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Paola Morales Torrado

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POLITICAL RISK INSURANCE AND BREACH OF CONTRACT COVERAGE: HOW THE INTERVENTION OF DOMESTIC COURTS MAY PREVENT INVESTORS FROM CLAIMING INSURANCE

Paola Morales Torrado†

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I. Introduction

Political risk is one of the risks that foreign investors fear the most when investing in Colombia. Such risk is related to security concerns, and may be evidenced through changes in policy, legislation, contractual relations with state entities, or economic instability. Each one of those situations may be viewed either as a legitimate response or as an immediate consequence to political instability and the violence that has affected the country for the past five decades.1 Due to the need to cover political risks, some entities such as the Overseas Private Investment Corporation and the Multilateral Investment Guarantee Agency have made risk reallocation possible through insurance or guarantee agreements,2 allowing investors to recover at least part of their investment.

In particular, these entities' regulations provide coverage for breach of contract when the investor is contracting with a governmental entity.3 Under such a scenario the investor insures almost the total cost of his investment, expecting to recover the amounts invested in the venture in case the government breaches its obligations.4 In any case, the investor must submit an enforceable arbitration award or judicial decision to the insurer, declaring that a breach by the governmental entity has occurred in order to make a claim.5

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2 Political risk insurance is not the only way available to allocate risks. In the particular case of international project finance structures, political risks can be allocated via agreement to the sponsors or the host government, or by means of credit enhancement, the creation of a reserve fund, and several contractual provisions and obligations. Depending on the features of each particular case, one way is preferred over others. See Scott Hoffman, The Law and Business of International Project Finance, 57-58 (Transnational Publishers 2d ed. 2001).


4 See Hoffman, supra note 2, at 397.

However, would the insurer cover losses where an arbitration award is set aside or the judicial decision is annulled? In a particular case before a court in Colombia, a judicial decision in 2002 set aside an arbitration award in favor of a foreign investor's subsidiary.\textsuperscript{6} Such a decision impliedly revealed that judicial review of an award may prevent awards from being final, and may impede the investor from raising a claim to recover the insured losses. In short, such a situation becomes a brand new political risk for foreign investors taking into account that a risk such as the one described above is not covered in the political risk market.

Foreign investment in developing economies has fallen since the September 11th terrorist attacks, the economic crisis in Argentina, and the corporate scandals in the United States.\textsuperscript{7} One of the reasons attributed to the decrease in foreign investment is that the coverage of the available political risk insurance seems to leave aside a significant array of circumstances that endanger foreign investors' interest.\textsuperscript{8} In this sense, an identification of new political risks is of the utmost importance not only to evaluate whether the available political risk insurance products are good enough to mitigate new risks, but to review the effectiveness of national legislation when facing new circumstances. After such diagnosis, measures may be taken in order to help mobilize capital throughout the globe, and to benefit developing countries in which political risks are present.

This paper presents (i) an overview of the foreign investment in Colombia, (ii) a review of the most commonly used political risk insurances, and (iii) an analysis of the TermoRío\textsuperscript{9} case as an accurate illustration of the new political risk identified above. On the basis of such analysis as well as on the current political risk coverage, two proposals in both local and international levels are made in order to on the one hand, prevent excessive judicial involvement in cases where arbitration has been chosen as the dispute settlement method to avoid local jurisdict-

\footnotesize{\textsuperscript{7} See \textit{INTERNATIONAL POLITICAL RISK MANAGEMENT – A BRAVE NEW WORLD} 19 (Theodore Moran et al. ed., 2004).} \\
\footnotesize{\textsuperscript{8} See \textit{id.} at 87.} \\
\footnotesize{\textsuperscript{9} See TermoRío S.A. E.S.P. v. Electrificadora del Atlántico S.A. E.S.P. (Arb. 2000). See also Council of State, \textit{supra} note 6.}
tions, and on the other hand, to enhance the existing breach of contract coverage for the benefit of investors and the political risk insurance market.

II. INVESTING IN COLOMBIA

For many developing countries, the possibility of attracting foreign capital and putting it to work is practically the exclusive means to take advantage of state of the art technologies and techniques, as well as better working capital. Also, it may open a legitimate channel to introduce improvements locally at all levels, benefiting the state through tax revenues. Nevertheless, attracting foreign investment has historically required a big effort on behalf of legislators and governmental authorities of the developing countries not only to the extent of implementing the appropriate regulation, but also to change the way local governments and citizens do business in the country.

The main reasons for allowing foreign investment to enter a country, as stated above, may vary from promoting development and providing modernization and welfare to the country, to the improvement of local productivity by the introduction of qualified working capital, new technologies and new techniques that otherwise would not be available in the country. As will be discussed later on, even when domestic foreign investment regulations do not provide solutions for the allocation of political risks, they bring an array of subsidies and incentives that work well in order to attract foreign investment.

In Colombia, the General Regime for Foreign Investment in Colombia and Colombian Investment Abroad ("RFI") is set forth in Decree 2080 of 2000, as amended by Decrees 1844 of 2003, and 4210 of 2004. Since its enactment, such a regulatory body has provided more flexibility in the procedures and more certainty in the legal rights recognized to foreign investors in accordance with customary international law.

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11 Decree No. 2080 of 2000 was published in Diario Oficial No. 44205 of Oct. 25, 2000 (Colom.). Decree No. 1844 of 2003 was published in Diario Oficial No. 45238 of July 4, 2004 (Colom.). Decree No. 4210 of 2004 was published in Diario Oficial 45762 of Dec. 14, 2004 (Colom.).
The RFI defines a foreign investor as any person or legal entity who is not a resident in Colombia and who invests offshore resources in the country.\textsuperscript{13} The principles that are applicable to foreign investment, as stated in Decree 2080 of 2000 and Decision 291 of the Cartagena Agreement are: (i) \textit{national treatment}, or the obligation of the authorities to give foreign investors the same treatment they give to nationals, especially in matters related to tax and ownership rights; (ii) \textit{universality}, meaning that investment is welcomed in the majority of economic sectors except for national security and defense, and processing and disposal of toxic or radioactive waste not produced in Colombia; (iii) \textit{general authorization} to invest in any sector of the economy, unless investment is targeted to any of the sectors having specific regimes that require previous authorization, such as oil, mining and financial sectors; and (iv) \textit{stability}, or the assurance given to the investor that even if the conditions for reimbursement and repatriation of the currency change by virtue of an amendment to the law, the investment regime in force by the time the investment was made will apply to it.\textsuperscript{14}

It is important to note that even when the RFI expressly states that there is automatic authorization to make the investment; investors are nevertheless obliged to register their investments with the central bank, Banco de la Republica, along with some information related to their legal nature as well as to the destination of the investment.\textsuperscript{15} Not complying with such registration will subject the investor to investigations and eventual fines that could be up to 200\% of the value of the investment.\textsuperscript{16} Specific industries such as the hydrocarbons, mining, telecommunications, and financial services such as insurance, are subject to a more complex regulation because of the direct intervention of governmental authorities in the regulation of the activities related to them.\textsuperscript{17}

\textsuperscript{13} Decree No. 2080 of 2000, art. 4.
\textsuperscript{14} The Congress of Colombia has recently enacted the Law of Stability for Foreign Investors, Law 963 of 2005, setting forth further protection to legal stability, complementing the mentioned principle.
\textsuperscript{16} Decree No. 1746 of 1991, art. 2.
\textsuperscript{17} Law 9 of 1991, art. 15 (setting forth the framework for government in order to regulate foreign exchange issues in Colombia).
Before making the investment, and once all the requirements stated by the RFI have been met, the RFI entitles investors to a full set of rights. These rights are closely related to the possibility for the investor to transfer and manage the proceeds of the investment (either by reinvesting them or by repatriating the proceeds to the place of the investor's origin or of its preference). Also, these rights allow the investor to liquidate its business and transfer such proceeds when desired.

