PARTNERSHIPS WITH MONARCHS — TWO CASE STUDIES:

CASE ONE

PARTNERSHIPS WITH MONARCHS IN THE SEARCH FOR OIL: UNVEILING AND RE-EXAMINING THE PATTERNS OF "THIRD WORLD" ECONOMIC DEVELOPMENT IN THE PETROLEUM SECTOR

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"L'Eveque D'York: Le Roi est la force et il est la loi.
Becket: Il est la loi écrite, mais il est une autre loi, non écrite, qui finit toujours par courber la tête des rois."
JEAN ANOUILH, BECKET OU L'HONNEUR DE DIEU, 3ième acte

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 . . ."
JEAN ANOUILH, BECKET OR THE HONOR OF GOD, Act 3

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NOTE FROM THE AUTHOR

This Article is part of a "twin series." The "twin series" consists of two case studies representing two major types of international business transactions ("IBTs") in the capital-intensive petroleum and energy sector. Case One explores and critiques the current patterns of "Third World" economic development in the exploration for, development and production of petroleum resources.\(^1\) Case Two, to be published in the forthcoming issue of this Journal, focuses specifically on the development of energy resources once petroleum has been extracted. Case Two dissects an Independent Power Project ("IPP") and then re-evaluates the role played by Multilateral and Project Financing in such a project. The overall purpose of these two case studies 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\(^2\) in this important sector, in hopes of spurring further studies and dialogues.

Although each case study is presented under separate title and published independently in two consecutive issues of this Journal,

\(^1\) The term "petroleum industry" is used herein to include all integrated companies that specialize in, inter alia, the exploration and discovery of petroleum, including both Crude Oil and Natural Gas. For Crude Oil and Natural Gas legal definitions in petroleum agreements, see infra note 293. 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 that energy is petroleum.

\(^2\) The phrase "foreign direct investment" ("FDI") refers to the type of transaction that generates a direct flow of capital, labor, and services across borders. FDI is distinguishable from "portfolio" investment, such as ownership of shares in a mutual fund or passive stock ownership. RALPH H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS (6th ed. 2003); see also George Thomas Ellinidis, Foreign Direct Investment in Developing and Newly Liberalized Nations, 4 J. Int'l L. & PRAC. 299 (1995) (defining FDI and assessing the risks inherent in it); cf. Enrique R. Carrasco & Randall Thomas, Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis, 34 COLUM. J. TRANSNAT'L L. 539, n.3 (1996) (defining portfolio investment as investment that results in no managerial responsibilities despite investment in financial assets). Before the beginning of the new millennium, as of 1998, FDI volume in the industrialized nation-members of the Organization for Economic Co-operation and Development ("OECD") reached $465 billion. OECD, Recent Trends in Foreign Direct Investment, FIN. MARKET TRENDS, June 1999, at 113.
both titles should be considered part of one single comprehensive study and analysis, with the second case study serving as a continuation of the first. Both cases together represent the full cycle of petroleum resources development—they describe what happens when gas is found offshore and then transported onshore to be used as fuel for the generation of electricity in the host country. Only when readers examine both cases together and consecutively will the author’s objective be fully achieved—to offer the academic and legal community a comprehensive and critical examination of the patterns of economic development in a developing economy. The final conclusions offered by the Author are based on both case studies and will be included in the next issue of this Journal.

Both cases use the Socialist Republic of Vietnam as the representative deal and factual context.

1. INTRODUCTION

1.1. 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.\(^3\)

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.\(^4\) The

\(^3\) See, e.g., WOLFGANG G. FRIEDMANN & JEAN-PIERRE BÉGUIN, JOINT INTERNATIONAL BUSINESS VENTURES IN DEVELOPING COUNTRIES (1971) (giving specific examples of joint international business ventures in the developing world); see also Aaron Bernstein, Welch's March to the South, BUS. WK., Dec. 6, 1999 at 74, 78 (stating that from 1986 to 1999, General Electric’s U.S. workforce fell by nearly fifty percent, while its foreign workforce nearly doubled); cf. Ellinidis, supra note 2 (explaining the risks inherent in FDI). For the view that the world’s resources are returned to the northern industrialized nations to feed the need of consumerism, see Tony McAdams, Globalization: New Demands for the Legal Environment of Business Course, 19 J. LEGAL STUD. EDUC. 239, 263 n.159-60 (explaining that the northern industrialized nations, with twenty to twenty-five percent of the world’s population, use about eighty percent of world resources). See also Michael Casey, Emerging Markets Re-emerge as Attractive Places to Invest, WALL ST. J., Mar. 13, 2002 (noting the return of investors to emerging markets such as those in Southeast Asia).

\(^4\) See, e.g., Cheryl W. Gray & William W. Jarosz, Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe, 33 COLUM. J. TRANSNAT'L LAW 1 (1995) (discussing the effect of legal rules on development in
European Union approved new memberships and continued to harmonize national laws as part of its regional integration policy.\(^5\) China actively sought membership in the World Trade Organization ("WTO") and, after much controversy, succeeded.\(^6\) 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),\(^7\) were believed to have grown faster than the developed nations.\(^8\) Trends of privatization and de-
regulation in the former centralized economies offered U.S. 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 large-scale and capital-intensive investments by the multinational corporations ("MNCs").

The economic prosperity of the Clinton era including the United States, for the year 2002, even with the economic crises of the late 1990s.)

9 Although the worldwide conduct of Multinational Corporations ("MNCs") has been a focal point for the international legal community, there is no universally accepted legal definition of the term MNC, even if such definition is critically needed for regulatory purposes. See, e.g., David Weissbrodt & Muria Kruger, Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, 97 AM. J. INT'L L. 901 (2003) (discussing definitional issues for enterprises governed by U.N. initiatives attempting to regulate MNC conduct).

Rather than propose a legal definition, Professor Mark Baker described MNCs as "entities [that] potentially [are] more economically powerful than Stalin's Soviet Union, and with more broad-based political influence than the Third Reich." Mark B. Baker, Tightening the Toothless Vise: Codes of Conduct and the American Multinational Enterprise, 20 WIS. INT'L L.J. 89, 89 (2001). But see McAdams, supra note 3, at 244 (attempting definitions for "international company," "multinational company," and "global company," observing that most multinational firms are more national and regional in nature, rather than truly global). Some efforts at a loose definition developed for the convenience of discussion and consensus building have been made by authors. For example, a MNC is defined as an entity who "owns (in whole or in part), controls, and manages value-adding activities in more than one country," and who "engages in production and/or service activities across national boundaries, financed by [FDI]." Thomas L. Brewer & Stephen Young, The Multilateral Investment System and Multinational Enterprises 11 (1998); see William H. Meyer, Human Rights and MNCs: Theory v. Quantitative Analysis, 18 HUM. RTS. Q. 369 (1996) (defining MNCs simplistically as corporations with affiliates or business establishments in more than one country); see also Peter Muchlinski, Multinational Enterprises and the Law 12-15 (1995) (considering the problems in defining MNCs).

(with its restoration of balance to the global market after the Asian and Latin American currency crises in the late 1990s) reinforced the United States' position as an economic superpower, fortifying the dominance of corporate America in the global economy.10

In particular, because domestic reserves have been depleted or otherwise off-limits 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 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.11 Yet, the "crown jewels" of the "Third World"12 may, or

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10 Recent economic studies challenge the conclusion that economic integration among the developed economies has fundamentally raised the correlation between U.S. growth and growth in other G-7 nations (Canada, France, Germany, Italy, Japan, and the United Kingdom). See, e.g., Brian M. Doyle & Jon Faust, An Investigation of Co-movements among the Growth Rates of the G-7 Countries, 88 Fed. Res. Bull. 427, 427 (2002) (arguing that shocks to economic growth may cause a simultaneous fall in output in many countries "even in the absence of any linkage across borders.").

11 In this Article, just as the acronym MNCs is used to refer to "Multinational Corporations," IOGCs will refer to "International Oil and Gas Companies" as a specific type of MNC.

12 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, Apr. 15, 1994, Marrakesh Agreement Establishing the WTO [hereinafter WTO Agreement], Annex 1A, THE LEGAL TEXTS—RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 143 (1999), 33 I.L.M. 1153 (1994) [hereinafter TRIMS Agreement] (explaining that "[o]n request, the Council . . . may extend the transition period . . . for a developing country Member."). available at http://www.wto.org/english/
may not have brought about a better life for the average "Third World" citizen. To date, many developing nations with petroleum resources are still struggling with poverty, corruption, and lack of resources.

In the 1980s, the term “Third World” was still used 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 careening in different directions at a bewildering rate.” Anatole Kaletsky, *A Dismal Outlook - For Some*, FIN. 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) (using 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 L. STUD. 1, 7-11 (1998-1999) (arguing that stereotypes of impurity and backwardness are essential to all understandings of “Third World”); Karin Mickelson, *Rhetoric and Rage: Third World Voices in International Legal Discourse*, 16 WIS. INT’L L. J. 353, 361-62 (1998) (observing the challenge posed by the “Third World” to accepted Western notions of history and international law).

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 JULIAN BURGER, REPORT FROM THE FRONTIER: THE STATE OF THE WORLD’S INDIGENOUS PEOPLES 11 (1987) (noting that the conventional term of “statehood” cannot be applied since “[i]ndigenous people number over 200 million and . . . live in all the five continents . . . .”); SADRUDDIN AGA KHAN & HASSAN BIN TALAL, INDIGENOUS PEOPLES: A GLOBAL QUEST FOR JUSTICE 36 (1987) (“All indigenous nations have the right of self-determination.”); FRANZ SCHURMANN, THE LOGIC OF WORLD POWER (1974); JACQUELINE STEVENS, REPRODUCING THE STATE (1999) (discussing the types of personal relationships that lead to political association); see, e.g., Ward Churchill, *The Law Stood Squarely on Its Head: U.S. Legal Doctrine, Indigenous Self-Determination and The Question of World Order*, 81 OR. L. REV. 663, 700 (2002) (describing the “Fourth World” as being 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).

13 See Baker, supra note 9, at 102-05 (describing how industrialized nations are draining the resources of the “Third World” and consequently enlarging the gap between the rich and the poor); see also Roger D. Billings, Jr., *Why Business Fails in Russia*, 35 INT’L LAW. 123 (2001) (discussing social and legal problems in post-Yeltsin Russia as an example that natural resources and an attempt at democracy did not guarantee economic or societal success).

the social turmoil often associated with the unhealthy economic gap between the rich and the poor within their own populace. For example, both Chad and Nigeria offer examples that rich petroleum reserves have not cured poverty issues or otherwise helped stabilize society.  


See, e.g., Baker, supra note 9, at 102 (discussing the disparity in income and the gap between the rich and poor in developing nations, as well as the gap in economic power between North and South).

Chad has recoverable reserves estimated at one billion barrels. At various times the following multinationals have been in Chad: Chevron, Conoco, Exxon-Mobil, and Shell. MBendi, Chad: Oil and Gas Industry Overview, at http://www.mbendi.co.za/indy/oilg/af/ch/p0005.htm. (last visited Nov. 20, 2004). Major Petroleum Activities in connection with oilfield and pipeline projects began as of 2000. CIA, Chad: Economy, in THE WORLD FACTBOOK, available at http://www.cia.gov/cia/publications/factbook/print/cd.html (last visited Nov. 20, 2004). Approximately eighty percent of Chad’s population is reportedly living below the poverty line. The infant mortality rate is at 95.75%. The average life expectancy from birth is approximately 48.51 years. Id.

Nigeria is the twelfth largest overall producer in the Organization of Petroleum Exporting Countries ("OPEC"), the tenth 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 two million barrels per day ("bbl/d"). 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. MBendi, Nigeria: Oil and Gas Industry Overview, available at http://www.mbendi.co.za/indy/oilg/af/ng/p0005.htm (last visited Nov. 20, 2004). Nigeria has continuously been listed by TI as the most corrupt country in the world. See Transparency Int’l, TI Corruption Perceptions Index 1996, at http://www.transparency.org/cpi/1996/cpi1996.pdf (last visited Nov. 21, 2004); see also Transparency Int’l, supra note 14 (comparing corruption among different
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 creation of the U.S.-led global coalition for fighting terrorism, and the unilateral approach of the United States (and its United Kingdom ally) in striking preemptive war against 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

countries. As of 2000, approximately sixty percent of Nigeria's population was reportedly living below the poverty line. The infant mortality rate was approximately 71.35%. Life expectancy at birth was approximately fifty-one years. CIA, Nigeria, in THE WORLD FACTBOOK, available at http://www.cia.gov/cia/publications/factbook/print/ni.html (last visited Nov. 20, 2004).


17 With respect to the U.S.-U.K. political and military alliance and occupation of Iraq (in contrast to France's vehement objection), the following facts suggest a similar (perhaps coincidental) alliance between U.S.- and U.K.-based IOGCs (as opposed to 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., Peggy Hollinger, BP and Mobil in European Fuels Merger: Annual Sales of Joint Operation to Exceed $20bn, FIN. TIMES, Feb. 29, 1996, at 1 (describing the success of the BP and Mobil joint venture); David Lascelles, BP and Mobil Aim to Get in Front and Stay There, FIN. TIMES, Feb. 29, 1996, at 21 (describing a partnership between BP and Mobil); see also Martha M. Hamilton, 3 Big Oil Firms Weigh Joint Venture: Merger of Refining, Marketing Operations Could Redefine Industry, WASH. POST, Oct. 8, 1996, at D1 (discussing merger trends and Mobil-BP and Shell-Texaco-Saudi Arabia's Armaco alliances).


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.\textsuperscript{18}

1.2. \textit{Summary of Objectives}

This "twin series" Article establishes two propositions:

(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."\textsuperscript{19}

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 \textit{Production Sharing Contract} ("PSC") or its variation—a cooperative model between IOGCs and host governments—has evolved into a


\textsuperscript{19} The term "monarch" was first used in this context by N.E. Maryan, formerly senior counsel for Exxon-Mobil and adjunct professor of law at Georgetown University. \textit{See} N.E. Maryan, Jr., \textit{Negotiating with the Monarch: Special Problems When the Sovereign Is Your Partner}, 745 PLI/Comm. 117, 130 (1996).
standardized model for petroleum exploration all around the world, and has dominated startup FDI in the petroleum industry for the past three decades. An IOGC-host government partnership such as the PSC model presents special legal issues, due not only to the unique nature of multinationals doing business in the developing nations, but also to the special status and sovereign powers of governments, well-supported in international law and political philosophy. This “twin series” Article explores these unique issues in the context of petroleum and energy FDI transactions typically supported by a complex, “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, called “Multilateral Financing.” The petroleum and energy sector is selected 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 has accumulated a multimillion-dollar foreign asset base and dispatched U.S. expatriates to handle transactions and projects in remote parts of the world such as Vietnam, Indonesia, Nigeria, and 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

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20 See, e.g., Mark W. Janis, An Introduction to International Law 157-59 (3d ed. 1999) (exploring international legal rules and process, and examining how these affect international relations); see also Thomas Hobbes, Leviathan (Everyman’s Library ed. 1987) (1651) (celebrating the sovereign state).

