trading Partner Screening Requirements,” 35 The Int’l Lawyer No. 1, 47-70 (Spring 2001) (identifying all governmental regulations and control over export shipments and outbound international business transactions). See also Notes 76-80 and 440-448, supra (identifying U.S. laws with extraterritorial effects and governmental control over business transactions as a result of U.S. economic sanctions taken against foreign nations).

\textsuperscript{426} For General Electric’s compliance program, see http://www.ge.com/en/commitment/ehs/compliance/ehs_compliance.htm. Enron’s Code of Ethics and Corporate Compliance Policy are now available on-line following the scandal, illustrating the lips service exhibited by certain members of Enron management.


\textsuperscript{427} For various Practicing Law Institutions courses on corporate compliance for international business, see, http://www.pli.edu.
In the marketplace, these voluntary corporate compliance policies and programs have either stated the “bare-bone” minimum expectations, or they have voluntarily included all aspirations for a higher and more detailed level of legal compliance and ethics. Or, quite often, publicly traded corporations have fluctuated their written policy statements and programs on a spectrum between the two extremes. I suggest that new law in the home jurisdiction be enacted, requiring publicly traded corporations to devise and disclose corporate compliance programs designed specifically for their investments and economic conduct overseas. The contents of these programs, however, are completely voluntary. These international business corporate compliance programs will be required by the new law to be reported and filed with an overseeing non-partisan Commission appointed by the President, serving a set term. These voluntary programs will serve as the self-imposed standards for U.S.-based multinational corporations. The public will be able to scrutinize these self-imposed programs, which subject the MNCs to constant scrutiny and pressure by the poll of community opinion. This disclosure law serves to increase the level of public exposure, awareness, and more constant idea-stimulating debates. In other words, MNCs are given a free hand to set their own standards. Once the standards are set, MNCs will be motivated to implement them via measurable programs, if all such programs are required by law to be disclosed to the public. The ensuing public debate will lead to self-regulation. Since MNCs are already competing against one another for favorable public opinion, under this model, eventually industries will come up with their own universal code of conduct.

The proposal that the SEC should impose upon U.S.-based MNCs social accounting and social audit obligations and disclosures, at least with respect to environmental and civil rights issues, has already been injected into academic discourse and legal advocacy since the 1970s. Likewise, the concept of corporations’ self-governance and voluntary compliance with social goals has recently been brought to the attention of policymakers. The Clinton

The concept of an ad hoc governmental work group formed to review or scrutinize corporate data for a specific purpose and as part of a voluntary “notification” process initiated by the companies is already present in U.S. law. For example, under the Exxon-Florio amendment to the Defense Production Act of 1950 (enacted as part of the Omnibus Trade and competitiveness Act of 1988), the Committee on Foreign Investment in the United States (CFIUS) is an ad hoc governmental body acting as delegatee of the President to review incoming foreign investment and protect the U.S.’s national security interests. See Exxon-Florio Amendment to the 1988 Trade Act, Pub. L. No. 100-418, 102 Stat. 1425 (1988) (codified at 50 U.S.C. app. 2170 [hereinafter "Exxon-Florio," or "the Amendment," or "Exxon-Florio Amendment"]).

The issue of whether a new government body should be created, or whether the SEC should undertake the oversight function, is reserved for another day.

Administration issued the Model Business Principles in 1994, although the Principles did not provide for implementation or enforcement, and in 1997, it approved the apparel industry’s Workplace Code of Conduct, which reflected an agreement between the industry and various human rights groups. In 1997, two legislative proposals were tabled for U.S. lawmakers toward the goal of establishing voluntary codes of conduct for corporations, although neither was enacted into laws. The notable trend, as pointed out by a commentator, has been to encourage proactive self-regulated solutions volunteered by MNCs as an effort to correct or enhance their public corporate image, at least in the consumer goods and manufacturing sector and in the community of governmental contractors. The public benefit of encouraging corporations’ voluntary disclosure and self-compliance programs with respect to anti-discrimination laws has also been tabled by commentators for public debates.

In whatever form the final regulatory model may take, voluntary corporate compliance programs must extend beyond minimal compliance with a set of U.S. laws having mandatory extraterritorial effect. Specifically, the program should include detailed mandatory training for key expatriate and international business personnel on international relations, multiculturalism, cultural sensitivity, and geopolitical awareness, as I have suggested above. These compliance programs may also include what the MNC views as its goals, responsibilities, and implementation of self-imposed guidelines governing the MNC’s international workforce, foreign asset base, and investment strategies. The disclosure must be made under the “Plain English” rule, a principle already incorporated into the SEC’s disclosure requirements and guidance.