Besides the rights recognized under the RFI to foreign investors in Colombia which tend to prevent political risks related to transfer of currency and, to some extent the risk of expropriation, there are several institutions that offer certain tools to shield investors from those risks. These tools are usually political risk insurance or guarantees. In this sense, two of the most relevant of those institutions are: (i) Overseas Private Investment Corporation (OPIC), from which Colombia has been receiving support since 1985, and (ii) the Multilateral Investment Guarantee Agency (MIGA), of which Colombia has been a member since 1994.

It is important to say that the Colombian national government fulfilled the mandate contained in Article 226 of the Political Constitution, which states that Colombia will "promote the internationalization of the political, economic, social and eco-logic relations on the basis of equity, reciprocity and convenience," allowing the participation of OPIC and MIGA in transactions where foreign capital is involved. As will be explained in the following section, these two entities provide insurance for a particular set of circumstances that constitute political risks, helping to attract and maintain foreign investment in Colombia.

A. Political Instability and Security Concerns as the Main Risks Recognized by Foreign Investors in Colombia

Colombia's history has proven to be one full of political struggles and violence. Although Colombia's democracy has

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18 See Decree No. 2080 of 2000, art. 10.
19 See Decree No. 2080 of 2000, art. 10, letters a-c.
20 See id. at art. 10, letter d.
21 COLOM. CONST. art. 226.
been one of the most stable in the entire region, the birth of politically-inspired guerrilla groups in the twentieth century and their strengthening after the 1980's has taken the lives of thousands of nationals as well as foreigners. This circumstance has made it nearly impossible for governmental authorities and private parties to take advantage of all the resources that the country possesses.

Many commentators have tried to identify the sources of violence. In a recent effort, consultants of the World Bank have classified the possible sources as follows: (i) armed conflict; (ii) social conflict, including poverty, inequality, political exclusion and impunity in the judicial system; and (iii) drug trade. Due to the "multidimensional and interrelated nature of the sources of violence in Colombia," the efforts of legislators, governmental authorities, and civilians in recent decades have not been sufficient to boost the economy and to take advantage of all the resources and capital existing in that territory.

Despite an increase in violence over the past few decades, Mr. Alvaro Uribe Velez, current president of the Republic of Colombia, along with other governmental entities, has been working on strengthening the democratic institutions as well as providing the legal framework that will facilitate the resolution of the conflicts that affect the country. Such effort is a means to solve the most troubling problems that affect Colombia. By enhancing the presence of the army throughout the national territory and attacking the guerrillas and paramilitary groups, the government has gained the trust of nationals and foreigners. However, even with governmental efforts to improve the

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23 See generally Colombia, supra note 1.
26 Id. at 39.
27 See supra note 24.
security situation and to provide legal tools to attract investment, the unexpected rise of risks makes it necessary to turn to the aid of international agencies in order to cover those risks.

III. POLITICAL RISK

A simple definition of the term "political risk" is "the risk or probability of occurrence of some political event(s) that will change the prospects for the profitability of a given investment." This type of risk has been generally perceived as a form of governmental interference in the way businesses are conducted in a country, as well as an attitude towards the investors who carry out such businesses. However, other political risks such as war and terrorism in which no governmental misconduct is involved, clearly fall under this definition.

Political risks in developing countries usually arise because many of those countries lack a well-tested legal framework to enforce contractual obligations and to fully recognize investor's rights to the proceeds of their investment. In addition, such countries' unstable economies and political environments usually drive governmental entities to adopt measures to somehow stimulate economic growth. These measures include, among others, expropriation, agricultural reforms or imposition of reinvestment requirements for foreign investors. Additionally, governmental entities are keen to limit the sectors that are allowed to receive foreign investment, to adopt policies to inflate prices and devaluate national currencies, as well as to intervene in otherwise private economic relationships. Under such a scenario, foreign investment interests would conflict with the interests of the country, making it impossible for the country to benefit from investment.

The sources of political risks may vary depending on their direct cause. They can originate by the direct influence of the

30 See Dan Haenel, Foreign Investments and the Management of Political Risk 5 (1983) (referring to the definition provided in the monograph for the Hearings on OPIC Authorization, prepared by the Committee on Foreign Relations and the Subcommittee on Foreign Assistance of the Senate of the US).
31 Id. at 71.
32 See The International Lawyer's Deskbook 69 (Lucinda Low et al. eds., 2004).
33 See Haenel, supra note 30, at 14.
34 See id.
government and its deliberative acts, or by other politically inspired events over which government has little or no control whatsoever. For example, the risks that are caused by deliberate conduct of the government can be: expropriation, limits to currency transferability or convertibility, confiscation, change of law, jurisdiction risks, and contract repudiation risks. On the other hand, the events over which government has minimal interference are: war, civil strife, terrorism, rebellion, revolution, among others.

Notwithstanding what the cause of the political risks may be, one of their main characteristics is that they are unexpected and impossible to predict by third parties such as investors. Despite their unpredictability, investors and governments use sophisticated financial tools and structured analysis in order to identify possible risks in international transactions, thus attempting to reduce the uncertainty of their occurrence. Even so, managers of corporations and decision-makers recognize political risk evaluation more as an art rather than a science, and usually do not consider models and tools when deciding to invest in a certain region. This is when the option of contracting with a political risk insurer becomes a good alternative to allocate such risks.

A. Political Risk Insurance

When investing abroad, investors contract with an insurer with one purpose in mind—to shield the investor's assets from losses that arise from unexpected risky situations. Therefore, the investor will always try to find a way to ensure that if an identifiable risky event arises, it can be managed by one of the parties to the transaction. Political risk insurance, as a way to allocate risks to a third party, can be contracted not only to cover equity losses, but also losses related to loans, leases, or

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35 See S. Linn Williams, Political and Other Risk Insurance: OPIC, MIGA, EXIMBANK and Other Providers, 5 PACE INT’L L. REV. 59, 64 (1993).
36 See Hoffman, supra note 2, at 57-81.
37 See Low, supra note 32, at 59.
38 See Haendel, supra note 30, at 84.
39 See Giugale, supra note 25, at 63.
40 See Haendel, supra note 30, at 140.
41 See generally Phillip Fletcher, A Legal Guide to International Project Finance (Milbank, Tweed, Hadley & McCloy LLP)(on file with author).
any other agreement made by the investor with other entities including host governments, as is the case of project finance structures.\textsuperscript{42}

B. \textit{Insurable and Non-Insurable Risks}

Although it has been said that "any risk is insurable if one is prepared to pay the premiums,"\textsuperscript{43} this is not entirely true for political risk insurance. In fact, certain situations that may be thought of as politically-related risks are not covered by political risk insurance: (i) currency devaluation; (ii) legitimate change of legislation in a country (such as export – import regulations, tax obligations and commercialization limitations); (iii) interference by authorities in the grant or renewal of licenses and permits and (iv) inflation.\textsuperscript{44} Considering that the nature of the risks is to some extent commercial and to some other extent political, concerns in the insurance market related to the difficulty of measuring those risks and the impossibility to fix appropriate premiums make those risks uninsurable.\textsuperscript{45} Therefore, parties to agreements must foresee the occurrence of these types of situations and allocate those risks among them.