21 After the global depression of the 1930s and the Second World War, delegates of some forty-four 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 IBRD (also “Multilaterals,” “Multilateral Agencies,” “Multilateral Organizations,” or “Multilateral Institutions”). See David J. Bederman, International Law Frameworks 143 (2001) (attempting to establish a framework for understanding international law). These two institutions, comprising some 183 state-members, are the grandest and most established Multilaterals. Multilaterals also include the regional institutions such as the Inter-American Development Bank, the Asia Development Bank, and the European Bank for Reconstruction and Development, as well as other World Bank affiliates such as the Multilateral Investment Guarantee Agency (“MIGA”) and the International Finance Corporation (“IFC”). These Multilaterals are also called the “International Financial Institutions” (“IFIs”). See, e.g., Margaret Hanson, The Global Promotion of Transparency in Emerging Markets, Global Governance 9, 63-79 (2003) (discussing roles of IFIs). The term “Multilateral Financing,” therefore, refers to funding provided by these Multilateral Agencies.
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 perspective.) These gaps are explained below.

The first gap 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 repeatedly used,

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See, e.g., John G. Scriven, Corporate Responsibility and Regulating the Global Enterprise, 16 TRANSNAT'L LAW. 153 (2002) (presenting the Symposium: The Globalization of Corporate and Securities Law in the 21st Century); see also Weisbrodt & Kruger, supra note 9 (providing an inventory of scholarship discussing MNCs' conduct).

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 here) 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. Dowling, Forum Shopping and Other Reflections on Litigation Involving U.S. and European Businesses, 7 PACE INT'L L. REV. 465 (1995) (emphasizing the importance of forum selection for international contractual disputes). This is due to the fact that the norm of dispute resolution in
they are elevated to legal norms that help shape international economic law, or modern lex mercatoria. In-depth scholarly litera-

international business transactions ("IBTs") has been either institutional or ad hoc arbitration, rather than a full-blown judicial resolution in a court of law. See GARY BORN, INTERNATIONAL COMMERCIAL ARBITRATION IN THE UNITED STATES 5, 11 (1994) (discussing the various respective strengths of institutional and ad hoc arbitration); Daniele Favalli, Survey of Recent Developments in International Arbitration, TEX. TRANSNAT'L L.Q. 14-18 (2001) ("By most appearances, the popularity of arbitration as a means of resolving international commercial disputes has increased significantly over the past several decades.").

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 trade 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) (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, 229-30 (1994) (describing lex mercatoria). 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 originating 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, for example, FILIP DE LY, INTERNATIONAL BUSINESS LAW AND LEX MERCATORIA 15-20 (1992); JANIS, supra note 20, at 275-79 (narrating the emergence of modern international commercial law from lex mercatoria); Eric Engle, Corporate Social Responsibility (CSR): Market-Based Remedies for International Human Rights Violations? 40 WILLIAMETTE L. REV. 103 (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 . . ."); John Honnold, The Influence of the Law of International Trade on the Development and Character of English and American Commercial Law, in THE SOURCES OF THE LAW OF INTERNATIONAL TRADE 70 (Clive M. Schmitthoff ed., 1964).

The phrase "international economic law" or "transnational economic law" has broader meaning than "international commercial law," which governs international sales, export-import transactions, and the shipment and distribution of goods and services. The concept of a broader body of "international economic law" was envisioned by Jessup to denote the equivalent of "customary international law" in the domain of economic and commercial relations. PHILIP C. JESSUP, TRANSNATIONAL LAW 2 (1956); see BEDERMAN, supra note 21 at 141; Hazel Fox, The Definition and Sources of International Economic Law, in INTERNATIONAL ECONOMIC LAW AND DEVELOPING COUNTRIES (Hazel Fox ed., 1992) (reviewing the development of international economic law literature); cf. Michael W. Gordon, A Comment on the Recent Change of the Name of the University of Pennsylvania Journal of International Business Law to Journal of International Economic Law, in RALPH H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS: A READER 25 (3d ed.) (providing satire on the emerging use of the phrase "international economic law"). On Jessup, see Oscar Schachter, Philip Jessup's Life and Ideals, 80 AM. J. INT'L L. 878 (1986).
tures 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 as a source of continuing legal education material to enhance their practice experience. 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 literature 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 multimillion-dollar MNC-government partnerships. With this "twin series" Article, I hope to meet that need by unveiling and explaining the esoteric and technically complex international petroleum and energy transactions. The explanation hopefully will dispel myths and provide 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 task of analyzing or monitoring MNCs' conduct or fashioning policies and relief for effective "Third World" economic development may run the risk of becoming cliché, mere rhetoric, and even euphemism. So far, any such empirical undertakings have been the exclusive province of economists, international think-tanks,

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25 For example, the international law debates continue as to whether foreign investment is highly beneficial to the developing states (the "neo-classical theory"), or whether FDI as practiced by MNCs is generally detrimental to "Third World" development (the "dependency theory"). T.J. Biersteker, *Multinationals, The State And The Control Of The Nigerian Economy* 3-51 (1987); see also James D. Nolan, *A Comparative Analysis of the Laotian Law on Foreign Investment, the World Bank Guidelines on the Treatment of Foreign Direct Investment, and Normative Rules of International Law on Foreign Direct Investment*, 15 Ariz. J. Int'l & Comp. L. 659 (1998) (outlining the debate as to FDI's beneficial or detrimental nature); Burns H. Weston, *The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth*, 75 Am. J. Int'l L. 437, 460 (1981) ("[A]t this stage in history the achievement of a world economy of human dignity requires at least some kinds of [FDI].").
and the Multilateral Institutions in support of their own missions. Legal academia 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 and 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

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For an individual effort at drawing correlations between free trade under NAFTA and "Third World" poverty using Mexico as an example, see Richard C. Williams, Globalization and Its Effects on the Developing World, Hand-Out Accompanying Address Before the Rocky Mountains Harvard University Club (Apr. 27, 2003) (unpublished manuscript, on file with the author). Richard C. Williams, Ph.D., concludes that since the execution of NAFTA, poverty statistics have become worse, based on data taken from websites for the Alliance for Responsible Trade, the London School of Economics, the International Labor Organization ("ILO"), the World Bank and its affiliates. Id. For example, since the implementation of NAFTA, the percentage of the Mexican population living in poverty (i.e., below $7.30 a day) increased from 58.5% to 79%. Id. At the beginning of globalization (approximately the 1960s), the rate of world unemployment, underemployment, and incomes under one dollar per day was less than twenty percent. Id. As of 2003, this percentage stood at approximately forty percent, according to ILO data. Id. 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 interpretations of World Bank data contradict Dr. Williams' conclusion—the global poverty rate did fall from twenty-nine percent to twenty-four percent, according to 2000 World Bank factsheets. See McAdams, supra note 3, at 254 n.100 (citing WORLD BANK GROUP, supra). 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.
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 "twin series" Article will spur further studies conducted by the legal academy, thereby firmly establishing the need to draw empirical data and make meaningful conclusions. In other words, better


28 For example, Tamara Lothian and Katharina Pistor have argued:

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.

Tamara Lothian & Katharina Pistor, Local Institutions, Foreign Investment and Alternative Strategies of Development: Some Views from Practice, 42 COLUM. J. TRANSNAT'L L. 101, 103-06 (2003). They 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. Id. at 108 (emphasis added).
studies and statistics are needed to support causative claims.29

1.3. Summary of Arguments

This Article will proceed as follows: Section 2 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 becomes the context for the discussion in Section 3. Section 3 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" IPP in which natural gas that is discovered is used to generate electricity. The discussion in Section 3 encompasses the following four unique legal and business issues, 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 open-door economy policy that invites the MNC to be in the country in the first place! These de facto cartels foster, promote, and fortify the power base of the host government's ruling elites, who become the "monarchs" of the twentieth and twenty-first centuries. This monopolistic pattern defeats the ultimate objective of free enterprise: the spreading of wealth and attainment of prosperity, based on a level playing field 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

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29 For example, one such causative claim that needs to be examined is whether the "shareholder's wealth maximization" model of U.S. corporate laws and its underlying philosophy has occasioned more economic inequality in the United States compared to other nation-members of the OECD. OECD statistics since 1996 seem to support this conclusion. See, e.g., 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, 541 (2000) (arguing "shareholders' core problems in the public firm cannot be readily resolved in a strong social democracy."). To the best of my knowledge, the impact of the U.S. model upon global economic inequality has not been tested, challenged, or otherwise examined or re-examined by way of empirical sampling.
programs. These bonus payments 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" into a governmental apparatus that may already be plagued by abuse of governmental power. Accordingly, I suggest that major industry players 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 PSCs or similar investment contracts. Cash bonuses should be replaced with 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 the MNC's long-term presence or elitist foothold in the country. Further, the very nature and purpose of the Stabilization Clause makes it inherently incongruent and legally problematic. The Stabilization 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 ("SOEs")—the MNC needs to recognize the

30 Interestingly, the United States' anti-corruption law in international business, the Foreign Corrupt Practices Act ("FCPA"), creates an exception from liability commonly described by lawyers and corporate executives as the "grease payment" exception. 15 U.S.C. § 78dd-1(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. United States v. Kay, 359 F.3d 738 (5th Cir. 2004) ("grease payments" are legal under the FCPA because they are considered part of the custom of doing business in certain foreign countries); United States v. Castle, 925 F.2d 831, 833 (5th Cir. 1991) (same); see also Toral Patel, Corrupt Practices in India: No Payoff, 20 LOY. L.A. INT'L & COMP. L. REV. 389 (1998) (discussing routine "grease payments" made in India).

sovereignty's power, yet, at the same time, must limit and
denounce such sovereign power when the "monarch" is engaging in
commercial activities.

(4) Project Financing as a means to isolate MNCs' corporate assets
from Political Risk exposures in the developing economies. Project Fi-
nancing has poured billions of dollars of funding into the "Third
World," either separately or as piggybacks of Multilateral Financ-
ing. (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 Multi-
lateral Financing—operate as a risk-allocation mechanism that ul-
timately puts risks of loss upon the taxpayers of the developed na-
tions, as well as the poor inhabitants of the "Third World." Both
financing techniques can also operate to preclude participation by
smaller or medium-sized entrepreneurship, 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" develop-
ment projects. Funding from smaller-sized banks should be made
available to smaller or medium-sized entrepreneurship, including
native businesses, so long as the income-producing nature of the
project can be verified and contractually assured under Project Fi-
nancing concepts.33

As a conclusion, Section 4 raises the need for reflection and fur-
ther reassessment of the current patterns, including the following

32 Although the post-Enron federal legislation, the Sarbanes-Oxley Act of
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, help shield the borrower and its corporate as-
sets from collateral risks or otherwise from contractual obligations beyond project
tasks and revenues.

33 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 Sar-
banes-Oxley Act of 2002. Id.
recommendations:

(1) The role played by MNC counsel, 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 principles of law common to the major legal systems of the world," or "the general principles of law recognized by civilized nations." This concept should expressly be
added to various state bar codes of professional responsibility 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 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; and (ii) in modern societies governed by the rule of law such as the United States, lawyers are often described as "officers of the court." Correspondingly, the IBT lawyer, regardless of her transactional specialty or employment, should be considered a member of the global legal community—a community guided and inspired by the rule of law recognized by "civilized nations."

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 "the [African, Caribbean and Pacific States' ("ACPs")] efforts to achieve self-reliant and self-sustained development based on . . . social values, their human capacities, their natural resources and their economic potential . . . ." The Fourth ACP-EEC Convention of Lomé, Dec. 15, 1989, 29 I.L.M. 783 (1990) (hereinafter Lome Convention) (emphasis added). The Lomé 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 Challenges and Options for a New Partnership: Green Paper on Relations Between the European Union and the ACP Countries on the Eve of the 21st Century from the Commission to the European Council, COM(96)570 final (aiming to "pave the way" for dialogue between those concerned with the expiry of the Lomé Convention) at http://europa.eu.int/comm/development/body/publications/1-vert/lv_en.htm (last visited Nov. 21, 2004). Now, it is a question of whether this commitment is merely lip service or may lead to negative consequences notwithstanding the best intentions.

See, e.g., MODEL BUS. CORP. ACT, § 3.02(13) (2002) (empowering corporations to "make donations for the public welfare or for charitable, scientific, or educational purposes"); see also A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (N.J. 1953).


See LA PORTA, supra note 36 (discussing the general principles of law recog-
(2) The regulation of MNCs' global conduct should be initiated by 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.\(^{40}\) 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 a prophylactic function against corporate ills such as fiduciary duties, third-party beneficiaries, the 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 ("NGOs") should be injected into the negotiation and dispute solution process. This is what I call "a public-interest approach" to the formation and interpretation of investment contracts between MNCs and "Third World" governments, in which property of the "people" is immediately at stake.

2. NEGOTIATING WITH THE "MONARCH" — A TYPICAL SCENARIO

The following real-life scenario, constructed based on public information,\(^{41}\) is used as a hypothetical to set the stage for discussion normalized by civilized nations).


\(^{41}\) See, e.g., R. THOMAS COLLINS, JR., BLUE DRAGON: RECKONING IN THE SOUTH CHINA SEA (2002) (describing the effort by Mobil Oil Corporation to return to Vietnam after a nineteen-year absence).
and to provide the context for legal analysis. All names of private parties have been omitted.

2.1. 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 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 United States, Russia, Japan, and Vietnam stood together, forming the backdrop for the signing table. (Historically, the United States 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 United States.) Ironically, nineteen 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 of South Vietnamese collaborators facing the prospect of communist "reeducation" camps. Almost twenty years had passed since then, but in April, 1994, no U.S. am-

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43 As of Jan. 2002, Vietnam reportedly has oil-proved reserves of 1.4 billion barrels per day, and natural gas reserves of 1.3 billion per cubic meter. CIA, Vietnam, in THE WORLD FACTBOOK, available at http://www.cia.gov/cia/publications/factbook/print/vm.html (last visited Nov. 15, 2004). Vietnam has no refinery. Accordingly, although it exports Crude Oil in volumes as high as nine 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 billion for 1997. Plans for refinery constructions are aimed for the early part of the twenty-first century. See STAT-USA, Market Research Reports (providing links to various countries' research reports), at http://strategis.ic.gc.ca/SSG/dd75600e.html (last visited Nov. 15, 2004).

44 See FRANK SNEPP, DECENT INTERVAL: AN INSIDER'S ACCOUNT OF SAIGON'S INDECENT END (1977) (describing the fall of Saigon from the perspective of a CIA analyst assigned to Vietnam).
bassador to Vietnam had been appointed. Under the Reagan-Bush “roadmap” policy, the United States 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 United States and communist North Vietnam, once making international headlines daily, was surely a creature of the past.