433 Cf. David Kahane, “Dispute Resolution and the Politics of Cultural Generalization,” Negotiation Journal 5-27 (January 2003) (advocating the use of multicultural contexts in devising deliberative processes for dispute resolution and negotiation, even if generalizations about cultural identities and values must be utilized for lack of a better alternative).

Professor Jacqueline Lang Weaver has lamented, “the key to preventing Enron-type scandals is disclosure...[but] what good is disclosure of something that almost no one can understand?"  

In summary, socially responsible citizenship in the world community by corporate America has an important role to play in the global economy. Short of an accepted universal Code of Conduct, the regulatory model to be used for governing MNCs should start with the home jurisdiction, modeled after the enforced self-regulation approach I discussed above. The model will turn the burden of being regulated into an opportunity for corporate America to showcase its social responsibility voluntary compliance. Ultimately, the self-regulation model must be elevated to a global level as part of the “legalization” or “internationalization” movement, and hence should not remain solely with the home jurisdiction. In other words, similar self-regulation models should be implemented in the Northern hemisphere (where most MNCs were formed or headquartered), among the developed nations sharing the same policy concerns. Otherwise, anomalous inequity will exist among MNCs. For example, U.S.-based MNCs will be burdened with the cost of funding and implementing the self-regulation model, whereas other MNCs may be able to escape such financial burdens simply because their home jurisdictions have not endorsed the same or similar model. This will result in the loss of competitive disadvantage for U.S.-based companies, causing them to be demoralized, and rendering the self-regulatory model ineffective.

4) Integration of Certain Prophylactic Principles of Law into the International Deal-Making and the “Legalization” Movement

The analysis of transactional patterns portrayed in this Article lends itself to certain legal concepts that can drastically change the landscape of current legal and business norms. However, the time and space constraint of this Article, as the beginner of a series, does not permit me to explore these legal solutions here in depth. I will, however, summarize my suggested legal solutions here, as a starter for further discussion elsewhere or on another day.

Consistent with the “source” doctrine in international law, certain general principles of law common to civilized nations should be incorporated into modern transnational economic law. Specifically, to help safeguard against the potential ills explored in this Article, the following three legal concepts should govern certain types of business partnership between “Third World” governments and the private sector.


a) The “Public Trust” theory and Government as the People’s Agent:

Property collectively belonging to the people is held in a “public trust” administered by the sovereign state. In industries where the state claims resource ownership for the “people,” the government holds the “people’s” property in “trust,” resulting in the creation of certain loyalty, care, and good-faith duties implicit in the role of governments as the “people’s” representatives. Whether acting in a sovereign or commercial capacity, a “Third World” government or its negotiating instrumentality is simply an agent of the people. Governments must, therefore, discharge their fiduciary duties in the execution and performance of contracts governing the disposition, use, and exploitation of “the people’s” property.

438 See, e.g., Borough of Neptune City v. Borough of Avon-by-the-Sea, 61 N.J.296, 303, 294 A.2d 47 (1972) (certain land “belonged to the sovereign but for the common use of all the people…”). The genesis of this principle is found in Roman jurisprudence, which held that “by the law of nature, the air, running water, the sea, and consequently the shores of the sea…were common to mankind…” Justinian, Institutes 2.1.1 (T. Sandars trans. 1st Am. Ed. 1876). That natural resources located beyond a nation-state’s continental shelf and exclusive economic zone belong collectively to humankind is also the tenet underlying the U.N. Convention on the Law of the Sea, U.N. Co. A/CONF.62/122, opened for signature Dec. 10, 1982, reprinted in 21 I.L.M. 1261 (entered into force Nov. 16, 1994).

439 In the context of property belonging to Indian tribes and other “aborigines of America,” U.S. courts have considered the government as trustee owing fiduciary duties to the people, measured by the same strict standards applicable to private trustees. See Ahuna v. Department of Haw’n Home Lands, 64 Haw. 327, 640 P.2d 1161 (1982) (recognizing Hawaiians as beneficiaries of trust; government as trustee, stating that “the trust obligations of [government] toward beneficiaries…may be determined by examining well-settled principles enunciated by the federal courts regarding lands set aside by Congress in trust for the benefit of other native Americans, i.e. American Indians, Eskimos, and Alaska natives…”). See also United States v. Mason, 412 U.S. 391 (1973); Seminole Nation v. United States, 316 U.S. 286 (1942) (“Under a humane and self-imposed policy…in many acts of Congress and numerous decisions of this Court, [the government] has charged itself with moral obligations of the highest responsibility and trust. Its conduct, as disclosed in the acts of those who represent it in dealings with the Indians, should therefore be judged by the most exacting fiduciary standards.”)