C. \textit{Commonly Insured Political Risks}

The risks faced by a foreign investor when investing in a developing country vary significantly and take diverse forms.\textsuperscript{46} The most commonly covered risks in the current insurance market are: expropriation, currency inconvertibility, transfer restrictions, political violence, and contract repudiation.\textsuperscript{47}

1. \textit{Expropriation}

Expropriation occurs when the government takes away from the investors ownership rights over their businesses.\textsuperscript{48} Expropriation may consist of a single event by which govern-

\begin{itemize}
\item \textsuperscript{42} See OPIC HANDBOOK, supra note 3, at 22.
\item \textsuperscript{43} See GIUGALE, supra note 25, at 70.
\item \textsuperscript{44} See HOFFMAN, supra note 2, at 57-82.
\item \textsuperscript{46} See HOFFMAN, supra note 2, at 26.
\item \textsuperscript{47} See Williams, supra note 35, at 64-65.
\item \textsuperscript{48} See id. at 66.
\end{itemize}
ment takes away a good owned by the investor without compensation, but it can also consist of what has been identified as "creeping expropriation or de facto expropriation," which means a series of events that result in a loss similar to the expropriation. In particular, creeping expropriation may come in the form of the manipulation of legal and administrative rules that make the investment unprofitable. An example of this kind of expropriation is when "the host government uses a combination of taxes, fees and other charges and devices to increase its share of the project's profits." Although creeping expropriation is very hard to prove, it is usually covered along with regular expropriation by political risk insurance.

2. Currency Inconvertibility

This risk of currency inconvertibility can be defined as the restriction or exchange control imposed by the governmental authorities that impedes the conversion of local currency into the currency consented to by the investor. Such control is usually caused by a shortage of foreign currency in the host country, negative trade balances, or excessive foreign debt. Although it is clear that there is a political element in setting the currency exchange rates, "devaluation is not an insurable risk, although it may be mitigated through hedging arrangements and other commercial devices."

3. Transfer Restrictions

Transfer restrictions occur when local banks or financial institutions are not allowed to export or remit currency to the place agreed by the investor, or when the investor is unable to

49 Low, supra note 32, at 70.
50 See Giugale, supra note 25, at 66.
52 See Hoffman, supra note 2, at 69.
53 See Tubbs, supra note 51, at 559.
54 Id. at 557.
55 See Hoffman, supra note 2, at 59.
56 See Low, supra note 32, at 71.
57 See Tubbs, supra note 51, at 557.
repatriate currency. This risk is usually tied in with the currency inconvertibility risk.

4. Political Violence

This is the least predictable of the risks. War, civil strife, revolutions, strikes, and acts of terrorism fall into this category. The loss covered under this risk is the loss of business income or the damage caused to the physical assets.

5. Contract Repudiation

This type of risk is usually present in project financings in the oil, energy or water sectors, in which it is usual to enter into agreements with governmental entities or state-owned enterprises. Contract repudiation covers the risk of a government’s failure to honor its contractual obligations, and it extends to the risk that the government “will refuse to arbitrate, obtain an award in its favor by fraud or duress, or fail or refuse to pay an award rendered in favor of the insured investors or lenders.”

D. Political Risk Insurance Providers

Overseas Private Investment Corporation (OPIC) and Multilateral Investment Guarantee Agency (MIGA) are the most important political risk insurance providers for foreign investments in Colombia.

1. Overseas Private Investment Corporation (OPIC)

In 1971, OPIC was established as an agency of the executive branch of the United States Government. It is organ-

58 See Hoffman, supra note 2, at 70.
59 See id. at 58.
60 See Tubbs, supra note 51, at 557.
61 See Hoffman, supra note 2, at 40.
62 See id. at 3.
63 See Low, supra note 32, at 72.
64 There are several other institutions that provide political risk insurance, such as the Export-Import Bank of the United States of America, the Inter American Development Bank, and some private insurers, among others. See Williams, supra note 35, at 89.
65 See Hoffman, supra note 2, at 403.
ized as a corporation, directed by a board of directors composed of eight individuals from the private sector who are appointed by the President of the United States and confirmed by the Senate. The remaining seven individuals are part of the United States government. OPIC's obligations are backed by the full faith and credit clause of the U.S. Constitution, and this pledge is included as a provision in every insurance agreement.

With the purpose of fostering international commerce and aiding projects that benefit the U.S. economy and enactment of foreign policy, OPIC conducts "finance, insurance and reinsurance operations on a self-sustaining basis." Throughout its years of operation, OPIC has supported over U.S. $164 billion of investments in countries which require social and economic development, and which have a bilateral agreement with the United States. This agency has been profitable ever since its first year of operation.

When an investor decides to request insurance from OPIC, he must apply for it before making the investment. The investor is also subject to eligibility requirements to contract with OPIC.

In order to check the eligibility of the investment, OPIC analyzes whether: (i) the host country has a bilateral agreement with the United States; (ii) the investor is a U.S. citizen, or a

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69 Id. at 361.
70 See GIUGALE, supra note 25, at 69.
72 See Zylbergalait, supra note 67, at 360.
73 See Low, supra note 32, at 223.
75 See OPIC HANDBOOK, supra note 3, at 1.
76 See Low, supra note 32, at 211.
77 See Zylbergalait, supra note 67, at 361.
78 See id. at 363.
79 See OPIC HANDBOOK, supra note 3, at 7.
U.S. corporation, or if it is a foreign corporation, whether over 95% of its stock is beneficially owned by U.S. citizens or corporations. OPIC also analyzes the eligibility of each project, and only grants the support if (i) the project is a new venture, (ii) it is an expansion of an existing enterprise, or (iii) it is a privatization or acquisition with developmental benefits. No minimum investment size requirements are contemplated. Besides the stated qualifications, OPIC has additional requirements: projects cannot be harmful to the U.S. economy, they cannot have a major adverse environmental impact in the host country, and they cannot violate internationally recognized worker rights. OPIC also demands compliance with generally recognized health and labor rights. It is important to note that OPIC has a contractual power to monitor the investor’s compliance with all the above obligations. Any breach of the obligations could amount to a default under the terms of the insurance agreement signed by the investor.

When estimating political risks, OPIC bases its estimations on past occurrences, claims, and some other factors that would usually lead to future claims. However, OPIC has additional sources that give it an advantage over other insurers. Since it is a U.S. agency, OPIC has access to confidential information of the State Department and the Central Intelligence Agency (CIA). This improves the identification of risks considerably.

As to the coverage, the main risks covered by OPIC are the following: expropriation, currency inconvertibility and political violence.

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80 See id.
81 See id.
82 See id.
83 See id. at 1.
84 See OPIC HANDBOOK, supra note 3, at 5.
85 In practice, OPIC requires investors to report activities, answer questionnaires and to allow OPIC’s representatives to visit project’s sites. OPIC HANDBOOK, supra note 3, at 5.
86 See id.
87 See Kessler, supra note 45, at 207.
88 See Low, supra note 32, at 206.
This risk does not only include expropriation and creeping expropriation, but also nationalization and confiscation. The expropriation will only be compensable if it deprives, directly or indirectly, the investor from the fundamental rights derived from the investment, forcing him to abandon the investment. It does not cover situations provoked by the investor or foreign enterprise or losses due to lawful regulation and taxation on behalf of the government. Governmental action, either at a national level or at a municipal level is required, but if such intervention is not illegal under either local or international law, it will not constitute expropriation subject to compensation. Due to the need of OPIC to review whether or not the conduct of the government deprives the investor from its fundamental rights, the actions of the government have to last for at least a year to amount to expropriation subject to compensation.