In 1994, Vietnam was looking forward to its 10 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. For three reasons, the deal had great significance to

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45 See ROBERT G. SUTTER, VIETNAM-U.S. RELATIONS: THE DEBATE OVER NORMALIZATION, CRS Issue Brief, May 12, 1992 (The “roadmap” policy used a “phased-in” approach and conditioned normalization of diplomatic relations with Vietnam on step-by-step accomplishments, among which was the resolution of various MIA (veterans Missing-In-Action) issues.)


47 To date, the territorial dispute over the groups of islands in the South China Sea has never been resolved, although claimants 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. CIA, Vietnam, supra note 43; see also Jonathan I. Charney, Central East Asian Maritime Boundaries and the Law of the Sea, 89 AM. J. INT’L L. 724 (1995) (discussing three developments that have impacted maritime boundary delimitation in Central East Asia); 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, 13 TEX. TRANSNAT’L L.Q. 56 (Nov. 1997) (discussing various legal theories underlying territorial disputes over the Spratlys); Brian K. Murphy, Dangerous Ground: The Spratly Islands and International Law, 1 OCEAN & COASTAL L.J. 187 (1995) (analyzing arguments made by six states claiming ownership of the Spratlys). 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. See Henry Scott Stokes, Oil Riches Off China’s Shores, N. Y. TIMES, Jan. 19, 1982 at D1 (detailing oil disputes in the South China Sea).
Vietnam, both figuratively and economically. First, the exploration Block was named after a Vietnamese folktale about a holy dragon reigning in the South China Sea, representing the forefather of the nation. Second, the deal, closed immediately after the United States’ 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,\(^{48}\) collectively owned all land, sea surfaces, minerals, and natural resources. PetroVietnam was simply an agent of the Central Government,\(^ {49}\) 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.

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In 1994, the IOGC was returning to Vietnam, only to claim the fruit of its work by resuming what it had started nineteen 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 twenty-six other oil companies to submit bids on some thirty offshore Blocks. In June 1973, the IOGC was awarded exploration rights on two of the thirty Blocks. By the end of 1973, the IOGC had sold thirty percent 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. In March 1975, the North Vietnamese army was 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.50

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 nineteen years ago. By virtue of a PSC, the IOGC would be conducting petroleum exploration as a contractor of the Socialist Republic's 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 Asia51 had focused on

50 COLLINS, supra note 41, at 21-23.

51 For reports on political oppression in East Asian and Southeast Asian countries, see AMNESTY INTERNATIONAL, 2003 ANNUAL REPORT, at http://
Vietnam’s poor human rights record, although the country had signed on to the majority of the U.N. human rights conventions. 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 movements or scholarly

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literatures debating corporate social responsibility in the IOGC's home base,54 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.55 In those faraway lands, freedom of speech, freedom of information, and freedom of choice can be luxuries rather than a matter of right.56

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 will ultimately result 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 PSC, the IOGC could withdraw from the country and write off its loss, and the question would become whether the 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

54 Stephens, supra note 9, at 45; Cynthia A. Williams, Corporate Social Responsibility in an Era of Economic Globalization, 35 U.C. DAVIS L. REV 705 (2002); see also Andrew Van Alstyne, Al Gedicks' Resource Rebels: Native Challenges to Mining and Oil Corporations, 15 SOC'Y & NAT. RESOURCES 862 (2002) (book review) (explaining the relationship between free trade and economic repression); Westfield, supra note 9, at 1075 (considering the human rights impact of multinational enterprises' conduct and suggestions to inject human rights concerns into MNCs' agendas); Branson, supra note 53. But see Morton Winston, NGO Strategies for Promoting Corporate Responsibility, 16 ETHICS AND INT'L AFF. 71, 86 (2002) ("NGOs cannot really force corporations to do anything and their attempts to influence corporate behavior by means of any combination of strategies and tactics are unlikely to be successful in the long run unless they are able to mobilize two other important constituencies: consumers and governments.").


56 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." VIETNAM CONST. arts. 17, 68-70.
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, would 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 FDI. 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.\footnote{See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.); BNA CORP. COUNS. WKLY., Sept. 17, 2003, at 281-288 (reporting on SEC comments emphasizing the need for accurate Management Discussion and Analysis and textual disclosure to accompany corporate financial statements in post-Enron era).}

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,\footnote{The non-U.S. interests were represented and publicly announced at the closing ceremony for the Vietnam Deal in Hanoi, 1994. COLLINS, supra note 41.} 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. For example, Vietnam had a history of warfare and revolutions. Its legal system was either in disarray or at best primitive.\footnote{Edward R. J. Neunnuebel, Vietnam: An American Lawyer's Perspective, in}
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 successfully have negotiated with a new form of post-Cold War "monarchy."  

2.2. Mapping the Scenery: The "Monarchs" of the Twentieth and Twenty-First 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 those concepts are understood 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


The following anecdote exemplified the Vietnamese public's indifference to past war matters and their lack of any harbored anti-American sentiments. During my business travels in Asia in the mid-1990s, I interviewed, at random, Vietnamese villagers in the outskirts of Hanoi and peddlers 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 in-
Perhaps the "monarch" analogy is especially appropriate for Vietnam because, notwithstanding the population's earnest zeal and healthy appetite for freedom and entrepreneurship, 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. According to Vietnamese-American activists, the fruits of FDI projects in Vietnam serve the self-interest and political agenda of the Politburo or government-connected elitists, unchecked by principles of liberal democracy or sound macroeconomic management. The effect of FDI has not 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

67 See, e.g., Pham Van Thuyet, supra note 62.
68 See Duong, supra note 52, at 295-96 (discussing corruption and the ineffectiveness of law in Vietnam, together with oppression in the form of banning dissident fiction); see also supra note 15 (discussing corruption in "Third World" countries).

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 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.


71 See, e.g., Gray & Jarosz, supra note 4 (relating David Ricardo's "comparative advantage" theory to trade context, and contrasting it to investment context); see also DAVID RICARDO, THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION (1911) (critiquing advocation of free trade policies for Europe).


Even in the past era of colonialism, when conquest was the accepted mode of territory annexation, nation-states still observed the display of sovereign powers and protocols, at least as lip service 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 France's occupation of Vietnam illustrated the well-intentioned extension of sovereign power by France. See, e.g., HO TAM HUE TAI, RADICALISM AND THE ORIGIN OF THE VIETNAMESE REVOLUTION (1992); NGUYEN VAN TRUNG, CHU NGHIA THUC DAN PHAP O VIET-NAM: THUC CHAT VA HUYEN THOAI [FRENCH COLONIALISM IN VIETNAM: TRUTHS AND MYTHS] (1963); Duong, supra note 52, at 313; Vinh Sinh & Nicholas Wickenden, Phan Boi Chau and His Autobiography, VIETNAM REV., Autumn-Winter 1996, at 206. During the years that preceded the negotiation of the 1884 Patenotre Treaty, which solidified French colonialism in Vietnam, a Vietnamese envoy was dispatched by the King of Vietnam to Paris, during which proceeding the Emperor of France was quoted as stating to the Vietnamese mandarins who led the envoy: "La France est beinvillante pour toutes les nations et proteger des faibles, mais ceux qui l'entravent dans sa marche ont a craidre 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 NGUYEN XUAN THO, LES DEBUTS DE L'INSTALLATION DU SYSTEME COLONIAL FRANCAIS AU VIETNAM (1858-1897), at 413-462 (2002); DEMOCRACY FOR VIETNAM, supra note 62 (recounting notes from the personal collections of certain descendants of the last royal family of Vietnam, which record the Nov. 5, 1863 proceedings in Paris); THE LITERATI OF VIETNAM 100 (1969) (edition no longer in print, on file with author); see also SHAWN FREDERICK MCHALE, PRINT AND POWER: CONFUCIANISM, COMMUNISM, AND BUDDHISM IN THE MAKING OF MODERN VIETNAM (2003) (one of the latest titles assessing Vietnamese culture and history against the influence of imported ideo-
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 affect 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:

(1) 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:
- Petroleum resources worldwide as well as in the United States 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.\(^7\)
- An IOGC's investment in the petroleum and energy sector is long-term, requiring decades of investment of cash, human capital, and technology.
- 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 is an example of economic and political influences on the petroleum market. The international contractual doctrines).

mechanism has helped achieve a certain degree of stability in 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.

(2) The human 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 technological 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 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 a caveat to the following simplified typology, developed only to map the


75 Approximately ninety percent of all transnational corporations are headquartered in the northern hemisphere. KARLINER, supra note 72, at 6; McAdams, supra note 3 at 249. 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 Hamilton, supra note 17 (discussing merger trends).

76 Under the Vietnamese Constitution, explicit in the provision of rights is the imposition of citizens’ duties owed to the State. See VIETNAM CONST. 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.”), available at http://www.vietnamembassy-usa.org/learn/gov-constitution5.php. The clear consequence of this constitutionally imposed “citizen’s duty” is the sacrifice of individual liberty for state interests, as declared by the government.

77 Horrigan, supra note 74, § 7.01.
scenery for discussion.

2.3. Simplified Typology of Today's "Monarchs"

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 seven 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 seven groups.

Group One: 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.

Group Two: The "U.S.-Embargoed" and "Economically Sanctioned" "Monarchs." This group may overlap with group one above, because Marxist countries such as Cuba and North Korea are officially on the United States' "economically sanctioned" list. This group also includes countries such as Iran or Libya, sanctioned by act of Congress, and countries such as Sudan and Myanmar, sanc-

78 Out of those four nations, only Cuba and North Korea remain on the U.S.'s embargo list. 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., Luat Dau Tu Nuoc Ngoai [Foreign Investment Law] (1987) (Vietnam); cf. New Investment Guidelines, NEW CHINA NEWS AGENCY, June 29, 1995.


tioned by Executive Orders. U.S.-based nationals and businesses (and at times their owned or controlled foreign subsidiaries) are banned from economic relations with these countries (including some countries in group one and all of group two). Some of the United States' economic sanctions, such as the Cuba boycott, raise unresolved questions challenging U.S. foreign policies.

Group Three: 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

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84 Senior Prime Minister Lee Kwan Yew of Singapore is a proponent and advocate of Asian-style modified democracy. See Senior Prime Minister Lee Kwan Yew, Democracy, Human Rights and the Realities, Speech to the Create 21 Asahi Forum (Nov. 10, 1992), in 16 SINGAPORE MINISTERIAL SPEECHES (1993); see also Frank Ching, Eye on Asia: Is UN Declaration Universal?, FAR. E. ECON. REV., Aug. 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. See HAN FOOK KWANG ET AL., LEE KUAN YEW: THE MAN AND HIS IDEAS (1998); LEE KUAN YEW, THE SINGAPORE STORY: MEMOIRS OF LEE KUAN YEW (Times Editions 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) (pointing out shortcomings of Yew's economic determinism—although Singapore's economic success fulfilled Prime Minister Yew's economic vision, the small nation already reached its height
private ownership of economic sectors is permitted, only SOEs 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.\textsuperscript{85}

**Group Four: 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.\textsuperscript{86} In the developing nations falling under this group four, natural resources are owned by the state, or by the "people" administered through the state.\textsuperscript{87} (Despite the economic dominance of countries such as the United States, Canada, France, and the United Kingdom, which so far as output quantities were concerned, leaving the fostering of creativity to be desired).

\textsuperscript{85} 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 repeatedly been delayed, and ongoing plans have called for the Singaporean government to divest its stakes in the electric utility sector as early as 2004. See ENERGY INFO. ADMIN., U.S. DEPT. OF ENERGY, SINGAPORE COUNTRY ANALYSIS BRIEF (describing Singapore's energy use and resources), at http://www.eia.doe.gov/emeu/cabs/singapor.html (last visited Nov. 20, 2004).

\textsuperscript{86} Countries in Group Four may overlap with Group One, because Group Four'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 Four is distinguishable from Group Two, because group Two is "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.

recognize private ownership of natural resources,\(^8\) state ownership of minerals is in fact the more common global regime.\(^9\) State ownership can be established by treaty or constitutional authority, as in the case of Russia, Mexico, Albania, and Yemen,\(^9\) and/or by specific petroleum legislation, as in the case of Russia, Kazakhstan, Bolivia, Guatemala, Peru, and Cambodia.\(^9\)

Governmental ownership can be established by treaty or constitutional authority, as in the case of Russia, Mexico, Albania, and Yemen,\(^9\) and/or by specific petroleum legislation, as in the case of Russia, Kazakhstan, Bolivia, Guatemala, Peru, and Cambodia.\(^9\)

\(^8\) 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 both countries' national jurisprudence. See, e.g., Amoco Prod. Co. v. S. Ute Indian Tribe, 526 U.S. 865 (1999) (resolving an ownership dispute over coal-bed methane gas deposits).

\(^9\) 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 remains exclusively with the state.


mandate the type of contract or form of 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 (i) 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, or (ii) as in the case of Cambodia, Australia, and Niger, the


94 In Ghana, Petroleum Operations are governed by the Petroleum Law of 1984, which empowers “Ghana National Petroleum Corporation” (“GNPC”) 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, Ghana: Oil and Gas Industry (explaining the oil and gas industry in Ghana), at http://www.mbendi.co.za/indy/oilg/af/gh/p0005.htm (last modified July 12, 2000).

95 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 (“SOEs”). See, e.g., Bob Williams, The Role of State Oil Companies, OIL & GAS J. (OGJ Special), Aug 16, 1993, at 55 (describing the rise of state-owned oil companies).


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procedure by which such contractual 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.

Group Five: 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 negoti-

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98 Willard v. First Church of Christ, Scientist, 498 P.2d 987 (Cal. 1972); Restatement (Third) of Property: Servitudes, § 2.6, rep. note (1999); Holbrook v. Taylor, 532 S.W.2d 763 (Ky. 1976); see also Othen v. Rosier, 226 S.W.2d 622 (Tex. 1950) (discussing implied easement).


100 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. BhP had already spent substantial efforts and energy exploring the area and evaluating commercial prospects of the gold deposit. Darden, supra note 87, at 60.
ated and specific government-private sector partnerships formed as a result.

Group Six: "Monarchs" as Gatekeepers: Various Degrees of State Control Over FDI Across the Board, Regardless of Sector or Industry.

A country may also impose minimum state equity ownership over 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

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ernmental 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.

Group Seven: Countries That Exercise De Facto or Decentralized State Control via 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 a 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.") The role of governments ranges across a wide spectrum, and constitutes a major influence in the pattern of "Third World" global economic development.

The term "monarch" may not be just rhetoric, after all.