440 See, generally, John Pratt & Richard Zeckhouser, “Principals and Agents: An Overview,” in J. Pratt & R. Zeckhauser, eds., Principals and Agents: The Structure of Business, Boston, Harvard Business School Press (1985). For a stronger advocacy of government’s fiduciary duties derived from agent-principal relationship, independent from the archaic “public trust” doctrine; see Lloyd R. Cohen, “The Public Trust Doctrine: An Economic Perspective,” 29 Cal. W. L. Rev. 239 (Fall 1992) (“Government officials are, in an economic and legal sense, agents. The principals of government agents are the people…[T]he insufficient incentive of government agents to protect collective rights in property…suggests the merit of a procedural remedy that allows or even encourages private persons to assert collective rights. We might view this as something analogous to a shareholder’s derivative suit in which the individual shareholder brings suit on behalf of and for the benefit of the corporation. I emphasize that this problem, to the extent that there is one, calls for a procedural, rather than a substantive remedy. It merely confuses the matter to call this remedy an exercise of so parochial a thing as the public trust doctrine…”) (emphasis added).

441 For a representative commentary on the origin of the “public trust” doctrine, see Lloyd R. Cohen, “The Public Trust Doctrine: An Economic Perspective,” 29 Cal. W. L. Rev. 239 (Fall 1992) (“The public trust doctrine comes to us from English common law that was at least tangentially related to earlier Roman law”). For an articulation of the modern public trust doctrine applicable in environmental protection context, see Joseph Sax, Defending the Environment: A Strategy for Citizen Action 163 (1970).
b) The “Corporate Derivative Fiduciary Duty” theory: As contractors of governments acting as agents for the “people,” MNCs must derivatively exercise duty of care, good faith, and loyalty owed to the “people,” and must discharge those duties in the performance of their investment contracts with governments, whether or not such duties are expressly embodied or delineated in contractual language. In this sense, corporate entities contracting with governments for “sub-agents” of the “people,” Certain types of FDI contracts executed by government as “agent” of the “people” should be construed in light of this “fiduciary duty” overlay.

c) The “Third Party Beneficiary” theory: Correspondingly, where the government holds property in “trust” for the people, there exists in every contractual agreement between MNCs and host governments a silent and innumerable group of parties in interest: the “people” as third party beneficiaries of all such investment contracts. As the natural consequence of the “Public Trust,” “Government as People’s Agent,” or “Corporate Derivative Fiduciary Duty” theories, both the MNC’s shareholder public and the people of the “Third World” should be regarded as “third party beneficiaries” of MNCs’ partnerships with governments. The interests of these two groups of “third party beneficiaries” (quite often standing an ocean apart) may conceptually conflict, but ultimately can be brought together to a meeting point of consensus. The negotiation process, in which the IBT lawyer plays a pivotal role, can become the bridge upon which compromises are reached and mutual

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442 In U.S. common law, under limited circumstances, the U.S. Supreme Court has confirmed that government contractors can enjoy the type of sovereign immunity often derived from, or attached to, the government’s status. See, e.g., Brown v. General Servs. Admin., 425 U.S. 820 (1976). See also Lamb v. Martin Marietta Energy Systems, Inc., 835 F. Supp. 959 (W.D. Ky 1993) (applying government contractor defense to preclude contractor liability when judgment would expend itself upon public treasury). The following question should be raised: If a civilized, developed jurisdiction such as the U.S. has derivatively extended the benefit of the government’s status to a private contractor, why can’t the fiduciary duties imposed upon the government be similarly extended to the same private contractor acting on the government’s behalf?

443 In Government of Rwanda v. Rwanda Working Group, 227 F. Supp. 2d 45 (D.D.C. 2002), the federal district court recognized that a person who contracts with a foreign government for the performance of services may have agreed to act as the government’s agent and hence will owe the foreign nation a fiduciary duty and a duty of loyalty, as judged under U.S. domestic law.

444 See Joshua Karliner, The Corporate Planet: Ecology and Politics in the Age of Globalization (1997); Tony McAdams, 19 J.Legal Studies Education at 249 (globalization strives for the riches of the global market, while leaving the “people invisible”).