Because of new needs in the insurance market, two additional risks can be covered: (i) expropriation of funds only, defined as "unlawful host government blockage of funds intended to be remitted as returns of the insured investment or earnings on it," which is tied to currency inconvertibility risk, and (ii) "coverage against losses resulting from the unlawful breach of specific host government obligations identified by the insured at the outset as vital to the successful operation of the project," which constitutes the so-called breach of contract coverage. It must be noted that OPIC coverage complements the breach of contract coverage by allowing recovery in expropriation cases when the governmental entity involved in the investment does

90 See Zylbergait, supra note 67, at 371.
91 See id. at 372.
92 See OPIC HANDBOOK, supra note 3, at 8.
93 See Zylbergait, supra note 67, at 375. Action on behalf of government-related entities is required as long as the entity is in control of the development of the project and they act as an authorized agent.
94 See id. at 371.
95 See id.
96 See Moran, supra note 7, at 19.
97 See OPIC HANDBOOK, supra note 3, at 9.
98 Such circumstances are evaluated on a case-by-case basis by the OPIC. Id.
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not comply with the dispute resolution clause included in the contract.99

ii. Currency Inconvertibility

This risk applies to currency restrictions that prevent investors from either converting or transferring the proceeds of the investment. As examples of currency restrictions, OPIC provides the following: (i) new restrictive foreign exchange regulations or (ii) failure by authorities to act on an application for hard currency.100

It is important to point out that inconvertibility coverage will only be applicable if the investor is not able through legal means to convert currency, but is able to tender local currency to OPIC.101 In the case of expropriation of funds, an illegal act on behalf of the government is required in order to claim such risk.102 OPIC insures earnings, returns of capital, principal and interest payments, and even technical assistance fees, among others.103 Currency devaluation has never been covered.104

iii. Political Violence

Through the coverage of this risk, OPIC compensates damage or destruction of tangible property caused by politically-inspired violence.105 OPIC is clear in stating that “an ordinary criminal act (such as robbery) to obtain financing for a political group would not be included in the term ‘political violence.’”106 According to OPIC’s insurance contractual provisions, the following situations are usually covered: declared or undeclared war; civil war; revolution; insurrection; hostile actions by national or international forces; or civil strife that includes polit-
cally motivated terrorism and sabotage. OPIC does not cover actions taken in order to achieve labor or student objectives. OPIC pays for asset damage and business income loss originated in the damage.

iv. Special Insurance Programs

OPIC also offers special insurance programs for oil, gas projects and other natural resource projects. Under these programs repudiation or breach of contract coverage is offered, in case of breach of contract by the governmental entity. Again, a more general breach of contract coverage is recognized under expropriation risk, making it available for ventures in other sectors different from those included in the special insurance programs, as long as they meet the requirements that OPIC deems fit, on a case-by-case basis. In practice, when the investor makes the claim, and OPIC pays it, OPIC becomes the subrogee of the claims of the investor. In such a scenario, OPIC will be entitled to the payment of the award or judicial decision.

The term of coverage will depend on what is being covered by the insurance. In the case of equity, the term is up to 20 years. In the case of loans, leases, or specific contracts, it will generally be equal to the term of the particular agreement. As to the amount covered, OPIC insures up to 90% of the investment. If the investment is made in equity, the amount insured will be equal to 270% of the initial investment (from which 90% corresponds to the total of the investment, and the remaining 180% to the future earnings).

107 See Zylberglaït, supra note 67, at 409.
108 See id.
109 See Hoffman, supra note 2, at 406.
111 See id. at 13-14.
114 OPIC Handbook, supra note 3, at 22.
115 See id.
116 See id.
117 See id.
In the case of Colombia, OPIC has participated as an insurer of U.S. investment in several projects including: communications; manufacturing; financial services; mining; oil and gas; and energy. According to the OPIC, more than U.S. $1.4 billion in insurance has been provided to Colombia in over 45 different projects.

2. Multilateral Investment Guarantee Agency (MIGA)

With a purpose to "enable developing countries [to] build up their local economies, reduce poverty and improve people's lives through promoting foreign direct investment," MIGA was created on April 12, 1988, as a multilateral development agency under the auspices of the World Bank Group with over 150 member-nations. Its purpose is to promote foreign direct investment, especially in developing countries, complementing the activities of the International Finance Corporation and the International Bank for Reconstruction and Development, and other international financial institutions. Specifically, this agency fosters foreign investment by providing political risk insurance, and by supervising and advising emerging economies to attract private investment.

During the last four years, MIGA has issued 711 guarantees to projects around the world, throughout Latin America, Asia, Europe, Africa and the Middle East, in several sectors such as the financial sector, mining sector, manufacturing, infrastructure, oil and gas sector and tourism. In the case of Latin America and the Caribbean, 37% of the guaranteed projects were financial projects, 35% were made in infrastruct-

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118 History of projects provided by Ellen Litton, at the Visitor's Center of the OPIC (Washington, D.C.).
119 Informal meeting and data provided by Ms. Alison Germak, Office of External Affairs of OPIC, Washington, D.C.
120 MULTILATERAL INVESTMENT GUARANTEE AGENCY, ANNUAL REPORT (2004) [hereinafter MIGA REPORT].
121 See MIGA INVESTMENT GUIDE, supra note 3.
122 See id.
124 See MIGA INVESTMENT GUIDE, supra note 3.
125 See MIGA REPORT, supra note 120.
127 See id. at 36
ture, 12% in oil and gas, 11% in tourism and services and 5% in agribusiness and manufacturing.128

Similarly to OPIC, MIGA reviews applications delivered by prospective investors with the purpose of verifying whether the investment and the investor are eligible for insurance.129 In general, MIGA's requirements are more flexible than those provided by OPIC. MIGA, as a result of being independent from any particular government, provides insurance for projects in countries where the United States has been reluctant to offer its support for legal or policy reasons.130 However, in all cases, its participation as an insurer is limited to projects that encourage development in emerging economies,131 a fact that might be seen as a disadvantage.

For the investor to be eligible to participate, MIGA requires him to be: (i) a national from a country member, different from the one that will be benefited from the investment; (ii) if it is a corporation, it must be incorporated and have its place of business in a member country, or be controlled by nationals of member countries; and (iii) if the entity is owned by a state, it will be eligible for a guarantee in case such entity is acting with a commercial purpose.132 It is also permitted for a national investor to invest proceeds obtained abroad and be eligible for the insurance offered by MIGA.133

Regarding the investment, the following requirements have to be met:

(a) The investment has to be made through equity, shareholder loans, loan guarantees of the shareholders, and unrelated third-party loans as long as the applicant for the guarantee is a shareholder. Other permitted forms of investment are contractual agreements of which the term is more than 3 years and which earnings depend on the profitability of the project.134

128 MIGA REPORT, supra note 120.
129 See MIGA INVESTMENT GUIDE, supra note 3.
130 See Tubbs, supra note 51, at 567.
131 See id.
132 See MIGA CONVENTION, supra note 123, art. 13.
133 See GIUGALE, supra note 25, at 83.
134 See MIGA CONVENTION, supra note 123, art. 12.
The eligible investment has to be targeted to a developing member country. The investment has to be targeted to: (i) a new project; (ii) the expansion or modernization of an existing project; or to (iii) acquisitions that involve privatization of entities owned by the state. The investment must also contribute to fulfill developing objectives of the host country, and has to be financially, economically and environmentally sound. Also, the project must comply with the laws of the host country.