3. DISSECTING TWO TYPICAL PETROLEUM AND ENERGY FDI TRANSACTIONS

In this Section, I will examine and dissect two types of major FDI transactions:

(1) The upstream petroleum transaction like the Vietnam Deal,

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104 Id.
in which the host country grants the MNC-IOGC the right to explore for oil and gas on national territory ("the Upstream Transaction"); and

(2) The midstream 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 ("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, Total-FinaElf, BP-Amoco, or Mitsubishi Oil). The Midstream Transactions, in particular, are the core business of the power 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.

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.) 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. Examples of Downstream Transactions are:

1) a franchise agreement 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 executed between the Marketing Division of an IOGC and an individual distributor or agent, who is a native of the host country. Depending on the language of this 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; and

3) an agreement to supply parts or services to an oil refinery in Southeast Asia 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. For an overview of petroleum downstream and marketing activities, see P.J. Ottino, Crude Oil Futures and Options in London, 7 OIL & GAS L. & TAX'N REV. 179, 191 (1988-1989).

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 News, Ex-Enron CEO Indicted, at http://www.msnbc.msn.com/id/4311642 (last visited Feb. 19, 2004); see also Enron, Annual Reports (showing changes in Enron's business practices), at http://www.enron.com/corp/investors/annuals (last visited Oct. 30, 2004). In 1999, Enron began to sell off large chunks of its power development services and subsidiaries, and International IPP Transactions became part of Enron's Wholesale Energy Services. Id. One of such transactions, Enron's sixty-percent-owned Dab-
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 Caterpillar). 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.

3.1. Case One: The Upstream Transaction

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 midstream (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 trichotomy 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 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

\footnote{108 The analysis of Case One applies only to the international petroleum sector. The analysis does not apply to the U.S. domestic oil and gas legal regime.}
downstream transaction (such as a franchise contract enabling a gas station franchisee to sell gasoline to the ultimate consumers).\(^{109}\)

In modern U.S. 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.”\(^{110}\)

### 3.1.1. History, Development, and Semantics

It has been said that petroleum exploration is a unique activity, wherein the party with capital, technology, and know-how agrees

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\(^{109}\) *See supra* note 106.

\(^{110}\) 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, e.g.*, KEITH W. BLINN ET. AL., *INTERNATIONAL PETROLEUM EXPLORATION AND EXPLOITATION AGREEMENTS: LEGAL, ECONOMIC AND POLICY ASPECTS* 108-09 (1986) (using the term “exploitation” in connection with the use of commercial reservoirs); *Model Form International Operating Agreement* (1990), reprinted in ANDREW B. DERMAN, *INTERNATIONAL OIL AND GAS JOINT VENTURES: A DISCUSSION WITH ASSOCIATED FORM AGREEMENTS* 94, 96 (ABA Section of Natural Res., Energy & Envtl. Law, Monograph Series No. 16, 1992) (using the term “exploitation” in its traditional, positive sense); *see also* “Decreto con Fuerza de Ley Orgánica de Hidrocarburos” [Decree With Force of Law Regarding Hydrocarbons], ch. 1, § I, art. 1 (Gaceta Oficial 2001, 37.323) (Venez.) (referring to exploration, exploitation, collecting, transportation and storage as petroleum “primary activities”), available at http://www.petroleumworld.com/oillaw.htm. “Exploitation” in Venezuelan law means all upstream phases subsequent to exploration (or what is known in the United States as “Development and Production”). It follows, therefore, 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. The lack of universality is further complicated by linguistic difficulties and translation issues.
to pay an owner of natural resources for the right to do work free of charge.\textsuperscript{111} 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 be given access to “farm the field”\textsuperscript{112} 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. The differences between the two systems are rooted in the development of Anglo-American versus French legal concepts of mineral resource ownership.

3.1.1.1. The Concessionary Model

In the Concessionary system, private ownership of mineral resources is allowed.\textsuperscript{113} 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.\textsuperscript{114} Today, it can be used synonymously with a country’s petroleum fiscal regime called the “royalty/tax” system.

\textsuperscript{111} DANIEL JOHNSTON, INTERNATIONAL PETROLEUM FISCAL SYSTEMS AND PRODUCTION SHARING CONTRACTS (1994).

\textsuperscript{112} 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. \textit{See} John S. Lowe, Analyzing Oil and Gas Farmout Agreements, 41 Sw. L.J. 759, 763-64 (1987) (determining origin of the term “farm out”).

\textsuperscript{113} \textit{See} generally GORDON H. BARROWS, WORLDWIDE CONCESSION CONTRACTS AND PETROLEUM LEGISLATION (1983) (giving examples of concessionary laws that allow private ownership of minerals); \textit{see also} Ernest E. Smith & John S. Dzienkowski, \textit{A Fifty-Year Perspective on World Petroleum Agreements}, 24 TEX. INT’L L.J. 13 (1989) (discussing and comparing Middle Eastern concessions to U.S. oil and gas leases).

\textsuperscript{114} 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 United States can readily serve as an example of a Concessionary system. The term may still be used in academic discourse.
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 availability of petroleum private ownership, the license in the Concessionary system denotes that Petroleum Activities may heavily be regulated by the state.

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 PSC. A Service Contract can be further divided into two categories: a Classic or Pure Service Contract, and a Risk Service Contract.

3.1.1.2. The Service Contract Model

In a Service Contract arrangement, ownership by, or title transfer to, the contractor is removed altogether. 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 Contract). Where such fee is not paid unless and until petroleum is discovered and produced, the contract is a Risk Service contract, because the contractor is taking the risk of exploration failure. If there is no

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115 See, e.g., Agreement between Petroleum Concessions, Ltd. and Sultan of Muscat and Oman (1937), reprinted in SMITH ET. AL., INTERNATIONAL PETROLEUM TRANSACTIONS (2000) (detailing an agreement whereby the Sultan of Oman and Muscat received a royalty on production).


117 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.
petroleum discovery, the contractor loses its investment and does not get paid by the government. 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) 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.

### 3.1.1.3. The PSC Model

In the following discussion, the term Production Sharing and the acronym PSC are used interchangeably.

Production Sharing concepts date back to French Napoleonic traditions, under which 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 agricul-

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119 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 (5th ed. 1996).

120 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 Technical Assistance Agreement Between Petroleos de Venezuela (PETROVEN) and Creole Petroleum Corporation, Jan. 1, 1976, in 2 COLLECTION OF INTERNATIONAL CONCESSIONS AND RELATED INSTRUMENTS 275, 280-82 (Peter Fischer & Thomas Waelde eds., 1982) (discussing the relationship between the host country and the MNC subsequent to nationalization).

121 F. H. Lawson et al., *Amos and Walton's Introduction to French Law* 93-94 (3d ed. 1967); Marcel Planiol, *A Treatise on the Civil Law* §§ 2392-94 (La. State L. Inst. trans., 11th ed. 1959). The French Civil Code originally gave owners of property ownership of the subsurface estate. *Code Civil* [C. CIV.] art. 552 (Fr.). However, 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.
tute. 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.\(^{122}\) 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.)\(^{123}\)

The first PSC was executed in Indonesia—a former Dutch colony—in the early 1960s, under the authority of the Indonesian 1945 Constitution,\(^{124}\) when the country began to take on its status as an oil-producing nation in the "Third World."\(^{125}\) The Production Sharing scheme came about as the result of gradual changes in the pattern of international petroleum exploration since the end of World War I. The enhanced bargaining positions of petroleum-producing countries throughout the years, as well as adverse actions taken by new regimes in places such as Libya and Iran,\(^{126}\) 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

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\(^{122}\) See generally JEAN BRISSAUD, A HISTORY OF FRENCH PRIVATE LAW 308-11 (Rapelje Howell trans., 1912) (detailing development of land ownership in France following French revolution).


\(^{124}\) INDON. CONST. art. 33 (stating that 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 AMERICAN EMBASSY JAKARTA, PETROLEUM REPORT INDONESIA 2003, at 6 (2003), at http://jakarta.usembassy.gov/petro2003/exsum2003.pdf.

\(^{125}\) The Republic of Indonesia, the world's largest archipelago, achieved independence from the Netherlands in 1949. The country's current problems include poverty, a strained relationship with the IMF, low investor confidence due to lack of reliable legal recourse, corruption, political instability, and a general lack of security in the region. As of 1999, approximately twenty seven percent of the population lived below the poverty line. 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. CIA, Indonesia, THE WORLD FACTBOOK, available at http://www.cia.gov/cia/publications/factbook/print/id.html (last visited Oct. 27, 2004).

and gas leases was replaced by a negotiated share of production, as high as a fifty-fifty profit split between the IOGC and the host government, as in the case of Venezuela in 1948. 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 "Cost Recovery Oil," if oil is discovered); and (2) production representing the contractor's profit (called "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.

3.1.2. 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 unless and until she finds and produces petroleum. There is no Production Sharing, nor fee for service, if the exploration venture fails. Principally, the differences between the PSC system and a Service Contract system depend on whether the contractor is compensated in cash or in kind (for example, payment made in Crude Oil 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 Oil. 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). The PSC is simply an in-

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127 Horrigan, supra note 74, § 7.03.
128 Failure does not necessarily mean that the Contract Area is devoid of potential reserves. Failure simply means that under a set standard of "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.
129 For a definition of "Crude Oil," see PETER, infra note 293.
130 See, e.g., KAMAL HOSSAIN, LAW AND POLICY IN PETROLEUM DEVELOPMENT 139 (1979) ("[I]f the title to the oil does not pass to the contractor till the point of export, then how could it be entitled to receive a price for the oil supplied by it to
novative deviation of the Risk Service Contract, 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, and Production). The Exploration phase alone may typically cover a term of five years. Examples of the PSC system include Egypt, Guyana, Indonesia, and Malaysia. As of the mid-1990s, the number of PSCs outnumbered Service Contract agreements by a ratio of five to one. 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 FDI for the past three decades.

Today, Indonesia's PSC model sets the standards for PSC terms, at least for the developing nations and countries in the Asia-Pacific region. The PSC may take thousands of hours of lawyers' and executives' time, culminating in 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.\(^{134}\)

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 (typically defined terms in the PSC).
- 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.

3.1.3. 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 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 in 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

\[135 \text{ See, e.g., Stan Dur, Negotiating PSC Terms, Petroleum Accr. \& Fin. Mgmt. J. 115-24 (Summer 1994).}\]
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 con-
sience—governments duly safeguard the “people’s” resources
and are inspired to use the proceeds of petroleum sales for the bet-
terment of their societies; IOGCs are respectful of the host coun-
try’s environment, labor, natural resources, 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 so as 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.

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 within which to examine the current pat-
tern of global economic development, and to raise certain argu-
ments regarding its windfall or pitfall. The seven PSC legal and
business issues are:

1. Operatorship;
2. Participating Interest (or Joint Venture Interest, as the case may
be), and related issues of transferability;
3. The “Carry” of costs and expenses;
4. Contractor’s Work Program or Minimum Work Commitment;
5. Commerciality standards, the IOGC-contractor’s Withdrawal
Rights, and other relevant economic judgments made by the
IOGC;
6. The government’s Fiscal Regime (consisting of elements such
as the Profit Split, Government Participation, and various re-
quirements for the payment of Bonuses, in addition to Tax
and Royalty);
7. The IOGC’s contractual devices to buffer itself against Political
Risks associated with the investment environment, in-
cluding the use of the Stabilization Clause.
3.1.3.1. 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.136 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.

3.1.3.2. Participating Interest, Joint Venture Interest, and Transferability

The JOA operator and PSC contractor can either be a single company, a Consortium of companies and interests, or a Joint Venture 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

136 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.
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 SOE of the host jurisdiction. (In the Vietnam Deal, PetroVietnam served a 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 able foreign investor. Where the local law requires such a 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).

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137 See Int'l Raw Materials, Ltd. v. Stauffer Chemical Co., 978 F.2d 1318, 1330-33 (3d. Cir. 1992) (treating joint venture and partnerships similarly); In re Groff, 898 F.2d 1475, 1476 (10th Cir. 1990) (applying partnership law to the property of the joint venture).

138 In re Groff, 898 F.2d at 1475 (holding that "the rules governing partners' interests in partnership assets also apply to joint ventures").
Where equity, risks, and costs are shared in an unincorporated petroleum Joint Venture arrangement, the result is typically the creation of "Participating Interests."\(^{139}\) 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 government or its SOE holds a Participating Interest in the project may also be described as a "Government Participation" system.\(^{140}\) Where there is Government Participation, the 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 operator-ship 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 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 "Farm-in/Farm-out Agreement" to effectuate the terms of the transfer (the transfer is a Farm-in for the assignee-Farmee, and a Farm-out for the assignor-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

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\(^{139}\) 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).

\(^{140}\) See, e.g., Derman, supra note 110.
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 pro forma or via 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, 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 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 alliances 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 geopolitical 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

\[141\] See, e.g., John S. Lowe, Recent Significant Cases Affecting Farmout Agreements, 50 INST. ON OIL & GAS L. & TAX'N 3-1 (1999) (analyzing Farmout Agreements, including risk spreading through equity protection).
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 geopolitical and economic.

If, however, the original IOGC manages to effectuate a Farm-out completely "offshore," purely for purposes of cost and risk sharing, while remaining 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 the IOGC's 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 region, if and when petroleum is found. Overall, risk-sharing alliances among IOGCs are often made subject to strict confidentiality agreements.

While such confidential international Farm-in/Farm-out arrangements may bear all the characteristics of large-scale acquisitions, they may not be governed by any nation's anticompetitive regulatory regime, let alone any regional oversight, for several reasons. First, these Farm-in/Farm-out arrangements do not implicate the IOGC's home jurisdiction's antitrust concerns or interest. Second, the transitional economies may not have developed effective and sophisticated anticompetitive laws. Third, the speculative nature of upstream endeavors—that prospective profit is rendered uncertain by various geological Appraisal Risks—can make the

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142 See Duong, supra note 49 (discussing territorial disputes in the South China Sea).

143 AIPN Model Agreements are available at http://www.aipn.org/modelagreements (last visited Nov. 20, 2004).
gauging and assessment of anticompetitive effects either premature, speculative, impossible, or inappropriate. Farmers and Farmers are obligated to spend money before they can make money, if they make money at all! In other words, due to the “hit-or-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 exploration business. Accordingly, how can there be any anticompetitive 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 intercorporate 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 anticompetitive 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 host governments. The cartel dominates and shapes a transitional country’s petroleum industry, and hence its national economy. This domination has impact beyond the border and can reach regional or global dimensions. The reality is that FDI 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 global market.