445 The notion that shareholders may directly or indirectly benefit or be injured by corporate management’s actions is firmly established in U.S. corporate law via the procedures of either derivative suits or direct class actions. See, e.g., Palmer v. U.S. Savings Bank of America, 553 A.2d 781 (N.H. 1989); Marx v. Akers, 88 N.Y.2d 189 (N.Y. App. 1996); Federal Rules of Civil Procedure R. 23(a) and (b); 23.1. See USCS Fed Rules Civ Proc R 23(2004). However, only in very narrow circumstances have U.S. courts recognized a shareholder’s right to sue as third party beneficiary of a contract between the corporate entity and a third party. Glass v. U.S., 258 F.3d 1349 (C.A. Fed. 2001) (shareholder had third party beneficiary status only if contract expressed promissor’s intent to benefit shareholder personally and independently of his or her status as shareholder).
economic goals achieved, but this must be done with the “people’s” interest in mind.

These legal concepts are nothing new. They have inherently been acknowledged in existing business and legal norms under national laws, although their full impact has not been made mandatory or formally proclaimed to be for the benefit of “Third World people.” For example, FDI contracts in the petroleum and energy sector already recognize the role of the host government as sovereign power granting foreign investors access to natural resources, land, and surface use, all proclaimed under national laws to be owned or controlled by the state on behalf of the “people.” In fact, these concepts exist in U.S. jurisprudence and do not have to be recognized as part of customary international law in order for them to be enforceable against U.S.-based MNCs with respect to their conduct abroad. The U.S. as a sovereignty has always proclaimed that its “jurisdiction to prescribe” has valid extraterritorial effect, which enables it to curtail the conduct of its nationals and citizens abroad. This extraterritorial effect as an extension of U.S. sovereign power has provided the basis for several bodies of important U.S. laws and regulations, with very harsh and far-reaching sanctions and impact, both for the protection as well as for the curtailing of U.S. nationals’ economic behavior overseas. Examples of these “ET effect” laws include federal income tax law, export control law, federal anti-trust laws, the Foreign Corrupt Practices Act (FCPA), economic sanctions law, certain aspects of U.S. anti-

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449 Export Administration Act, 50 U.S.C. App. 2401 et seq. (continued by Executive Order 13222, dated August 17, 2001, and implemented by regulations administered by the Bureau of Export Administration (BXA) found at 15 C.F.R. Part 774; Sections 736.2; Part 744; Part 746, Section 742.8-10; Part 742; Sections 734.4, 740.3(d), 736.2, and 770.3. See also Export Administration Regulations.; Simplification of Export Administration Regulations, 61 Fed. Reg. 12714 (March 25, 1996). For a non-U.S. view, see Harris, “The Extraterritorial Application of U.S. Export Controls: a British Perspective, 19 N.Y.U.J. It’l L. & Policy 959 (1987).


discrimination in employment laws, the Carriage of Goods at High Sea Act (COGSA), the Federal Bill of Ladings Act (FBLA), and most recently, the USA PATRIOT Act of 2001.

Further, these legal principles do have support in existing international law, and customary international law is part of the law of the United States. The traditional concept of “statehood” in international law implies the integration of three elements: 1) the “people”; 2) their territory; and 3) their representative government. If one of these three integral elements is missing, there is no statehood or sovereignty under international law. The interest of the “people,” therefore, is an integral part of any sovereign voice, yet the voice of the host government is not always synonymous with the voice of the “people.” At best, the notion that governments can best represent the interest of citizenry is like a rebuttable resumption -- in “Third World” business deals, whether governments effectively act for the “people” may present a gap between law and reality.

5) Incorporation of Two Practical Procedural Safeguards into the Current Pattern of Dispute Resolution Methods in International Deal-Making

International business disputes are often resolved via either institutional or ad hoc arbitration. Where an arbitration award is non-binding or otherwise


is challenged as invalid, or where arbitration has not effectively been agreed to, or otherwise cannot be enforced under the applicable law, there exists an opportunity for the foreign investor to bring a lawsuit against the host government or its SOE, or vice versa. (Suits will also have to be brought to enforce an arbitral award.) Where to file suit may practically depend on those assets of the defendant that are readily available for attachment or subject to judgment execution, together with other jurisdictional and “forum non conveniens” principles under the law of the forum where suit is filed (lex fori). The interpretation of international economic law by judicial and arbitral tribunals must include these “third party beneficiary,” “public trust,” “government as people’s agent,” and “corporate derivative fiduciary duty” concepts. These concepts must be applied to the adjudication or resolution of international disputes, as courts, arbitrators, and legal drafting workgroups seek to doctrinally “internationalize” cross-border business contracts in order to supplement and harmonize national laws, toward the formation of a rule-of-law system that hopefully meets the consensus, conscience, and confidence of our modern civilized world.