It is important to point out that before MIGA insurance is issued, the host country must give its approval. Usually, MIGA obtains such approval by itself, increasing "the likelihood that the host government will work with MIGA in a way that reduces claim exposure." This feature is considered to be an advantage over other insurance providers because the direct involvement of the agency assures host country cooperation.

Article 22 of the treaty for the constitution of MIGA states that the guarantees issued in favor of an investor will not exceed 150% of the total subscribed capital on behalf of the investor. MIGA is free to negotiate contractual provisions providing lower amount limits. The coverage of the guarantee issued by MIGA is very similar to the one offered by OPIC. However, a significant difference is that the risk of breach of contract is considered a general risk and can be contracted for any type of investment in which a governmental entity intervenes, and is not limited to energy and oil and gas projects, nor depends on a case-by-case analysis as provided in OPIC's regulations. This will be explained in more detail later.

The next subsections discuss the risks covered by MIGA.

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135 See id. art. 14.
136 See MIGA INVESTMENT GUIDE, supra note 3.
137 See id.
138 See GIUGALE, supra note 25, at 83.
139 See MIGA CONVENTION, supra note 123, art. 15
140 See HOFFMAN, supra note 2, at 399.
141 See MIGA Convention, supra note 123, art. 22.
i. Currency Inconvertibility and Transfer Restrictions\textsuperscript{142}

It covers the losses faced by the investor for its inability to convert local currency into the consented currency and impossibility of transferring it abroad, due to lack of foreign exchange or adverse change in laws and regulations.\textsuperscript{143} It applies to capital, principal amounts, interest, profits, royalties or other remittances. It also covers the delays in converting currency attributable to the local government.\textsuperscript{144} Once the investor delivers the currency to MIGA, it will pay the compensation in the consented currency.

\textbf{ii. Expropriation and Similar Measures}\textsuperscript{145}

The coverage of these risks protects investors from losses derived from any administrative legal action on behalf of the government, taken with the purpose of depriving investors from all or part of their ownership rights over the investment.\textsuperscript{146} Confiscation, nationalization and creeping expropriation are covered, as well as partial expropriation over tangible assets and funds.\textsuperscript{147} Similarly to OPIC, MIGA will not compensate when government has exercised legitimate authority over the assets.\textsuperscript{148}

\textbf{iii. War and Civil Disturbance}\textsuperscript{149}

MIGA covers the loss, damage, disappearance or destruction of tangible assets caused by "politically motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coup d'états, sabotage, and terrorism."\textsuperscript{150} It also covers interruption, for a certain period of time provided in the contract, of activities due to the aforementioned circumstances, and which could amount to a total loss.\textsuperscript{151}

\textsuperscript{142} Id. at art. 11(a)(ii).
\textsuperscript{143} See HOFFMAN, supra note 2, at 399.
\textsuperscript{144} See MIGA INVESTMENT GUIDE, supra note 3.
\textsuperscript{145} MIGA CONVENTION, supra note 123, art. 11(a)(ii).
\textsuperscript{146} See HOFFMAN, supra note 2, at 399.
\textsuperscript{147} See MIGA INVESTMENT GUIDE, supra note 3.
\textsuperscript{148} See HOFFMAN, supra note 2, at 399.
\textsuperscript{149} MIGA CONVENTION, supra note 123, art. 11(a)(iv).
\textsuperscript{150} MIGA INVESTMENT GUIDE, supra note 3.
\textsuperscript{151} See id.
iv. Breach of Contract\textsuperscript{152}

MIGA covers the breach or repudiation of the contract on behalf of the government that is party to it.\textsuperscript{153} The investor must start dispute resolution procedures, and obtain an award in its favor.\textsuperscript{154} In case the investor's counterparty is not willing to pay the award, or the procedure is not following its due course because of the conduct of the governmental entity, MIGA will pay the compensation to the investor. MIGA is also entitled to pay a provisional compensation when the final decision in the procedure is pending.\textsuperscript{155}

As to the extent of the risks covered, it should be noted that new risks can be added to the ones stated above on an ad hoc basis.\textsuperscript{156} Then, in case both the investor and the host country so require, the vote of the majority of MIGA's board of directors\textsuperscript{157} may enhance the coverage.

MIGA's guarantees are usually issued for a period of 15 to 20 years, depending on the nature of the particular project or venture,\textsuperscript{158} and for a maximum amount of U.S. \$200 million per project.\textsuperscript{159} The percentage of the guarantee will cover up to 90\% of the equity investment plus up to 45\% of earnings.\textsuperscript{160} In the case of loans, MIGA guarantees up to 95\% of the total amount, plus up to 135\% of the loan to cover accrued interest.\textsuperscript{161}

According to the annual reports of MIGA, several projects have been insured in Colombia.\textsuperscript{162} During the years of 1997, 1999 and 2001, projects in the mining, financial and energy sectors have been insured against risks of expropriation, transfer restrictions and war and civil disturbances for amounts from

\textsuperscript{152} MIGA Convention, supra note 123, art. 11(a)(iii).
\textsuperscript{153} See Hoffman, supra note 2, at 400.
\textsuperscript{154} See MIGA Investment Guide, supra note 3.
\textsuperscript{155} See id.
\textsuperscript{156} See Williams, supra note 35, at 86.
\textsuperscript{157} See Giugale, supra note 25, at 85.
\textsuperscript{158} See MIGA Investment Guide, supra note 3.
\textsuperscript{159} See id.
\textsuperscript{160} See id.
\textsuperscript{161} See id.
\textsuperscript{162} See MIGA Annual Reports, http://www.worldbank.org (follow "Publication" hyperlink to "Document Reports" hyperlink and then run a search for "Annual Report") (last visited on Sept. 27, 2005)
U.S. $35 million to U.S. $100 million.\textsuperscript{163} MIGA has also contributed the marketability of the country, through the assistance to Corporacion Invertir en Colombia – Coinvertir, the governmental entity in charge of the promotion of foreign investment in Colombia.\textsuperscript{164}

### E. Breach of Contract Coverage as a Way to Mitigate Risks When Governmental Authorities Overreach their Powers

Both OPIC and MIGA provide political risk coverage in case there is a breach of contract by the contracting governmental authority. In short, and using infrastructure projects, commentators have said that the “investor must first seek recourse against the host government through the dispute resolution mechanism applicable to the project agreement, and the government must fail to honor a favorable award or judgment.”\textsuperscript{165} In other words, an investor will be able to make a claim as long as he exhausts available remedies, obtains a favorable award or judicial decision evidencing such breach of contract, and tries to enforce it without success.\textsuperscript{166}

A further explanation must be made with respect to the coverage of breach of contract. Despite its name, this type of coverage refers only to the “wrongful failure by the host government party to pay an award following an agreed-upon arbitration or other dispute resolution procedure.”\textsuperscript{167} In this sense, it excludes the protection against a simple failure of the host government to comply with its obligations under an agreement before exhausting the available remedies that, in the end, will determine what is due to the investor.\textsuperscript{168}

On the basis of the above, the following steps must be taken in order for an investor to make a claim under the breach of contract coverage:\textsuperscript{169}

\begin{itemize}
  \item See \textit{MIGA Report, supra note 120; MIGA Annual Report} (2003).
  \item Moran, \textit{supra} note 7, at 43.
  \item See \textit{id. at 42}.
  \item Moran, \textit{supra note 7}, at 47.
  \item \textit{Id. at 49-52}.
  \item See \textit{id. at 50}.
\end{itemize}
(a) Resort to arbitration, if the disputed agreement contains an arbitration clause. Otherwise, go to court.
(b) Obtain a final and binding award or decision, not subject to appeal.
(c) Seek enforcement of the award or decision.
(d) Face the impossibility of enforcement due to the failure of the host government to pay within a period of 90 to 180 days, depending on the insurer.