An example of a business environment consisting of de facto petroleum cartels is the oil development picture in poverty-stricken Chad: all four IOGC giants (Exxon-Mobil, Chevron, Conoco, and Shell), at various times have joined forces to develop the industry there. Three out of the four are U.S.-based corporate

144 Commentators have long cautioned against the risk of global monopoly in the new millennium. For the year 2000, worldwide mergers totaled nearly $3.5 trillion. McAdams, supra note 3, at 264; Ed Crooks, Deals Start to Dry Up After A Record Year, FIN. TIMES, Apr. 12, 2001, at 3. This figure does not include de facto combinations of capital, such as the pattern discussed in this Article.
giants, and although Shell is a Dutch company, it has substantial producing subsidiaries or affiliates in the United States. Critics of MNCs may opine that a U.S.-based de facto cartel has positioned itself to control 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 twenty 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 the 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 in China, Germany, the former Soviet Union, and Eastern Europe. But even if this privatization scenario can

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145 For information regarding Shell Oil Co. and its substantial operations in the United States, see supra note 17 and accompanying text.

146 See, e.g., Matthew D. Bersani, Privatization and the Creation of Stock Compna-
successfully materialize one day, the public at that time might still be too poor and too sick to afford ownership of shares in a publicly traded petroleum 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.)

3.1.3.3. 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.


147 See supra note 15 (discussing public data on the natural resources and living conditions of Nigeria and Chad).
Understandably, the 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.

3.1.3.4. 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-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 in the peculiar 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 the 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.\footnote{See Convention on Independent Guarantees and Standby Letters of Credit, Dec. 11, 1995, 2169 U.N.T.S. 190 (explanatory note by the UNCTRAL Secretariat) (stating that the Convention is designed to facilitate the use of independent guarantees and standby letters of credit), available at http://www.unctral.org; Roy Goode, Abstract Payment Undertakings in International Transactions, 22 BROOK. J. INT’L. L. 1 (1996) (discussing the legal implications of abstract payment undertakings such as Standby Letters of Credit); Egon Guttman, Bank Guarantees and Standby Letters of Credit: Moving Toward a Uniform Approach, 56 BROOK. L. REV. 167 (1990) (remarking that unknown credit standing of purchasers has led to the development of standby letters of credit).} 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.\footnote{See, e.g., Goode, supra note 148.} 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 an 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 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.

3.1.3.5. Standards of Commerciality and Contractor's Withdrawal Rights

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 future costs and the 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 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 ob-
tained 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.\(^{150}\) 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 from the project 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 "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.

\(^{150}\) As a legal concept, "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, "Mechanical Completion" alone is not sufficient; the plant must also be capable of "Commercial Operation." These are often legal terms defined in the contract to help determine whether the design-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. See, e.g., Duong, supra note 38 (manuscript Section 3.2) (discussing Case Two, the Midstream Transaction); John G. Mauel, Common Contractual Risk Allocations in International Power Projects, 1996 Colum. Bus. L. Rev. 37.
In contrast, the host country will also want to have the discretion to declare whether a discovery is Commercial, as such a 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 an 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 contractor's decisions and, in general, will want the contractor to prolong or expand exploration work in hopes of future finds for development.

3.1.3.6. 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 taxes, royalties, the production share or Government
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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.151

From a macroeconomic 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 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.152 In economic terms, “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, 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

151 JOHNSTON, supra note 111, at 9-15.
152 Id. at 6; see ZUHAYIR MIKDASHI, THE INTERNATIONAL POLITICS OF NATURAL RESOURCES (1976) (discussing businesses that exploit natural resources); RICARDO, supra note 71, at 33-45 (discussing economic concepts of “rent”); Paul Davidson et al., The Relation of Economic Rents and Price Incentives to Oil and Gas Supplies, in STUDIES IN ENERGY TAX POLICY 115 (Gerard M. Brannon ed., 1975) (discussing the supply of oil and gas Economic Rents).
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 fifteen percent of the value of production.\footnote{\textit{See} JOHNSTON, \textit{supra} note 111, at 54 ("Anything above 15\% is getting excessive.").} 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 United States, 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.\footnote{\textit{Depending on the terms of the PSC, if the income tax charged by the host country meets certain criteria set by the U.S. Internal Revenue Code, the U.S.-based IOGC-contractor will receive an income tax credit toward the taxation of its worldwide income levied by the U.S. Internal Revenue Service. \textit{See} 26 U.S.C. §§ 27, 901, 902, 904, 960 (2003); Rev. Rul. 78-222, 1978-1 C.B. 232 (1978); Internal Revenue Service, \textit{Topic 503- Deductible Taxes}, at http://www.irs.gov/taxtopics/tc503.html (last visited Nov. 15, 2004); \textit{see also} Terrence R. Chorvat, \textit{Ending the Taxation of Foreign Business Income}, 42 ARIZ. L. REV. 835, 840 (2000) (favoring an exemption taxation system for foreign-sourced income); Joseph Isenbergh, \textit{The Foreign Tax Credit: Royalties, Subsidies, and Creditable Taxes}, 39 TAX L. REV. 227, 248-49, 251-52 (1984) (noting that the foreign tax credit prevents double taxation of overseas businesses). The use of “double taxation treaties” as bilateral agreements between sovereigns to avoid double taxation of corporate and individual residents is also a widespread practice in international taxation.}}
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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: (1) provides a fair return to the nation-state as well as to private industry (otherwise, no foreign investor would invest); (2) avoids undue speculation or unpredictability (which would dissuade foreign investment); (3) limits undue administrative burden upon the government as well as foreign participants (which would also dissuade investment); (4) provides sufficient flexibility to cope with the country’s changing needs; and (5) creates healthy competition and market efficiency.155

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 they gain 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 sovereign’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 re-

source 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 norm 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 mere result of governments' incompetence, mismanagement, and other macroeconomic errors. 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 payment" problems, which can jeopardize the country's good standing in the international monetary system administered by the IMF.\textsuperscript{156} A good supply or surge of hard currency imports may restore a country’s economy and its place in the international monetary system. Yet, in a pervasively corrupt country where bribery is received at the very top levels of government, hard currencies poured into the country can also become illicit contributions to the "bloated Swiss bank accounts" of corrupt government officials.\textsuperscript{157} A recent scandal and federal anti-bribery investigation initiated by the U.S. Department of Justice involved finder’s fees and acquisition payments made by the defunct Mobil Corporation (now Exxon-Mobil by virtue of corporate merger).\textsuperscript{158} The payments 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


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 sufficient to make the economy strong. See \textit{International Monetary Fund, World Economic Outlook,} September 2002: Trade and Finance, ch. 2 (2002) (discussing vulnerabilities in the world economy including global external imbalances and corporate finance in emerging markets), available at http://www.imf.org/external/pubs/ft/weo/2002/02/.


\textsuperscript{158} Gerth, \textit{supra} note 14, at A10 (corrupting oil production in Kazakhstan); John Tagliabue, \textit{Kazakhstan is Suspected of Oil Bribes in the Millions}, N.Y. Times, July 28, 2000, at A5.
President of the Republic. Similar bribery allegations have been made against the giant international construction company, Halliburton, with respect to its work in Nigeria.

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 FDI. The CPI compilers concluded that a large share of corruption was the explicit product of MNCs, headquartered in leading industrialized nations, using large-scale bribery and kick-backs to obtain contracts in the developing world and in countries in transition. Other anti-corruption activists outside of the TI’s network have also argued that "[a] country becomes or remains poor in accordance with a familiar formula: Its corrupt government—intent on maximizing the Swiss bank-accounts of its leaders—routinely 'sells' the national economy to a group of cronies who . . . pay rich bribes for the guaranteed right to monopolize their respective sectors" in the local and regional market. If this allegation can empirically and consistently be proven, the "development" model of global economics is an abject failure. With the web of corruption in place as a way of life, there is no way for the "rich" democracies to help the approximately three billion people who are citizens of some one hundred impoverished nations, unless the flow of capital and resources can get to the people who need them. But is this web of corruption perpetuated by MNCs, and which one comes first, the chicken or the egg? Serious attention, therefore, must

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159 See Tagliabue, supra note 158, at A5 (freezing accounts belonging to Kazakh president Nursultan A. Nazarbayev).

160 Nigeria in Probe of Halliburton, supra note 14, at A3; Gold & Wilke, supra note 14, at A6 (inquiring under the FCPA); see also Dow Jones Newswires, supra note 14 (alleging a corruption scandal between Nigerian officials and Halliburton subsidiary for a gas plant contract).


162 Mueller, supra note 157, at 2.

163 Id.
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.164

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.165 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 thirty four nation-states.166 In the United States, on November 10, 1998, President Clinton signed into law the International Anti-Bribery and Fair Competition Act, implementing the OECD Convention.167

The OECD Convention obligates its signatories to enact national legislation prohibiting international bribes. Most developing nations (commonly lumped together as the "bribe-receiving" nations) are not members of the OECD and, hence, are not bound by the OECD Convention's mandates. It is ironic, however, that several "bribe-receiving" nations have always had either policy


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 (2000) (outlining issues in the fight against international corruption and bribery in the twenty-first century). The Author argued that the FCPA and its progeny are 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.


statements or written laws condemning and sanctioning briberies of their officials, long before the OECD Convention came into being. For example, in Vietnam, Communist Party leaders officially stressed the fact that corruption offended the nation’s cultural values, as well as the communist model of rigid party disciplines, yet the principles stated by national leadership contradicts the reality of life on the street. The question in “Third World” real-life is whether, in a country such as Vietnam, where government bureaucrats typically earn approximately U.S. $30-50 a month, and where the colloquial expressions of “jungle’s law” made by “sleeping lawmakers” are used by commoners to refer to the nation’s legal system, those anti-corruption laws and policies exist on paper only.

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 United States’ international lobbying efforts to persuade the Western industrialized nations to adopt anti-corruption laws analogous to the U.S. anti-bribery legislation, the Foreign Corrupt Practices Act (“FCPA” or “the Act”).

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

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168 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-1990s, when FDI in Vietnam was gradually increasing to its peak (prior to the Asian currency crisis), see WILLIAM A.W. NEILSON ET AL., VIETNAM INVESTMENT MANUAL 42-43 (Frederick Burke ed., 1995) (discussing the prosecution of corrupt government officials in passing as part of an international law firm’s country report); ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: INDOCHINA: VIETNAM, LAOS, CAMBODIA 15, (4th Quarter 1993) (waging anti-corruption campaigns); see also Resolution Issued by the Communist Party of Vietnam Central Committee’s Sixth Plenum (Voice of Vietnam radio broadcast, Feb. 24, 1999) (authorizing the Politburo to undertake research to meet the need to increase the fight against corruption, stating further that party officials at all levels should be made responsible for “anticorruption activity”), available at http://www.undp.org.vn/mlist/develvn/O21999/post21.htm.

For another example of national anti-bribery criminal law in Asia, see Teodoro Kalaw IV, Anti-Corruption Laws and Regulations in the Philippines, 37 ASIA BUS. L. REV. 45 (2002) (surveying the Philippines’ anti-bribery criminal sanctions imposed both upon the giver and the receiver of bribes).

169 Duong, supra note 52, at 295.

"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 demanded a 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.

In addition to the OECD Convention, regional efforts also evidence 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 unsuccessfully spearheaded efforts toward a similar convention for African countries. 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 de-

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174 See, e.g., Alhaji B.M. Marong, Toward a Normative Consensus Against Corruption: Legal Effects of the Principles to Combat Corruption in Africa, 30 DENVER J. INT'L L. & POL'Y 99, 100 (2001) ("[A] specific African discourse on corruption is identifiable, taking place under the auspices of the GCA . . . .").


176 See, e.g., Abbott & Snidal, supra note 14, at 141 (developing "a simple model of the interaction of 'value' and 'interest' actors" and analyzing the development of the OECD Convention from the interplay thereof); see also Shaw, supra
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. In its best defense, the OECD Convention is an example that both models can co-exist, serving as the showcase for this "legalization" movement.

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 under the FCPA, which has tactfully been used as model anti-bribery legislation for nation-states acting under the mandates of the OECD Convention. Enacted in response to the Lockheed scandal in Saudi Arabia, note 164, at 692-93 (advancing the moral character of anti-bribery laws with arguments based on economic forces—bribery boosts prices unjustifyably, encourages poor management, endangers freedom of economic choices, increases transactional costs, reduces state revenues, increases public expenditures, and burdens consumers).

See, e.g., Abbott & Snidal, supra note 14, at 141-42 n.2 (distinguishing "value" from "interest" models with citations to "influential examples" of the dialogs between proponents of these models).

Id. at 145-47.

Id.; see also Kenneth W. Abbott, The Many Faces of International Legalization, 92 AM. SOC'Y INT'L L. PROC. 57, 57 (1998) ("The legalization of international relations is a highly variable phenomenon.").

For a "moral" defense of the FCPA, see, for example, Shaw, supra note 164, at 689 (relating values and economic interests).

Arabia in the 1970s,\textsuperscript{162} the FCPA does not prohibit bribes 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.\textsuperscript{183} 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."\textsuperscript{184} 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.\textsuperscript{185} Further, to be liable under the Act, the company making the bribe must act with a "knowing" state of mind.\textsuperscript{186} "Knowing" is defined to include awareness of a "high probability of the existence of [certain] circumstances [required for the offense]."\textsuperscript{187} The legislative history indicates that a deliberate "burial of one's head under the sand"\textsuperscript{188} to refute knowledge will not eliminate liability under the Act, so long as knowledge of the predicate circumstances can be proven or established.\textsuperscript{189} Thus, concepts such as "conscious disregard," "deliberate ignorance," or "willful blindness" are meant by the leg-


\textsuperscript{184} 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." 15 U.S.C. §§ 78dd-1(f)(1)(A), -2(h)(2)(A), -3(f)(2)(A) (emphasis added).

\textsuperscript{185} Under the current interpretation of the FCPA, if payment is 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, 835-36 (5th Cir. 1991).


\textsuperscript{187} Id. § 78dd-1(f)(2)(B).

\textsuperscript{188} The phrase "burying 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 of corruption that may constitute a violation of the FCPA or U.S. export control law.

islature 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 macroeconomic 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 on the part of the host government’s individual leaders. How cash bonuses or payments are used may disingenuously be 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 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. Violations of

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190 Id.; see also United States v. Jewell, 532 F.2d 697, 701-02 (9th Cir. 1976), 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).
accounting or auditing requirements with respect to the documentation and explanation of payments made in connection with international business activities may become separate violations of the FCPA.\textsuperscript{191} (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 under U.S. securities law.\textsuperscript{192}

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.\textsuperscript{193} "Reasonableness" and "accurate and fair reflection" can easily be met with respect to the bonus payments,\textsuperscript{194} 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.\textsuperscript{195} 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 closed doors in governmental offices of the host country within the exclusive province of sovereignty.\textsuperscript{196}

If indeed bonuses or any type of cash payments are meant for

\textsuperscript{191} 15 U.S.C. § 78m(b) (2000).
\textsuperscript{192} Id. § 78m(b)(2).
\textsuperscript{193} Id. § 78m(b)(2)(A).
\textsuperscript{194} See, e.g., DON ZARIN, DOING BUSINESS UNDER THE FOREIGN Corrupt PRACTICES ACT § 6.6 (2003) (discussing the legality of donations or concessions made to governmental entities).
\textsuperscript{195} Id.
the benefit of the "people", anti-bribery law enforcement with respect to the use and disbursement of multimillion-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 back home 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.