The doctrinal tension between a universal model of positivism and a relative multicultural concept allowing for variations of standards has been an ongoing debate in modern international jurisprudence. The post-Second World War efforts at a universal human rights framework, via U.N. documents such as the various post-World War II human rights conventions, see http://www.un.org/partners/civil_society/hr.htm, illustrate that a relative degree of success in attempting universal normatives can be achieved over time. However, the problem and challenge continue to be the teeth, and the enforcement realism of the current universal human rights framework. Universal human rights law, therefore, continues to be regarded as “soft” or aspirational law, rather than “hard” law having the effect of the “mandatory rules.” But a set of aspirational universal standards that can serve as a checklist or goals is still better than no standards at all. Law has both a prescriptive as well as an expressive function. In its expressive function, law allows a society of free men and women to declare behavioral standards and articulate “our aspirations for the kind of society we wish to be.” Stephen L. Elkin, “Libertarian Confusions,” The Responsive Community 49-58 (Fall 2002) (discussing Richard Epstein’s “The Principles of a Free Society”).
While the aforementioned legal concepts are sound and can even be viewed as jurisprudentially conventional, real-life issues do emerge in their application to certain FDI contracts. One such perplexing legal and practical issue is the challenge of identifying new causes of action for the “people,” or according legal standing and parties-in-interest status to potential litigants for access to the adversarial and decision-making processes, both nationally and internationally. Specifically, in contract negotiation, as well as in arbitral proceedings or lawsuits, who can speak the voice of the “peoples/third-party beneficiaries,” apart from the governments? (Currently, the voice of the people at times can be heard ad hoc and isolatedly, primarily via public opinion often expressed outside the developing nation, or in the work of international public interest or shareholder activism groups. The voices expressed by these groups can also be politicized or fragmented in their own esoteric way. Public opinion often varies and can highly be politicized by tension and competition among various interest groups, especially in our pluralistic global community.)

Instead of attempting to resolve substantively these perplexing and potentially highly politicized issues, I will simply advocate two practical procedural solutions:

a) Because the voice of the “third party beneficiaries” can relatively be represented by Non-Governmental Organizations (NGOs)/International Non-Governmental Organizations (INGOs), and other shareholder activist groups, these public interest organizations should be given limited access to the negotiation of FDI projects receiving Multilateral Financing, even though these groups are not parties to the investment contracts. As a matter of mandatory procedure, these groups must be invited to participate in the negotiation, at a minimum, in the form of written inputs presented to governments, the MNCs,

462 My choice to use procedural solutions to incorporate substantive law has support from at least one commentator. see Lloyd R. Cohen, “The Public Trust Doctrine: An Economic Perspective,” 29 Cal. W. L. Rev. 239 (Fall 1992) (“Government officials are, in an economic and legal sense, agents. The principals of government agents are the people...[T]he insufficient incentive of government agents to protect collective rights in property...suggests the merit of a procedural remedy that allows or even encourages private persons to assert collective rights. I emphasize that this problem, to the extent that there is one, calls for a procedural, rather than a substantive remedy. .”) (emphasis added).

463 More than 10,000 NGOs have developed around the globe as grassroots, public interest responses to global “civic” concerns. Organizations such as Amnesty International (human rights), Oxfam (poverty, hunger), and Greenpeace (ecology) have become highly visible and powerful. Anthony Giddens, The Third Way and Its Critics at 123, 144 (2000); Tony McAdams, “Globalization: New Demands for the Legal Environment of Business Course,” 19 J. Legal Studies Education 239, 247 (2001). The growth of NGOs suggests the vitality of an information market for the commercial future of the world. Id.