The breach of contract coverage provided by insurers such as OPIC and MIGA is typically focused on the procedural risks that may be faced by an investor when the host government is not willing to either honor its obligations derived from the dispute resolution mechanism, or to enforce the award or judicial decision when it is not favorable to the host government. Such coverage seems to be consistent with a narrow interpretation of the international law principle of denial of justice, applicable to foreigners when facing procedures in sovereign states. The principle of denial of justice is defined as "a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of justice or remedial justice, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice, or a manifestly unjust judgment."

On the basis of the stated definition, the principle of denial of justice has been used in three different senses, depending on the interpretation given to the principle. In a broad sense, it "seems to embrace the whole field of State responsibility, and has been applied to all types of wrongful conduct on the part of the State toward aliens," which means to include acts by the executive, legislative, or judicial branches of the state. In a narrow sense, it is "limited to refusal of a state to grant an alien access to its courts or a failure of a court to pronounce a judg-

170 See id.
172 See Garcia, supra note 171.
ment." In an intermediate sense the phrase, denial of justice "is employed in connection with the improper administration of civil and criminal justice as regards an alien, including denial of access to courts, inadequate procedures, and unjust decisions." Under the intermediate sense, denial of justice may occur on a procedural level as well as on a substantive level; hence it requires a thorough review of the decision. In any case, "a decision does not constitute a denial of justice unless it is so obviously wrong and unjust that no court honestly has arrived at such conclusion." Under this interpretation, a denial of justice case is hard to prove, and determining whether there is a denial of justice will depend on the decision-maker's opinion.

The narrow interpretation explained above seems to be closest to the coverage of OPIC and MIGA, considering that both require the investor to initiate a procedure to enforce its rights under an agreement and to demand that there be impossibility to enforce a final decision before the competent courts. In the same sense as with the breach of contract coverage, the narrow interpretation of the denial of justice principle only recognizes procedural impediments to enforce the final decision, and does not cover cases in which the substance of the decision is so "wrong and unjust that the court had to be corrupt or biased."

With regard to the limited scope of the breach of contract coverage, it seems that the underlying reason for excluding mere breach of obligations on behalf of the host country from such coverage is rather simple and cost-effective from an insurer's point of view. Insurers, either private or public, prefer to have a final decision made by a court or an arbitration tribunal as to the breach of contract favoring the investor, rather than make such decision themselves, in my opinion, "outsourcing" such decision to the competent authorities. Therefore, if the award is set aside, or if the judicial decision is annulled, a claim cannot be paid by either OPIC or MIGA because there would not be a declared breach of contract.

174 Id. at 250.
175 Id.
176 Lerner, supra note 173, at 261.
177 HOFFMAN, supra note 2, at 332.
178 See Moran, supra note 7, at 52.
In the following section, the analysis of a case brought before the courts of Colombia illustrates the political risk that lies in the intervention of domestic courts when reviewing and setting aside an award on the basis of broad legal powers, and reveals a doubtful application of the arbitration rules available in the seat of the arbitration.

IV. COLOMBIAN PERSPECTIVE: TERMO RÍO CASE

During the 1990s, due to the need to restructure the public utilities sector, to avoid losses and ensure efficiency in the rendering of such services, the Colombian government started a long-term plan through the privatization of several public entities. This plan included the possibility for private investors to participate in the water, energy and telecommunications markets under the supervision of the governmental entities. Under such a perspective, the Colombian government would maintain its capacity as planner and regulator of the public utilities sector, but would permit private entities to provide the services contributing to the efficiency of the service.

Under such a scenario, the Termo Río case involved two companies, one state-owned, and the other a subsidiary of a foreign company. These two companies entered into a power purchase agreement (PPA). After six months of the execution of the PPA, because of a decision of the Colombian national government to liquidate the state-owned entity, a breach under the PPA arose. Therefore, an arbitration tribunal was appointed in order to solve the dispute in accordance with the provisions of the PPA.

After a long and controversial arbitration procedure, an award was rendered by the arbitration tribunal. Under such

179 See National Council of Economic and Social Policy, Docs. 2932 (Apr. 12, 1997) and 2950 (Sept. 24 1997).
180 See id.
181 See id.
184 See Termo Río S.A. E.S.P.
185 See id.
award, the state-owned entity was to pay its counterparty approximately U.S. $60 million for breaching its obligations. However, a judicial action was brought before the Council of State, the highest judicial authority with the power to review awards involving state-owned entities. The judicial decision annulled the arbitration award on grounds different from those provided under national arbitration regulations and contradicting parties' consent.

A. Parties to the Agreement

According to the facts stated in the arbitration award issued by the arbitration tribunal in the TermoRío case, dated December 21, 2000, one of the parties to the procedure was TermoRío S.A. E.S.P. ("TermoRío"), a corporation incorporated under the laws of Colombia whose majority shareholder was Sithe Energies, a U.S. company. TermoRío was the claimant in the procedure and the supplier under the PPA. Electranta S.A. E.S.P. (Electranta), a state-owned entity incorporated under the laws of Colombia, was the respondent and buyer under the PPA.

B. Terms of the PPA

The agreement provided that TermoRío would supply 266 megawatts of energy to Electranta for a term of 20 years, by virtue of a public bid awarded to TermoRío among seven other participants. The agreement would be subject to the laws of Colombia, and it included an arbitration clause which was amended as follows:

Any controversy or difference that may arise within the parties and that is related to execution, interpretation, performance or termination of this agreement shall be resolved by means of any

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186 See id.
187 See id.
188 See Council of State, supra note 6.
190 See TermoRío S.A. E.S.P.
191 TermoRío S.A. E.S.P.
192 Id.
193 Id.
of the alternative dispute resolution mechanisms, amicable compositeur, or transaction within a term of no more than 3 weeks. If no agreement is reached by the parties, the dispute shall be settled by an arbitration tribunal under the ICC Rules. The tribunal will be composed by 3 arbitrators who will be appointed by the ICC. The place of arbitration will be the city of Barranquilla, Colombia. The award, which will be binding, shall be issued within 3 months.\textsuperscript{194}

It is important to point out that by the time the agreement was executed by the parties,\textsuperscript{195} the applicable rules for arbitration procedures in Colombia were contained in Law 315 of 1996 that regulates international arbitration, still in force today, Law 23 of 1991 and Decree 2279 of 1989, which set forth the general regime of mechanisms for alternative dispute resolution.\textsuperscript{196} These regulations recognized the enforceability of the arbitration award rendered by an arbitration tribunal when the parties agreed to bring their disputes before it, and stated that such agreement derogates the right of the parties to go to court to make claims that were submitted to arbitration.\textsuperscript{197}

Such regulation, though, was not perfectly clear regarding the possibility for the parties to choose their arbitration rules. Only the international arbitration law expressly allowed, and still does allow, parties to choose their procedural rules. However, nothing is said regarding the domestic arbitration procedures.\textsuperscript{198} Hence, the issue of whether the parties were or were not in an international arbitration scenario plays a very relevant role along the procedure of the TermoRío case, and is reviewed on several occasions. Despite this issue, the parties consented, as stated above.