Imposition of stricter due diligence duties upon the IOGCs, which are in the best position to conduct such due diligence, should be considered 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 IOGCs should be required to conduct due diligence and to 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 "people's" interest and contributing directly to the local community. 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.\textsuperscript{197} 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.\textsuperscript{198} If administered via an NGO, the use and disbursement of 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 (i) minimize or alleviate cash bonus requirements (other than those earmarked cash payments exemplified above), or (ii) otherwise replace cash payments with social programs. Any concern regarding the potential misuse of

\textsuperscript{197} See, e.g., A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 589-90 (N.J. 1953) (articulating the doctrine of corporate social responsibility as a rationale for state legislature allowing corporations to make charitable contributions for public welfare, scientific, or educational purposes); see also MODEL BUS. CORP. ACT § 3.02(13) (2002); A.A. Berle, Jr., Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049, 1050 (1931) (discussing public policy considerations underlying “the law governing every corporate power”); E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145, 1154 (1932) (remarks of Owen D. Young, Chairman of General Electric); Faith Stevelman Kahn, Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy, 44 UCLA L. REV. 579, 588 (1997) (indicating that while cash is the “most popular currency” for corporate contributions, donation of products, property, and equipment also occur). Compare Warren E. Buffet el al., Hostile Takeovers and Junk Bond Financing: A Panel Discussion, in KNIGHTS, RAIDERS AND TARGETS 10, 14 (John C. Coffee, Jr. et al. eds., 1988) (quoting panelist Warren E. Buffett as saying that “not one CEO has reached in his pocket and pulled out 10 bucks of his own to give to this marvelous charity”), with Milton Friedman, A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits, N.Y. TIMES, Sept. 13, 1970 (Magazine), at 32, 126 (“[T]he 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 . . . .’”).

\textsuperscript{198} Political contributions made abroad by U.S. companies are subject to FCPA implications. 15 U.S.C. §§ 78dd-1(a)(3), -2(a)(3), -3(a)(3) (2000). In contrast, the OECD Convention does not mandate national laws addressing corrupt political contributions. OECD Convention, supra note 165. The U.S. Supreme Court has held that corporate entities are entitled 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) (discussing domestic political control by corporations in early twentieth century America). 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.
cash bonuses for corrupt purposes will practically be rendered moot. The tremendous leverage and bargaining power that the MNC-IOGC community has over host governments should be exercised and put to use in accordance with a systematic "public interest" and "social responsibility" objective. This objective can only be accomplished if the MNC-IOGC community is governed by a "self-enforced regulation" model, which encourages the MNC-IOGC community to provide 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 national bureaucracies, 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.

3.1.3.7. 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

199 See Duong, supra note 38 (manuscript nn.412-13 & n.421) (discussing authorities for management-based regulations); supra note 40 and accompanying text. For a scholarly survey of transnational corporations' existing self-regulations programs, see Ans Kolk et al., International Codes of Conduct and Corporate Social Responsibility: Can Transnational Corporations Regulate Themselves?, 8 TRANSNAT'L CORPS. 143, (1999).

200 McAdams, supra note 3, at 252.

acting in the best interest of its people and is itself 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 for the country and its inhabitants. While this point may first seem obvious, 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\(^{202}\) 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 is more an art than an exact science.\(^{203}\) 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, Vietnam, Iran, and Libya is 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 acts 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. MAGA can amount to “creeping nationalization or expropriation,”204 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 over time.205 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 United States, 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 twenty or thirty years long.206 Exploration (quite often an initial five-year commitment) may involve very high risks of failure—for years, the conventional explorationist often commented that out of ten ventures, at least nine were unsuccessful—although recent technological advances—particularly 3-D seismic technology—may have increased the probability of exploration success to a percentage much higher than the dismal ten percent of 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-


205 Id.

206 DERMAN, supra note 110, at 65.
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, top-tier IOGCs typically 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 will 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 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 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


208 See supra note 197 and accompanying text.
investors, or, at best, the provision of a "voice" forum for other stakeholders such as employees or creditors. Even in the United States' "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 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 geopolitical dynamics of the home jurisdiction and the political agenda of its lawmakers. The fact that geopolitical dynamics drive the effectiveness of enforcement, or lack thereof, is a reality of the global community. It is precisely because of this

209 See Engle, supra note 24, at 117 ("[M]ost efforts . . . [at reforming U.S. security law to promote corporate attention to human rights issues] have focused . . . on shareholders' rights to propose resolutions for adoption by the company."); Paul Redmond, Sanctioning Corporate Responsibility for Human Rights, 27 ALTERNATIVE L. J. 23, 23 (2002) ("Corporate law[’s] . . . concerns are with financial accountability to investors, not accountability for human rights standards.").

210 See, e.g., SEC v. Transamerica Corp., 163 F.2d 511, 513 (3d Cir. 1947) (considering Lewis Gilbert’s shareholder proposal that shareholders, rather than directors, select company’s auditors); McDonald’s Corp., Notice of McDonald’s Corporation 2001 Annual Shareholder’s Meeting and Proxy Statement, Item 4 (recommending a vote against a shareholder proposal addressing human rights for Chinese workers), available at http://www.shareholder.com/Common/Edgar/63908/950131-01-500546/01-00.pdf (last visited Nov. 16, 2004); DAVID BOLLIER, CITIZEN ACTION AND OTHER BIG IDEAS, A HISTORY OF RALPH NADER AND THE MODERN CONSUMER MOVEMENT, ch. 1 (recounting Nader’s “Campaign GM” during which he helped push through a new federal auto safety law in the 1970s), available at http://www.nader.org/history/bollier_chapter_1.html (last visited Nov. 16, 2004). Proxy fights by insurgents are expensive, and SEC Rule 14a-8 requires that shareholder proposals be limited to 500 words. However, the SEC has proposed changes to current Rule 14a-8 for the benefit of shareholders. 15 U.S.C. § 78a (1999); 17 C.F.R. § 240 (2001); 17 C.F.R. § 240.14a-8 (2001) [hereinafter Rule 14a-8] (addressing procedures and requirements for shareholders' proposals and their inclusion in a company's proxy statement), available at http://www.sec.gov/rules/final/34-40018.htm; see also Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-39093 ("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."), available at http://www.sec.gov/rules/proposed/34-39093.htm (last visited Nov. 16, 2004).

For more recent SEC proposals to amend Rule 14a-8, see supra note 53.
reason that public international and humanitarian law has often been criticized as inspirational law or "soft" law, without enforcing teeth.\footnote{Herbert V. Morais, The Quest for International Standards: Global Governance vs. Sovereignty, 50 U. KAN. L. REV. 779, 780-81 (2002) (discussing "soft law" versus "hard law" on issues of global governance).}

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.\footnote{UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, THE SOCIAL RESPONSIBILITY OF TRANSNATIONAL CORPORATIONS, U.N. Doc. TD/UNCTAD/ITE/IIT/Misc. 21 (1999) (advocating that, in an age of increasing globalization, transnational corporations must have a social duty to do more than maximize shareholder value), available at http://www.unctad.org/en/docs/poiteitm21.en.pdf.} 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 tyrannical the regime may seem. Once fully invested in the country, IOGCs are naturally long-term supporters of the incumbent governments 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 U.S. Overseas Private In-
vestment Corporation ("OPIC"). So long as the United States has

213 Political risk insurance and investment guarantees are provided by the following institutions, two of which, the Overseas Private Investment Corporation ("OPIC") and the Export-Import Bank ("ExIm"), are bilateral Export Credit Agencies ("ECA") formed by the United States:

1) MIGA: Partly funded by the World Bank, MIGA provides insurance 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 co-insurance and re-insurance programs. Noncommercial 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 INV. GUAR. AGENCY, 1996 ANNUAL REPORT (1997) (discussing growth in FDI); Multilateral Inv. Guar. Agency, About MIGA (discussing MIGA’s mission to promote FDI into developing countries), at http://www.miga.org/screens/about/about.htm (last visited Oct. 29, 2004).

2) OPIC: Political risk insurance and investment guarantees can also be obtained by U.S. 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. 22 U.S.C. §§ 2191-2200b (2004). 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. See Overseas Private Inv. Corp., The Overseas Private Investment Corporation (OPIC) (providing an overview of the organization), at http://www.opic.gov (last modified Nov. 10, 2004); see also Randi S. Cohen, OPIC Insures Investment in Central and Eastern Europe and the Baltic States, 1 NEW EUR. L. REV. 95, 121-23 (1992) (discussing the growing role of OPIC in insuring private investors in the former Soviet Union).

3) 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’ 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. See Export-Import Bank of the United States, Export-Import Bank of the United States (providing an overview of the organization), at http://www.
not embargoed a country, or otherwise set limits on trade or investment, U.S.-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 (1) the "internationalization" doctrine, and (2) 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 able MNCs. These techniques lock the incumbent government into


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"), part of the Ministry of Finance. See Ministry of Fin. Japan, Ministry of Finance, at http://www.mof.go.jp/ (last visited Oct. 29, 2004) (providing an overview of the organization). All such bilateral agencies have their own criteria for Project Financing to facilitate "Third World" economic development.

The above-mentioned 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") (for more information on the TDA, please visit http://www.tda.gov), or long-term interest-free loans provided by the International Development Association ("IDA"), a World Bank affiliate. See David Blu-mental, Sources of Funds and Risk Management for International Energy Projects, 16 BERKELEY J. INT'L L. 267, 269 (1998) (examining how energy companies can operate in emerging economies through various funding strategies available through multilateral and bilateral institutions); see also U.S. Agency for Intl Dev., U.S. Agency for International Development (providing an overview of the organization), at http://www.usaid.gov/ (last visited Oct. 29, 2004).

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.

3.1.3.7.1. The "Internationalization" Doctrine

Conflicts of law (or "private international law," as that term is used in Europe)\textsuperscript{215} can present the most haunting and perplexing issues for lawyers and academics,\textsuperscript{216} 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 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 IBTs.\textsuperscript{217} In its ulti-

\textsuperscript{215} See, e.g., Convention on the Law Applicable to Contractual Obligations, art. 15, 1998 O.J. (C 27) 34 (using the phrase "private international law" to describe what United States lawyers know as "conflicts of law").

\textsuperscript{216} See, e.g., P. M. NORTH, CONTRACT CONFLICTS 9, 17, 297 (1982); Stephen B. Burbank, Jurisdictional Conflict and Jurisdictional Equilibration: Paths to a Via Media?, Papers Presented at the Conference on Transatlantic Business Transactions: Choice of Law, Jurisdiction and Judgments (June 1-3, 2003) (considering forum non conveniens and lis pendens from an American perspective); Symeon C., Symeonides, Choice of Law in American Courts in 1995: A Year in Review, 44 AM. J. COMPAR. L. 181 (1996); see also DETLEV VAGTS, TRANSNATIONAL BUSINESS PROBLEMS 466-72 (1986) (exploring choice of law in contracts, one of the most confusing areas of conflicts of law, and presenting possible solutions to the confusion); Carlo Croff, The Applicable Law in an International Commercial Arbitration: Is It Still a Conflict of Laws Problem?, 16 INT'L LAW. 613 (1982) (discussing whether arbitrators should choose the applicable law to an international contract via the use of a private international law rule).

\textsuperscript{217} See supra note 213 (discussing international political risk insurance entities); see also FILIP DE LY, INTERNATIONAL BUSINESS LAW AND LEX MERCATORIA 15-20 (1992) (comparing the example of a medieval law merchant to the present-day concept of lex mercatoria); John Hononold, The Influence of the Law of International
mate objective, the doctrine calls for the universal incorporation into the local law of all those industry norms or practices that are so well-established they become part of modern *lex mercatoria*, or, more broadly speaking, international economic law. The doctrine establishes that interpretation of 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 investment contract from a local law contract to an international contract, bringing the project to international and industry standards, notwithstanding its local *situs*.

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218 See, *e.g.*, supra notes 23-24 (explaining the term *lex mercatoria*). The phrase "international economic law" has broader implication than "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 currencies as revenues. When this trend is observed in agricultural products, it means that the poor of the "Third World" "starve" in order to supply the best products for the "First" and "Second World," and to enable their country to accumulate hard currencies via export to satisfy international debt obligations. The result is a "Third World" standard of living that can shock the conscience of, or quite often can 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 generally VICTOR HUGO, *LES MISERABLES* (Charles E. Wilbour trans., 1862) (a novel, popularized in American pop culture by way of a Broadway production almost a hundred years after author Hugo’s death, is an example of such moral decisions). Globalization, in its most efficient and noblest form, should
From a broader perspective, the “internationalization” doctrine evolves as part of the international legal community’s efforts to eliminate or minimize the 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, lawyers’ efforts have been spent 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.220 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.221

3.1.3.7.2. The Stabilization Clause as Protection Against Political Risks

The “internationalization” doctrine has precedential support from a long line of confidential arbitration decisions.222 These deci-

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221 See, e.g., Bonny v. Soc’y of Lloyd’s, 3 F.3d 156, 162 (7th Cir. 1993) (affirming “choice-of-forum” and “choice-of-law” provisions in international agreements); RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 187 (1971) (stating that “choice-of-law” provisions are enforceable).

222 See Texaco Overseas Petroleum Co. v. Libyan Arab Republic, 53 I.L.R. 389, 391 (Int’l Arb. Trib. 1977) (holding that the contract provisions and resulting arbitration at issue were subject to international law for interpretation, not Libyan law); see also Lena Goldfields Arbitration, 5 Ann. Dig. 3 (P.C.I.J. 1930) (holding that “the proper law of contract” was international, not Russian law); Saudi Arabia v. Arabian Am. Oil Co., 27 I.L.R. 117, 153-72 (Arb. Trib. 1958) (holding that while parts of the contract were governed by Saudi Arabian law, other parts were
visions 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 example 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.

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 to be governed by international law if no law was expressly chosen by the parties; Sapphire Int'l Petroleum Ltd. v. Nat'l Iranian Oil Co., 35 I.L.R. 136, 175 (Int'l Arb. Trib. 1963) (holding that the parties deliberately excluded the application of Iranian law and, therefore, submitted contract interpretation and performance "to the principles of law generally recognized by civilized nations"); BP Exploration Co. v. Libyan Arab Republic, 53 I.L.R. 297, 329 (Int'l Arb. Trib. 1973) (holding that general principles of law should be applied, including those which may be applied by international tribunals); Libyan Am. Oil Co. v. Libyan Arab Republic, 62 I.L.R. 140, 171 (Int'l Arb. Trib. 1977) (holding that when a contract involves two foreign countries, because their legal systems are dissimilar, the applicable law should be the general principles governing conflicts of law in private international law); AGIP S.p.A. v. People's Republic of the Congo, 1 ICSID (W. Bank) 306 (1993), 21 I.L.M. 726 (1982) (holding that international law principles can "supplement" any gap in Congolese law or whenever international law is necessary for dispute resolution).