464 For an account of the history of recent partnership between NGOs and MNCs in the corporate ethics crusade, see Ethan B. Kapstein, “The Corporate Ethics Crusade” (Foreign Affairs September 1, 2001). See also Morton Winston, NGO Strategies for Promoting Corporate Responsibility, 16 Ethics and International Affairs 71 (Spring 2002). See also Hannah L. Buxbaum, “Conflict of Economic Laws: From Sovereignty to Substance,” 42 Va. J. Int’l L. 931 (2002) (“International, regional, and non-governmental organizations – rather than treaty negotiations between sovereigns – have...played an increasingly important role in the development of law applicable to transnational activity”).
and the various work groups within the Multilateral Institutions, with mandatory responses from these parties as a condition for funding. The negotiating parties to a deal will thus be placed directly under the pressure of formally responding to public scrutiny and to address public interest arguments during the formation of investment contracts. The selection of the participating public interest groups can depend on the recommendations of the Multilateral and other international organizations, including the United Nations and its various organs, and priority should be given to locally formed NGOs.\textsuperscript{465} This procedure does not compromise confidentiality objectives, because in most cases, high-profiled multi-million-dollar FDI projects receiving Multilateral Funding are physically visible, and already attract publicity and scrutinizing news coverage. This limited “participating” procedure will also force the Multilateral Institutions to voluntarily implement more transparency to their internal workings and application of funding criteria.

\textbf{b) Decision-makers in dispute resolution} – whether judges or arbitrators – should be mandated to consider voices of these same public interest groups by way of \textit{amicus curiae} briefs, testimonies, or equivalent. In this regard, confidentiality requirements traditionally accorded institutional or \textit{ad hoc} arbitration proceedings should be waived, but only to a limited extent. The resolution of international contractual disputes has traditionally been purely economic in substantive nature, and has remained private and confidential from a procedural perspective. Final resolutions have been popularized only by the mutual consent of the parties involved.\textsuperscript{466} The determination as to which INGOs/NGOs, or any other public interest groups may be allowed access to an otherwise confidential and private proceeding, and to what extent, can rest in the capable hands and sound discretion of judicial and arbitral tribunals, who already are called upon and charged with the expertise to make many decisions and to exercise discretion routinely in dispute resolution.

At a philosophical level, incorporating a “public interest” approach to MNCs’ international business deal-making as a way of monitoring MNCs’ behaviors is not a novelty concept. Similar proposals have been made to change the existing legal framework of corporate governance, although the effectiveness

\textsuperscript{465} Unfortunately, only approximately 15% of NGOs are from the developing countries. \textit{See} Errol E. Harris & James A. Yunker, Toward Genuine Global Governance: Critical Reactions to ‘Our Global Neighbors’ at 48 (1999). Tony McAdams, 19 J. Legal Studies Education at 241.

of these proposals in real-world dynamics remains questionable. For example, proposals to install “public interest directors” in Board composition have been challenged as merely serving a “window-dressing” function. In reality, these directors were regarded as antagonistic spies, were met with suspicion and treated with lack of cooperation and, hence, were often denied resources or information access. Eventually, they became co-opted into the mainstream culture, were transformed, and ultimately turned counterproductive to their original public interest mission. Likewise, proposals for corporate “social accounting” and “social audits” have also been criticized as “window-dressing,” unnecessarily increasing corporate expenditures without effectively furthering social goals. Accordingly, in whatever form the “management-based” self-regulation model may take, it should avoid the shortcomings of previous proposals. Its measurability, therefore, must be based on a “disclosure” or “monitoring” template that accomplishes all of the three following objectives: (i) allows management to become truly self-motivated in the competition for improved public image and goodwill in the marketplace; (ii) allows socially conscientious institutional investors and third-party institutions direct access to corporate governance; and (iii) allows regulators to effectively foster both management incentives and public-interest third-party input.

Rethinking Globalization, Legal Regionalism, International Harmonization and Standardization of Law

A global market is one in which geography, political or cultural norms do not restrain demand and supply. In a global market, economic functions are based on transnational interdependence. As such, the very notion of globalization threatens and undermines the sanctity of sovereign power. Globalization thus occasions the need for an integrated regulatory network in which sovereign mandates must be reconciled and compromised to avoid conflicts. Private enterprises will support such a network because it reduces the cost of compliance as well as the cost of dispute resolution under various national regimes. Because globalization enables the convergence of national substantive rules and legal norms, it serves the mutual interests of all economic and governmental actors.

International institutions have been, and will continue to be created to serve this goal. The WTO and NAFTA are examples of institutional frameworks created in the past decade, but these frameworks represent the perspective of governments. At the same time, the grouping of nation-states to develop legal norms (for example, a “regionalism” approach to the development of international economic law typified by the European Union model) has also forced nation-states to table their mutual interests and develop common grounds for “legalization.” Efforts to harmonize national legal rules by the U.N. Commission on International Trade Law (UNCITRAL), the International Institute for the Unification of Private Law (UNIDROIT), the International Chamber of Commerce (ICC), and other international legal work groups also demonstrate

this “legalization” trend. Yet, these institutional voices and efforts have not always truly reflected the interests of all market participants, especially those “Third World” inhabitants whose demand and supply needs are directly at stake.