Within six months of signing the PPA, governmental authorities started to implement the privatization plan in order to improve the efficiency and competitiveness of the public utili-

\textsuperscript{194} Author's translation.

\textsuperscript{195} See TermoRío S.A. E.S.P. (including the date in which an amendment to the arbitration clause was made, during Jan., 1998).


\textsuperscript{197} See Decree No. 2279 art. 2 (1989). See also NIGEL BLACKABY ET AL., INTERNATIONAL ARBITRATION IN LATIN AMERICA 115 (2002).

\textsuperscript{198} See Decree No. 2279 of 1989. See also Law 23 of 1990.
ties sector. Under this plan, Electranta’s majority shareholder, Corelca S.A. E.S.P., was going to be capitalized and Electranta was to be liquidated. The remaining assets were to be transferred to a newly created company called Electricaribe S.A. E.S.P. (Electricaribe).

In view of this situation, TermoRío’s representatives proposed amendments to the PPA, foreseeing an eventual default of the PPA after the liquidation of Electranta, and, aware that under the terms of such agreement their consent had to be requested in case of a sale of assets. The proposal included an authorization for the registration of a new agreement in the same terms of the PPA, according to requirements of law, but under which Electricaribe would take the place of Electranta and become the buyer. Electranta agreed to such amendments and promised to register them before the competent authority to comply with the applicable law. Shortly after, witnessing the liquidation of Electranta and the transfer of all of its assets before the registration of the new agreement, TermoRío decided to bring a claim to an arbitration tribunal for breach of the PPA in 1999.

C. Arbitration Procedure

Pursuant to the arbitration clause agreed to by the parties as well as under the ICC rules, three Colombian arbitrators were appointed, and proceedings started in the city of Barranquilla. Along with the response to the claims, Electranta submitted objections as to the competence of the arbitration tribunal to decide the matter, due to: (i) the invalidity of the arbitration clause for not complying with the applicable rules; and (ii) for not being an international arbitration, because the par-

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199 See National Council of Economic and Social Policy, supra note 152.
201 See TermoRío S.A. E.S.P.
202 See TermoRío S.A. E.S.P.
203 See id.
204 See id.
205 See id.
206 See id.
207 See id.
208 See id.
ties did not expressly state so in the arbitration clause. 209 Additionally, a request to stay arbitration was filed by Electranta due to the existence of two different civil and criminal procedures related to the case. 210 By means of an interim award, and pursuant to the ICC rules, 211 the arbitration tribunal reviewed and confirmed its competence to hear the matter. 212

On the basis of the Colombian arbitration regime, 213 the arbitration tribunal decided to go along with the arbitration procedure considering that the will of the parties to arbitrate evidenced their preference for international arbitration over judicial remedies. 214

Although the arbitration tribunal did not spend much time on the issue of its jurisdiction, and especially on the issue of the internationality of the arbitration, it was clear that its decision favored the consent of the parties to arbitrate. 215

It is important to note at this point that from a reading of the Colombian international arbitration regime, 216 such regime can be applied as long as the parties agree that the arbitration has an international character, and at least one of the following criteria are met: 217

(a) That the parties' main place of business was located in different states, when signing the arbitration clause.
(b) That the place of execution of the main agreement is different from the place of residence (or main place of business) of the parties.
(c) That the place of arbitration is different from the place where the parties have their residence. 218

209 See TermoRío S.A. E.S.P.
210 See id.
211 See id.
212 The Tribunal applied the regulation in force by that moment in Colombia, including Decree No. 1818 of 1998, which was enacted after the execution of the PPA.
213 Decree No. 2279 of 1989, art. 2. See also COLOM. CODE OF CIV. P., art. 97.
214 See TermoRío S.A. E.S.P.
215 See id.
216 See Law 315 Diario oficial 42878 art. 1 (Sept. 1996) (Colom.).
217 See id.
218 The Constitutional Court of Colombia extended the application of this requirement, for the case in which one of the parties is a national from a different state than that in which it is residing. Hence, a nationality test must also be conducted. Decision C-347 of 1997.
(d) That the dispute involves the interest of more than one state and the parties have expressly so agreed.
(e) That the arbitral decision affects directly and unmistakably the interest of international trade.

Another important feature of the International Arbitration Law is the possibility to choose procedural rules, such as the ICC or the UNCITRAL rules, thus avoiding the application of the domestic civil procedure legislation to the arbitration. In the TermoRio case, both parties consented to apply ICC rules and the arbitration tribunal followed those rules closely from the beginning of the procedure, according to the parties' consent.

Once the arbitral tribunal determined its jurisdiction, it moved on with the procedure, seemingly taking for granted that the arbitration clause was valid. It evidenced the parties' will to opt for an international arbitration, and, since foreign investment was involved in the transaction between TermoRio and Electranta, such transaction affected international commerce interests.

In this regard, commentators have reviewed how Article 1 of Law 315 should be interpreted in order to fulfill the requirement of internationality in the arbitration. It has been said that:

At first sight [Article 1] gives the impression that it requires the parties to 'stipulate' or express their will, that their arbitration be international. However, a close reading of Law 315 and its legislative history leads to one conclusion: what was meant was that there be a valid arbitration agreement; internationality was to be solely a matter of specific criteria on internationality set forth in Article 1.

In other words, following a strict civil law approach, a review of the legislative history prior to the enactment of Law 315 illustrates that legislators' intention was that the validity of the

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219 See Law 315 of 1996, art. 2.
220 After 1998 with the enactment of Decree No. 1818, it is still not clear whether the parties can opt for procedural rules of independent institutions to avoid domestic regulation. See Decree No. 1818 of 1998, art. 116.
221 See TermoRio S.A. E.S.P.
222 See id.
223 BLACKABY, supra note 197, at 131.
arbitration agreement and the consent of the parties were enough evidence of the parties’ desire to opt for an international arbitration. Under the mentioned interpretation, the arbitrators’ conclusion as to the validity of the arbitration agreement and to the internationality of the dispute was made in accordance with the law.

On December 21, 2000, the arbitration tribunal issued an award, in which the following issues were discussed: \(^{224}\)

1. *Existence and Validity of the PPA and its Amendments*

Electranta objected to the validity and existence of the PPA and its amendments, on the following grounds: \(^{225}\) (1) the PPA was null and void because it contravened rules issued by the Regulatory Commission for Energy and Gas \(^{226}\) (CREG); and (2) there was a lack of authority on behalf of the representative of Electranta who signed the agreements, since he was the legal representative of Electranta while acting as one of the directors of TermoRío. \(^{227}\)

With regard to the first ground, the arbitration tribunal stated that the PPA did not violate any of the rules and regulations applicable thereto. \(^{228}\) In particular, it stated that even when the CREG requested some clarifications once the parties signed the agreement, none of those clarifications were imperative rules, and the violation of such clarification could not affect the existence and validity of the agreement. \(^{229}\) The arbitration tribunal added that since the parties signed the PPA, such contract validly existed under the applicable laws. \(^{230}\) Whether the registration was or was not made did not impede the PPA from being valid, and it did not affect the provisions and obligations contained therein.