See Sapphire Int'l Petroleum Ltd., 35 I.L.R. at 175.

See Coale, supra note 214, at 222-26 (describing various types of Stabilization Clauses, their purposes and their application); see also WORLD BANK LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT, VOLUME 1: SURVEY OF EXISTING INSTRUMENTS (1992) (discussing "stability of contract" clauses).


See Nolan, supra note 25 (discussing aspects of state licensing as expres-
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 United States 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.

A nation's "jurisdiction to prescribe" does not necessarily stop at the physical borders, although its extraterritorial reach must be supported by a valid exercise of sovereign power rooted in customary international law. This means that a certain nexus must exist to support the extraterritorial extension of national jurisdiction. The nexus can 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 to, or otherwise avoid relational conflicts with, another state); or
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 Ins. Co. v. California, 509 U.S. 764, 765 (1993) (expanding U.S. antitrust jurisdiction and reducing the likelihood of U.S. courts invoking comity to decline jurisdiction over foreign acts causing substantial effect in the United States despite conflicts with foreign law).

Commentators have also noted that the size and attractiveness of the U.S. market, as well as the United States' enormous political and economic power, ac-
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 could just "sell" or "pawn" a nation-state, its people, and its natural resources to a private party and waive sovereign power altogether. 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 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 count for the geopolitical expansion of the U.S. prescriptive authority notwithstanding objections from other countries. Id.

See IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 107 (4th ed. 1990) (discussing concepts of territory and sovereignty); JANIS, supra note 20, at 174-80 (discussing arms control and disarmament and the "return to restraint by the sovereign states"); Duong, supra note 38 (manuscript n.457).

"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.
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 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 Overseas 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 the concessionaire irretractable rights."\textsuperscript{236} According to the tribunal, in granting concessions to IOGCs, Libya did not alienate but, instead, fully exercised its sovereign power to contract.\textsuperscript{237} To the extent international arbitral decisions constitute modern \textit{lex mercatoria}, it can be said that Stabilization Clauses are valid under international law.\textsuperscript{238} In various forms, the Clause has increasingly become standard practice in most PSCs executed with "Third World" countries.\textsuperscript{239}

\textsuperscript{235} Id. Dispute resolution in IBTs 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 "New York Convention"). \textit{See} Convention on Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. 5, 21 U.S.T. 2517, 330 U.N.T.S. 3, 12 (recognizing the need for "greater uniformity of national laws on arbitration"). Accordingly, there has been no court case addressing the validity of the Stabilization Clause in the international context.

\textsuperscript{236} \textit{See} Texaco Overseas Petroleum Co., 53 I.L.R. at 474 (citing the reasoning of Saudi Arabia v. Arabian Am. Oil Co., 27 I.L.R. 117, 168 (Arb. Trib. 1958)).

\textsuperscript{237} Id. at 477; \textit{see also} Kimmo Mettala, \textit{Governing-Law Clauses of Loan Agreements in International Project Financing}, 20 INT'L LAW. 219 (1986) (addressing "choice-of-law" issue for loan agreements).

\textsuperscript{238} \textit{See} James L. McCulloch \& Christina M. Abascal Deboben, \textit{The Foreign Corrupt Practices Act and Other Legal Considerations Relevant to the Oil and Gas Industry in Latin America}, 77 TUL. L. REV. 1075, 1087 (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") (quoting Michelle Flores, comment, \textit{A Practical Approach to Allocating Environmental Liability and Stabilizing Foreign Investment in the Energy Sectors of Developing Countries}, 12 COLO. J. INT'L ENVTL. L. \& POL'Y 141, 161 (2002)).

\textsuperscript{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 sovereignty power to proscribe conduct of its citizens by way of inhumane regulatory measures affecting the peoples' liberty interests should likewise be less than "permanent" and, hence, can similarly be circumvented by acts of outsiders premised upon international humanitarian laws. Such humanitarian laws 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 \textit{Doe I v. UNOCAL Corp.}, No. 00-56603, 2002 U.S. App. LEXIS 19263 (9th Cir. Sept. 18, 2002), the court barred Burmese villagers' claims against the military government of Myanmar and a U.S. oil company, using the "Sovereign Immunity Doctrine" codified in U.S. statutory law. \textit{See} Foreign Sovereign Immunities Act, 28 U.S.C. §§ 1602-07 (2000) (codifying a foreign state's immunity from the jurisdiction of U.S. courts unless the challenged act of such foreign state falls under statutory exceptions laid out in §§ 1605-07). The UNOCAL case has been
When carefully drafted and broadly applied, the Stabilization Clause can shield the investment from new taxes, new legislation, new regulations, decrees of nationalization or expropriation, or any other form of a 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 of the applicable law. This is potentially 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 (the “Six Premises”), as explained below.

3.1.3.7.3. Challenging and Reexamining the Popular Stabilization Clause – the Six Premises

3.1.3.7.3.1. 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. This is the gist of permanent sover-
eighty. In fact, this sovereign power constitutes the type of macro-
and microeconomic oversight critical to nation-building as well as
to the building of an efficient world economy. U.S. courts have
recognized permanent sovereignty as an "inalienable right"
uniquely applicable to a nation-state's control power over its natu-
ral resources and economic activities, and, as such, permanent sov-
ereignty cannot be waived. If the reverse scenario had been pre-
sented to the American public and its court system—that a non-
U.S. investor wanted a political subdivision or branch of the U.S.
government to waive the United States' rights to enact new legisla-
tion 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 took the investor to table it for discussion.

3.1.3.7.3.2. 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 govern-
ment is toppled or denounced as illegitimate, one of the three ele-
ments of "statehood" (territory, people, government) becomes
missing. Therefore, a contract executed by a defunct or illegitimate
government, which never had the recognition of the "people," is
not binding upon a nation. 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

241 See Banco Nacional De Cuba v. Chase Manhattan Bank, 658 F.2d 875, 889
(2d Cir. 1981) (citing a U.N. General Assembly resolution emphasizing permanent
sovereignty over natural resources).
242 See supra notes 64, 228 (discussing elements of "statehood").
243 See PATRICIA ADAMS, ODIOUS DEBTS: LOOSE LENDING, CORRUPTION,
AND THE THIRD WORLD'S ENVIRONMENTAL LEGACY 165 (1991)
("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 etc., this debt is odious for
the population of the State.") (quoting ALEXANDER SACK, LES EFFETS DES
TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS
FINANCIÈRES [THE EFFECTS OF STATE TRANSFORMATIONS ON THEIR PUBLIC DEBTS AND
OTHER FINANCIAL OBLIGATIONS] (1927)).
regime's voluntary compliance, instigated by 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'état or revolution uprooting the current political or legal foundation. But even if the new regime is amenable to establishing 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 IOGC's incentive to support the incumbent regime long-term, in an effort to control and minimize Political Risks.

3.1.3.7.3.3. The Third Premise: The Host Government or Its 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

Herein lies the paradox: if the foreign investor is already haunted by such skepticism, such that she has to insist on a Stabilization Clause, why is she entering into a binding contract recognizing the legitimacy or stability of such a political regime in the first place?

244 See Harris Corp. v. Nat'l Iranian Radio & Television, 691 F.2d 1344 (11th Cir. 1982) (noting that the new regime after the Iranian revolution in the 1970s refused to honor contracts executed between U.S. companies and the former government); accord Am. Bell Int'l, Inc. v. Iran, 474 F. Supp. 420 (S.D.N.Y. 1979); M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT (1994). Another 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 rescinded by the incoming government. Press Release, Patricia Adams, Probe International, Philippine Government to Dismantle Marcos Nuclear Plant (Feb. 28, 2000), at http://www.odiumdebts.org/odiumdebts/index.cfm?DSP=content&ContentID=9; see also Maristella Cardenas, Freedom from Debt Coalition: Philippines, ECAs in the Philippine Power Sector and the Continuing Debt Problem (Dec. 12, 2003) (arguing that a new government is not obliged to honor existing contracts that hurt the interest of the people), at http://www.jubileesouth.org/news/EpZyVyuAVISMrrFluL.shtml. Likewise, the validity of contracts made in Namibia under regimes controlled by South Africa has also been questioned.
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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 its 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 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.\(^2\)\(^4\)\(^5\) The Clause 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.

\(^{245}\) Cf. Menachem Mautner, Contract, Culture, Compulsion, or: What is so Problematic in the Application of Objective Standards in Contract Law?, 3 THEORETICAL INQUIRIES IN L. 545 (2002) (questioning objective approaches, such as "the economic man," to contract interpretation; analyzing the role of culture in contract formation; arguing that contract-making is the functional equivalent of "trust" because 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).
3.1.3.7.3.4. The Fourth Premise: Principles Respecting the Sanctity of Contract are Part of International Law, Starting With the Law of Treaties

Likewise, among those principles of contract law that should constitute the "general principles common to the major legal systems" as a source of customary international law is another legal concept called voluntary assumption of risk. Where the legal and political environment of the host country is extremely volatile, the IOGC 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 preinvestment 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

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248 See, e.g., Restatement (Second) of Torts, § 496C (1965) (discussing the concept of implied assumption of risk in American law: 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); Deena B. Bothello, Note, An Unequal Balance: Repudiation and Restitution in Mobil Oil Exploration & Producing Southeast Inc., v. United States, 80 Or. L. Rev. 1469 (2001) (criticizing the Court's holding allowing an oil company to recoup its loss as upsetting principles of voluntary assumption of risks undertaken by the oil company when it entered into a contract with the local government).
measures improve, rather than jeopardizing, the investor’s bargained-for position under the investment contract. As a practical solution, the clever IOGC 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-à-vis the host government will get the broadest protection from such a standardized, jointly negotiated, and coordinated Stabilization Clause. The smaller investor who is not part of any “joined forces” or “de facto cartels” will not get such broad 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.

(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

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249 The “Renegotiation Clause” may be considered a species of the Stabilization Clause, or it can be viewed as 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 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
3.1.3.7.3.5. The Fifth Premise: The Natural Result of the First Four Premises – Capacity to Contract and Negotiating Objectives

It follows, therefore, that 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 (1) the contracting capacity of the host government or its agent in the deal-making process; and (2) 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.

(1) Host Government's Capacity to Contract. Of critical importance in the contracting process is the issue of who can bind the nation-state. The "double hat" nature of the government's role as a contracting party—either as sovereign state 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

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benefits ascertained based on the characteristics of the gas found. A "Review Clause," however, 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 70 (Natural Resource Law Section, American Bar Association Monograph Series No. 16, 1992); see also McCulloch & Abascal Deboen, supra note 238 (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. & POL'Y INT'L BUS. 451 (1998) (citing modern contractual practice of moving from traditional Stabilization Clauses to preferred renegotiation clauses).

250 In the Vietnam Deal, PetroVietnam wore two hats: first, as a representative of the sovereignty; and, second, as an SOE/commercial entity doing business for the government and of which the government was the sole owner.
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economically powerful the MNC is, the more chance it will 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 its constituent units may be ambiguous. The constituent states may, within their 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 the foreign investor or even immobilize the project, at least during the period of political in-fighting. Likewise, it is not unheard of for the actual practice to differ from the written rules.251

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 non-existent on these critical legal issues.)

Where the host government has designated an SOE to serve as the 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.”252 It may or may not have corporate assets, if it does, its

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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 Grazhdanskii Kodeks RF [GK RF], arts. 114, 115, *translated in*
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 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 starting point.

But that is not all. As the ultimate risk control measure, MNCs may attempt to get parliamentary approval of their contracts, including the Stabilization Clauses aided by all the “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. In such a case, legislative approval of the investment contract is mandatory. Where parliamentary approval is not mandatory, it still provides additional assurance at the highest level and bolsters the validity of all 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, parliamentary approval 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, instead of 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

CIVIL CODE OF THE RUSSIAN FEDERATION: PARTS ONE, TWO, AND THREE 55-56 (William E. Butler ed. and trans., 2002). On the other hand, SOEs in the Russian 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 id. arts. 294, 296.

Id.
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 arise as to whether provisions of the contract are 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). For example, the PSC often addresses other matters such as customs, export-import of goods and services, labor, taxes, and environmental and workforce safety, many of which are beyond the regulatory power of petroleum authorities. Legislative approval of the PSC may affirm the petroleum authorities' power, but not necessarily its application to 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 on the nation-state. As such, the Clause can deter and 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 a nation-state's Parliament or Congress, its taxing, Treasury, or Central Bank authorities would 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, this type of power transfer 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 that 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 implications for a nation, which go well past the four corners of the investment contract.

In the past few decades, MNCs have tried, and have succeeded, in obtaining parliamentary 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 econ-
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 close-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 either 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.

(2) The Paradoxical Negotiating Objective of the IOGC Investor. It follows from the discussion above that the MNC-IOGC's objectives are two-fold: to bind the host government (i) both in its sovereign capacity; and (ii) in its commercial capacity, in the same contract. Such a posture may be viewed by legal scholars as inherently paradoxical; yet it has been done as a practical matter to facilitate "Third World" economic development, and, with respect to U.S.-based MNC-IOGCs, as a necessary strategic measure to accommodate the current status of U.S. law, as 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."255

To serve its purpose, the Stabilization Clause must be interpreted as a 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 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.

254 See generally OECD, ASSESSING INVESTMENT OPPORTUNITIES IN ECONOMIES IN TRANSITION 11 (1994).
255 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, supra note 9, at 103.
This paradoxical negotiating objective is necessitated by the current state of U.S. laws and 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 United States), the host government or the SOE acting on the government's behalf may attempt to assert two defenses: (i) the jurisdictional defense of Sovereign Immunity, now codified in the U.S. Foreign Sovereign Immunity Act ("FSIA") \(^{256}\) (the "Sovereign Immunity Doctrine"); and (ii) 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"). \(^{257}\)

Both the Sovereign Immunity and Act-of-State Doctrines have firm roots in U.S. laws. The Sovereign Immunity Doctrine compels federal courts to relinquish subject-matter jurisdiction over an action against a foreign state, in due respect for principles of comity rooted in customary international law, \(^{258}\) unless certain statutory exceptions are met under U.S. law. \(^{259}\) 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. \(^{260}\) Under the Act-of-State Doctrine, a U.S. court should not "sit in judgment" of another country's sovereign act "within its own territory," \(^{261}\) because the substitution of judgment would infringe upon an executive function, causing sovereign embarrassment or discord in international relations, and undermining the "separation of power" bedrock of

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\(^{258}\) Schooner Exchange v. McFaddon, 11 U.S. 116 (1812).