The harmonization of national laws does little to serve the global market if harmonization starts from systems of national laws that serve the unitary voices of corporate giants supported by renewed “monarchies” as their business partners. In order for legal harmonization and economic globalization to be meaningful, the voices of “Third World” constituents who should be third party beneficiaries of certain government-private sector contractual arrangements in their countries should drive the goals of global economic development, just as much as other institutional voices have already participated in the process. But who is to speak the voice of such constituents? The regional and international law-drafting processes pioneered by work groups from the developed nations must be reexamined and expanded to include voices of other actors. Specifically, these processes must include input of international and local public interest groups representing the voices of “Third World” inhabitants, as diversely and as widespread as possible.

In examining the action and policy of the Bush Administration, liberal scholars have cautioned that unilateralism will intensify gaps and conflicts among political, economic, and religious cultures, confirming their notion that the U.S., or the “West” it symbolizes, is imperialistic. Only true multilateralism worked from the “bottom up” in terms of the development ladder, rather than the “top down,” can adequately address these issues. So far, the Multilateral Agencies, MNCs and governments have all become partners


“Every nation, in every region, now has a decision to make. Either you are with us, or you are with the terrorists…”

469 Scholars have referred to the trend of unfettered capital-driven force as “globalization from above,” distinguishable from ‘globalization from below,’ which encompasses the notion of the welfare state. See Tony McAdams, 19 J. Legal Studies Education at 268, citing Richard Falk, Predatory Globalization: A Critique 13-17 (1999) (“[G]lobalization from below…would work to humanize and democratize the process of globalization and give attention to citizen interests not meaningfully represented by the current globalization-from-above [patterns]). Accord Dorval Brunelle, Alternative to Globalization (Black Rose Books Winter 2004) (suggesting “World Economy and Fair Trade” as alternative to “Globalization and Free Trade”; advocating engagement at both local and global levels).
in “Third World” economic development, in ways that may not always benefit the native inhabitants. Although the Multilaterals, in their fifty years of history, have been subject to much scholarly and community criticism with respect to their economic policies, they have also been praised for the *de facto* expansion of their original goals – a phenomenon described by commentators as the “mission creep.” This “mission creep” embraces other public concerns into the bundle of “economic considerations” traditionally characterizing the Multilaterals’ missions. This is the current status of “economic multilateralism” and “Third World” economic cooperation at the beginning of the new millennium.

Globalization will only bear its fruits if it gives birth to a truly stronger, healthier, and all-encompassing “middle class” that transcends national and cultural borders. The emergence of such a borderless middle class will quickly alleviate the clash between the culturally or economically dominant and the culturally or economically oppressed, because the overall economic model strives to include all. To achieve this vision, all diverse voices and interests should be reflected in the pattern of global economic development.

But even if the voices of INGOs, NGOs, and public interest groups are included and legitimized as part of negotiation and dispute resolution, this liberalization or expansion of processes does not necessarily assure that the interest of “Third World people” is adequately protected. The protection of these “third party beneficiaries” can only be ultimately achieved in the formation and development of international economic law itself. Whether influenced by a common-law or civil-law system, the harmonization of law, as well as the accompanying legal drafting and development processes should not be left isolatedly to national courts or confidentially shielded arbitrators who determine outcomes of disputes on an *ad hoc*, case by case basis. Harmonization should become part of an agenda that join together all economic, political, and public interests. Watchdog functions must be accomplished through 1) the dynamics of special interest lobbying and promulgation of multinational regulations by the MNC’s home country under its prescriptive jurisdiction; 2) the law-making processes of the host country, whereupon the public interest voices are consulted and allowed to be involved


471 The “mission creep” has prompted commentators to question whether roles of the Multilaterals should be expanded to include the implementation and enforcement of international humanitarian law. *See, e.g.*, Daniel D Bradlow, “Should the International Financial Institutions Play a role in the Implementation and Enforcement of International Humanitarian Law,” 50 Kansas L.Rev. 695, 707-09 (2002).