\(^{261}\) See 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.\textsuperscript{262} 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."\textsuperscript{263} 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 United States.\textsuperscript{264} Commentators, however, have noted the decline in the use and invocation of the doctrine in past decades.\textsuperscript{265}

In practical terms, the Act-of-State Doctrine functions as a con-

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\textsuperscript{263} In \textit{Sabbatino}, the Supreme 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." \textit{Sabbatino}, 376 U.S. at 428.


conflict-of-law principle and, in this regard, does not advance the interest of the MNC-IOGC. The doctrine establishes that the law of the forum (*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 *lex fori*. The doctrine's practical impact lies in the consequence of its application: only *lex loci* or *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. law, two exceptions to the Sovereign Immunity and Act-of-State defenses have been carved out by statute, 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 (1) the sovereign act constitutes a "taking" of an investor's property "in violation of international law" (the "International Law Exception"); and/or if (2) the sovereign act in question constitutes a "commercial activity" (the "Commercial Activity Exception").

(1) 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 view-

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points in the ongoing North-South dialogue since the day of the Cuban Revolution and throughout the 1970s and 1980s. 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 in order to justify federal court subject matter jurisdiction. Under the FSIA, without such territorial nexus to the United States, the International Law Exception does not apply.

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269 U.S.C. § 1605(a), (a)(3) (2000) ("A foreign state shall not be immune from the jurisdiction of courts of the United States 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 of the foreign state and that agency or instrumentality is engaged in a commercial activity in the United States . . . .") (emphasis added).

270 Id. With respect to the Act-of-State Doctrine, the International Law Exception took the form of a statutory amendment to the Foreign Assistance Act (the "Second Hickenlooper Amendment" or "Sabbatino Exception," enacted to overturn the Sabbatino decision and to overcome the Sabbatino presumption that the adjudication of the act of the foreign state would embarrass the executive branch). 22 U.S.C. § 2307(e)(2); see also 108 CONG. REC. 7,893 (1962). In Sabbatino, the U.S. Supreme Court applied the Act-of-State Doctrine to avoid review of Cuba's taking of U.S. investors' property. Under the Second Hickenlooper Amendment, in general, the Act-of-State Doctrine does not apply to a foreign taking of U.S. investor's property in violation of international law, thereby narrowing the scope of the Act-of-State-doctrine for the benefit and in the interest of U.S. investors. The Amendment thus created the International Law Exception to the Act-of-State Doctrine, equivalent to the "International Law" statutory exception under the Foreign Sovereign Immunities Act. U.S. courts have not been receptive, and have generally preserved the application of the Act-of-State Doctrine unless a case "precisely" fits
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. So long as the divergence of opinion persists, any proposed rule of law will fall short of the status of customary international law because the disagreement defeats the notion of consensus accorded to universally accepted custom.\textsuperscript{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.

(2) The Commercial Activity Exception. In contrast, no such territorial nexus to the United States is needed for the Commercial Activity Exception to apply in order to defeat the host government's claim of Sovereign Immunity. In general, compared to the statutory International Law Exception, the Commercial Activity Exception may be an easier test for U.S. investors to meet under the FSIA, because the exception 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 resolve questions of international law.

The Commercial Activity Exception illustrates the "defensive" application of the United States' "extraterritorial jurisdiction to

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\textsuperscript{271} Custom, as a source of international law, is created through the practice and opinion (\textit{opinio juris sive necessitates}) of states, and by a state's behavior when it acts out of a sense of legal obligation. \textit{Restatement (Third) of Foreign Relations Law} § 102(1)-(2)(1987); \textsc{Rebecca M.M. Wallace, International Law} 9, 15 (2d ed. 1992).
"Commercial Activity" is statutorily defined as "either a regular course of commercial conduct or a particular commercial transaction or act." 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." Since the host government's violation of the Stabilization Clause may constitute a breach of the investment contract, the "nature" of such breach may render 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 Activity. 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 the legislative act of a sovereignty. By statutory definition, it is the nature of the act (the entering into a commercial deal and subsequent 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

\[\text{272} \quad 28 \text{ U.S.C. § 1605(a)(2) (2000) (emphasis added).}\]
\[\text{273} \quad 28 \text{ U.S.C. § 1603(d) (2000).}\]
\[\text{274} \quad \text{Id.}\]
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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.\textsuperscript{275} The ambiguity haunting the scope, availability, and vitality of 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. Furthermore, compared to Sovereign Immunity, which must be applied based on interpretation of the FSIA’s statutory elements, the judge-made Act-of-State Doctrine results from case-by-case judicial balancing of factors that may warrant abstention.\textsuperscript{276} Accordingly, from a risk-management standpoint, the probability of success or outcome of an Act-of-State Doctrine defense in litigation may be much harder to assess. The doctrine carries more risk and less certainty, and hence poses a 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 decisions! 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

\textsuperscript{275} See Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 (1976) (plurality opinion) (deciding that pure commercial obligations of a foreign government were not within the Act-of-State protection). The part of the opinion outlining the Commercial Activity Exception was agreed to by only four of the nine justices and hence continues to be of doubtful, or less significant, precedential value). Cf. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964) (deciding in favor of judicial abstinence due to foreign policy considerations and avoiding detailed analysis of the Act-of-State Doctrine). \textit{But see} Hunt v. Mobil Oil Corp., 550 F.2d 68 (2d Cir. 1977) (recognizing Commercial Activity Exception to Act-of-State Doctrine as viable law); \textit{see also} W.S. Kirkpatrick & Co. v. Envtl. Tectonics Corp., 493 U.S. 400 (1990) (holding that the 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).

\textsuperscript{276} \textit{Sabbatino}, 376 U.S. at 428 (“[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 of property within its own territory by a foreign sovereign government...”).
is “pawning” her subjects for the benefit of the throne! When serving as a permanent shield for the “bad acts” of a corrupt, incompetent, and recalcitrant government, both the Sovereign Immunity and Act-of-State Doctrines can become an accomplice to a pattern that obstructs, instead of furthers, the social goals underlying the “development” model when it reaches the “Third World.”

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 United States, as certain aspects of sovereign powers 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 mechanisms 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. Furthermore, in commercial deals, governments should ultimately be held liable to their peoples, and in the appropriate cases should be made accountable to the global market for failure to conform with their contractual obligations. This accountability should serve as a deterrent against governmental “bad acts” or mismanagement of national affairs. 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 where there is 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

277 John H. Jackson, Sovereignty-Modern: A New Approach to an Outdated Concept, 97 AM. J. INT’L L. 782, 785 (2003) (“[T]he rethinking of ‘sovereignty’ is necessary to escape the traps of use or misuse of older sovereignty thinking . . . .”).

278 McAdams, supra note 3, at 241, citing KENICHI OHMAE, THE END OF THE NATION STATE, at viii (1995) (suggesting that the practice of liberal democracy in the West and the notion of national sovereignty are being called into question by globalization).
U.S. forum that applies \textit{lex fori}'s jurisdictional principles to the adjudication of the IOGC's breach of contract claim, or to the IOGC's request for the enforcement of a favorable arbitral award.\textsuperscript{279} The Stabilization Clause, bolstered by various "sovereign capacity" and "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.

\textbf{3.1.3.7.3.6. The Sixth Premise: Remedies Available 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 remedy? This question strikes at the core of the Stabilization Clause and reveals a dangerous pitfall for foreign investors seeking to enforce it 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 drilling work for 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 would give a virtual windfall to the IOGC-contractor. Restitution would make the company whole notwithstanding the potential losses it might have endured due entirely to Appraisal Risks. Restitution would also rescue the company from financial losses resulting from entering into an imprudent commercial deal in which the IOGC has apparently misevaluated 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

\textsuperscript{279} Lower courts have held that overcoming the Sovereign Immunity jurisdictional defense does not necessarily establish \textit{in personam} jurisdiction over the sovereignty under the standards of \textit{Int'l Shoe Co. v. Washington}, 326 U.S. 310 (1945). See, e.g., \textit{Carey v. Nat'l Oil Corp.}, 453 F. Supp. 1097, 1101 (S.D.N.Y. 1978) (dismissing claim against Libya's National Oil Corporation on ground that the discontinuation of oil shipments to the U.S. plaintiff's Bahamian subsidiaries did not cause a "direct effect in the United States," and therefore did not provide the "minimum contacts" necessary to give the court personal jurisdiction over the defendant).
bargaining power, but also alters the nature of sovereignty. "Third World" governments can exercise and enforce their sovereign power against their entire "Third World" populations, but if such a government wants to enforce the same power 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-scale 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 almost entirely its status quo prior to the execution of a domestic petroleum exploration contract.\(^{280}\) In order to secure a mineral lease to explore for oil off the North Carolina coast, Mobil had paid an upfront cash bonus of $156 million in addition to annual rentals.\(^{281}\) Analogous to a Signature Bonus in an international petroleum deal, the $156 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 of access 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 a 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 the Interior refused to approve the project based on new legislation,\(^{282}\) the lower court ordered restitution, allowing the company to recoup its initial investment.\(^{283}\) The Supreme Court held that because the government repudiated the contract and impaired its economic value, the refund of the cash


\(^{281}\) Id. at 609.

\(^{282}\) Id. at 611-13.

\(^{283}\) Id. at 613-14 (citing Conoco, Inc. v. United States, 35 Fed. Cl. 309 (1996)).
bonus to the company was appropriate, whether or not the contract would have ultimately proved to be profitable to the company.\textsuperscript{284} 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.\textsuperscript{285} Such a statement is the government's "individualized speech" in the commercial context, and not just an exercise of sovereign power.\textsuperscript{286} 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.\textsuperscript{287}

At least one commentator has severely criticized the \textit{Mobil} decision as over-broadly redefining contractual relationships and expanding contract law for the benefit of big businesses simply because the United States is a contracting party.\textsuperscript{288} 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, simply because 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.\textsuperscript{289} 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.\textsuperscript{290} When legislation is regarded as "individualized speech," the nature of law changes from that of a function of order and justice to a means

\textsuperscript{284} \textit{Id.} at 608 (citing \textit{RESTATEMENT (SECOND) OF CONTRACTS} § 373, cmt a, illus. 1 (1979), which provides an example calling for full restitution on a seller's breach of contract for a sale of land at a price higher than its market value). A sale of land, however, is entirely different from a contract from access rights to explore for oil, after which both landowner and operator will share in production and the profit resulting therefrom.

\textsuperscript{285} \textit{Id.} at 619-20 ("[I]f legislation passed by Congress and signed by the President is not a 'statement by the obligor,' it is difficult to imagine what would constitute such a statement.").

\textsuperscript{286} \textit{Id.} at 607 (citing United States v. Winstar Corp., 518 U.S. 839, 895 (1996)).

\textsuperscript{287} \textit{Id.} at 624.

\textsuperscript{288} Bothello, supra note 248.

\textsuperscript{289} \textit{Id.} at 1483.

\textsuperscript{290} \textit{Id.} at 1484-85.
of facilitating transactions and their 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 economy’s 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 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 multimillion-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-scale investment contract may arguably subject 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

\[291\] Id. at 1485-86.

IOGC lawyer, the Stabilization Clause is like the American Express card—don’t leave home without it!

My *Six Premises* serve only to call the attention of the legal community to 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 the important petroleum industry and energy sector of the global economy. As such, the Clause’s popularity should create a frown or, at a minimum, a sense of ambivalence for the prudent scholar. The *Six Premises* analyzed above are intended to expose the dynamic, intricate, intense, and at times disturbing nature of MNC-government confidential partnership negotiation. Considering the imbalance of economic power, as well as the pattern of feeding self-interests, these partnerships can turn into fruits laden with a juice that can be poisonous to the “people” invisible at the negotiation table. Invisible as they are, they will be tasting those fruits because, from a policymaking 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 accumulate 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

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check-and-balance arm of a public interest watchdog representing a concerned international humanitarian community. As the trend for the globalization and "internationalization" of law is calling for various transnational work groups to sit down together and look at the foundation for modern *lex mercatoria*, new procedures and methods 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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In summary, current scholarly discussions may have provided a battleground for competing philosophies and political debates on globalization. The ultimate hope is that the new millennium will bring about a new world order and a new outlook on globalization, wherein true equalization of resources, development of infrastructure, and distributive education will eradicate poverty in every corner of the world. In reality, for years the nature of partnerships between the "Third World" nation-state and the MNC private developer—the apparatus for the realization of this noble goal—has not changed. In fact, the pattern has simply been solidified and reinforced with the opposite result, especially when the interests of the inhabitants of the host country are taken into consideration. The well-formed patterns of these exclusive and confidential partnerships are seemingly inevitable and exceedingly unsatisfactory, yet extremely difficult to change.

So far, I hope to have provided a detailed description of the structure of petroleum development transactions, both with the detachment of a researcher and the clear stand of a social advocate. My thesis points to the following conclusion: when MNC-IOGCs enter into natural resources development projects with many of the lesser-developed countries, the economics of these development projects combined with the politics of the host country almost inexorably leave out those who should be among the primary beneficiaries—namely, the ordinary citizens and small business enterprises of the host country. The economic forces in these projects inevitably lead to the creation of bilateral cartels, with groups of large corporations on the one side and, on the other side, a singular government interest representing solely the ruling elites. The
forces of "free enterprise" competition have no play, particularly in
countries with less-developed political systems, where the check-
and-balance political process of a true democracy may not be
available. As I have stated, when the modern "monarchs" shake
hands with the MNC rainmakers, the door to true capitalism is for-
ever closed to the inhabitants of the transitional economies.

The development of international economic law has done little
to help correct the imbalance, partly due to the "Catch-22" position
created by the very process through which modern international
economic law is formed over time. These exclusive monarch-
investor partnerships in the petroleum sector help create modern
lex mercatoria governing the industry, with MNCs' well-trained
lawyers actively participating in the process. The lawyer, when
structuring and drafting client-protection devices in these interna-
tional development projects, is in effect writing law that will gov-
ern the lives of millions of people whom that lawyer may never
know and for whom no legal recourse will ever exist to guard
against the lawyer's excesses or over-zealous conduct, all in the in-
terest of a powerful client occupying a superior position in a less-
than-arms-length negotiation. Further, disputes are typically re-
solved not in public tribunals but within the confines of confiden-
tial arbitrations, whose results in turn contribute substantially to
the development of modern international economic law. In the
eyes of the critical legal theorists, such modern international eco-
nomic law has been created by elites in their own image in order to
serve their own purpose. The losers are those billions who can
never be part of the negotiation.

In the next case study ("Case Two") to be published in the en-
suing issue of this Journal, I will go on to describe the next step of
the Vietnam Deal, in a scenario where the natural gas discovered
and developed from successful exploration off the Vietnamese
coast will be used onshore as fuel supply for the generation of elec-
tricity to serve the host country and region. In Case Two, I will
identify the necessary complicity of international organizations
such as the World Bank and IMF, as well as the private interna-
tional banking sector as financiers. At the end of the analysis of
Case Two, I will offer some suggestions and conclusions that will
hopefully remedy the ills this "twin series" Article (taken together)
has, and will have, identified.

(to be continued)