472 Tony McAdams, 19 J. Legal Studies Education at 245, 252 (observing that critics view WTO, World Bank, and IMF as tool of rich industrial interests, and that these institutions restrict government programs in developing nations toward further promotion of free market strategies imposed upon loan recipients).

in the drafting stages; and 3) last but not least, long-term meaningful political changes in the developing economies. Only responsible and competent governments can truly bring about true economic prosperity for the “Third World” public, but this can only be achieved if equal opportunities in education become available to “Third World” inhabitants as a necessary infrastructure for the future. Otherwise, regime changes in response to political chaos will simply be the outcome predicted in George O’Well’s classic Animal Farm – there is a change of guards, but the new guards are just a different manifestation of the old ones. This has been the hard fact of our world. The lesson of Vietnam (as we have been discussing the Vietnam Deal) should set a “déjà vu” path to be watched out for, with respect to central Asia and oil-rich Iraq currently awaiting stabilization and development.

The Role of MNCs and the Need for a Formalized Public Interest Approach Toward International Deal-Making

The world community continues to face serious issues such as the eruption of violence, military aggression, or act of war, all legitimized by slogans of national security, religions, and territorial principles. Addressing these issues isolatedly in accordance with the political agenda of countries’ leaderships is to ignore the true undercurrent dynamics and the synchronized, cause-and-effect nature of these issues. Root causes, direct or indirect, contributing or primary, must be examined. Perhaps one such root cause is the increasing gap between the rich and the poor, regardless of national borders. Perhaps another such root cause is the disguised return of colonialism and monarchies, whether intended or coincidental. It is hoped that this Article helps identify a small part of the landscape upon which some of these root causes may have arisen, ultimately raising these issues to a different level of awareness.

Despite the rapid privatization process since the collapse of Marxism as an obsolete economic model in Europe, the nation-state nonetheless remains the major economic force in the developing countries, and is likely to retain its role in the foreseeable future. The continuing state involvement in business transactions with MNCs occasions a number of contractual techniques that become legal norms by repetitive and prevalent usage and impact. The fact that the MNC-host government contract remains the main tool for patterning global economic development is not a vice in itself. After all, freedom of contract and the exercise of bargaining power are the gist of free enterprise. What may be problematic is the way in which the contract is formed and implemented. The goal, therefore, is not necessarily to eliminate these partnerships, as they are essential to nation building and the development of a world economy. Instead, there is a need for a formalized mechanism to enable public scrutiny of these partnerships. These partnerships must be examined, perhaps with more transparency, notwithstanding their confidential nature, via the direct participation of independent public interest actors, such that changes can take place in the way these partnerships are formed and shaped. Such a formalized “public interest” approach to the formation and interpretation of foreign

investment contracts in certain industries comports with the spirit of what scholars have considered as the compassionate “Third Way” movement to global economics. The “Third Way” movement advocates “social democracy” based on social commitments to the poor and the disadvantaged without undermining free market.475

MNCs do not categorically qualify as “bad guys” just because they are rich. Modern society’s extraordinary economic and technological progress brought about by major corporations is undisputed. What IOGCs are doing in the worldwide petroleum and energy sector simply reflects what humans have been doing since the beginning of history – the uncovering of natural resources to serve the needs for human survival and technological betterment. Today, if armed with a better breed of corporate counsel and executives, together with a differently focused, self-imposed corporate code of social responsibility, MNCs are among the group of actors best situated to address global issues – from poverty, inequality, race, gender and religious discrimination, child labor, environmental pollution, overall workforce abuse and exploitation, as well as the wise and effective use of state-of-the-art technology to serve humankind. This “social responsibility” mission is only possible via the individual awareness and changing attitude of the MNC international executive and his/her lawyer, working in pair as they continue their globe-trotting. The focus on MNCs should not be the rhetoric of holding money or power as the source of evil, since free enterprise should freely be at work. Rather, scrutinizing MNCs’ conduct should constitute a wake-up call regarding the need for a formalized, systematic public interest check-and-balance approach toward the internationalization of law.

Overall, considering all angles of public debates, the stern critic and thoughtful policymakers should question whether the ultimate objective of the multilateral process – the eradication of “Third World” poverty, as administered via institutions such as the World Bank, the IMF, and the WTO -- has adequately been discharged, and how government-MNC partnerships have helped or have hurt “the dream of a world free from poverty.” As the first step, new legal mechanisms must be made available for exclusive and confidential MNC-host government partnerships to formally include the voices of “Third World” inhabitants via independent public interest advocacy. No solution will emerge overnight, but as a starting point and for many years to come, this Article hopes, at a minimum, to invite a dialogue on how these new legal mechanisms must be structured and implemented.

Glossary of Legal and Industry Jargon and Acronyms

(to be developed only if requested by accepting journal or publisher
and can be supplied within one week to 10 days)