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\(^{224}\) *See TermoRío S.A. E.S.P.*  
\(^{225}\) *See id.*  
\(^{226}\) CREG, a regulatory entity created by means of article 69 of Law 142 of 1994 with the purpose of setting the rules of the public utilities sector, maintaining levels of competence and fulfilling the needs of the consumers.  
\(^{227}\) Electranta was a minority shareholder in TermoRío.  
\(^{228}\) *See TermoRío S.A. E.S.P.*  
\(^{229}\) *Id.*  
\(^{230}\) *Id.*
In relation to the second ground, the arbitration tribunal found evidence to justify that the representative of Electranta who signed the PPA and its amendments had full authority to do so under the certificate of incorporation of Electranta and its statutes.\(^\text{231}\) Considering that the person who signed the agreement acted as representative of Electranta while also acting as a director in TermoRío, and since such circumstance was not recognized by the law as a ground to challenge such person's competence to perform as either of them, the arbitration tribunal dismissed that particular claim.\(^\text{232}\)

Further reviewing the last ground, the arbitration tribunal stated that the grounds to challenge competence of a person must be expressly stated in the law, citing the Constitution of the Republic of Colombia and the law applicable to individuals who serve as officers of state-owned entities.\(^\text{233}\) In such sense, additional grounds cannot be created for each case depending on the needs of each claimant.\(^\text{234}\) In addition to that, the arbitration tribunal also considered that if the law provides the possibility for the entities of the energy sector to constitute alliances and to collaborate in the same ventures, it would not make any sense to prohibit the participation of one entity in the other's business, even when both of the entities have common directors or officers.\(^\text{235}\)

2. **Force Majeure**

The respondent stated that it was impossible to perform his obligations under the contract due to the intervention of the Colombian government, as well as to the consequent liquidation and transfer of its assets to a newly created company.\(^\text{236}\) In the opinion of Electranta, such event was outside of its control. Furthermore, the decision to liquidate the company was due to a national governmental policy. Therefore, it constituted a force majeure event.

In response to this ground, the arbitration tribunal stated that the decision of liquidating a state-owned company such as

\(^{231}\) See id.

\(^{232}\) See id.

\(^{233}\) See id.

\(^{234}\) See id.

\(^{235}\) See id.

\(^{236}\) See TermoRío S.A. E.S.P.
Electranta was not due solely to the will of the government.\textsuperscript{237} The arbitration tribunal stated that in order to liquidate a state-owned company, there had to be grounds recognized by law to proceed that way.\textsuperscript{238} The grounds under which the government was making such decision were, among others, mismanagement of the state-owned company and eminent risk of insolvency, which under either situation should not be considered as force majeure events. Even when the liquidation of Electranta was made pursuant to the government's plan to improve the efficiency in the sector, the decision of the government to intervene in the activities of Electranta was justified by the legal grounds stated above.\textsuperscript{239}

In such sense, the arbitration tribunal stated that Electranta could not argue that its liquidation was an unforeseeable or an unavoidable event, as it was required under Colombian legislation to prove force majeure because it was public knowledge that the company had become unsustainable.\textsuperscript{240} This argument was also applied by the arbitration tribunal to the issue of the transference of Electranta's assets, which, according to the arbitration tribunal, was, in a general sense, the immediate consequence of the liquidation of a company that was not viable and that was causing losses to the national treasury.\textsuperscript{241} In addition to the above, the fact that the assets were going to be transferred constituted a breach under the terms of the PPA, considering that by such action, TermoRío's interests were affected.

3. Lack of Registration of the PPA

The respondent claimed that the fact that neither Electranta nor TermoRío registered the PPA prevented obligations from arising out of the contract.\textsuperscript{242} He also added that the lack of registration made the agreement nonexistent; therefore, no breach of contract occurred under its terms because the obligations contained therein never arose.\textsuperscript{243}

\textsuperscript{237} See id.
\textsuperscript{238} See id.
\textsuperscript{239} See id.
\textsuperscript{240} See TermoRío S.A. E.S.P.
\textsuperscript{241} Id.
\textsuperscript{242} Id.
\textsuperscript{243} Id.
When analyzing this ground, the arbitration tribunal manifested its awareness of the need to register the PPA, considering that if the parties did otherwise, the main obligations of the PPA, such as the supply of power, the fixation of the price and the payment could not be performed. 

The arbitration tribunal also stated that the obligation to register the PPA was mutually shared by both of the parties. Contrary to what Electranta claimed, the registration was not a requirement for the existence of the PPA.

In its decision, the arbitration tribunal recognized that there was evidence in the record showing that in several occasions TermoRío made its best efforts to comply with its obligations. According to the arbitration tribunal, TermoRío acted reasonably and diligently by proposing alternatives for the fulfillment of their obligations under the PPA and also drafted amendments to the PPA. It was also clear to the arbitration tribunal that, as opposed to its counterparty’s efforts, Electranta’s representatives did not do anything to overcome the difficulties in complying with the obligation of the registration of the PPA, and that Electranta should be liable for such omission.

Considering the above-referenced arguments, and after analyzing the relief requested by TermoRío, the arbitration tribunal awarded TermoRío with an amount close to U.S. $62 million, including damages and expenses.

D. Judicial Review of the Award

As per the compilation of facts contained in the Council of State’s decision, within five days after the arbitration award was issued, Electranta brought a claim before the Tribunal of the District of Barranquilla requesting an annulment of the award. Electranta argued that the arbitration agreement was null and void under Sections 1 and 4 of Article 163 of Decree

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244 See TermoRío S.A. E.S.P.
245 Id.
246 Id.
247 Id.
248 Id.
249 See Council of State, supra note 6.
1818 of 1998.\textsuperscript{250} By means of a later brief, Electranta verified that the proper competence to solve the issue was in the Council of State pursuant to Article 36 of Law 446 of 1998,\textsuperscript{251} and so it moved the claim to the latter tribunal.

1. Competence of the Council of State

When reviewing the grounds Electranta based the annulment on, the Council of State concluded\textsuperscript{252} that it was the competent authority to review this request for annulment because the PPA involved two entities that provide public utilities, and one of them was a state-owned company.\textsuperscript{253} It was also competent because the nature of the PPA was related to activities and services usually rendered and regulated by the state.\textsuperscript{254} According to the Council of State, by assuming its competence to review the present case, it was setting a precedent in order to maintain certain uniformity as to the proper jurisdiction that should resolve disputes whenever a state-owned entity is involved.\textsuperscript{255}

With regard to the argument to declare the arbitration clause null and void, the Council of State held that Electranta cited the wrong legal framework to request a review of the award.\textsuperscript{256} According to the Council of State, the proper grounds for annulment are those contained in Article 72 of the Law of Administrative Contracts.\textsuperscript{257} Notwithstanding that fact, such article does not provide that an arbitration clause is null and void as a ground for annulment of an award. Despite this limitation, the Council of State assumed the review of the arbitra-

\textsuperscript{250} This article sets forth the reasons to declare an award null and void. The reasons stated on behalf of Electranta were: (i) invalidity of the arbitration clause, and (ii) failure to practice evidence as requested by the parties, when such evidence would have been determinant in the outcome of the dispute. Article 163 of Decree 1818 of 1998 by which the statute of alternative dispute resolution mechanisms is set forth.

\textsuperscript{251} This article modified some of the powers of the Council of State, and added the power to decide the annulment of arbitration awards that arise from agreements governed by the law of administrative contracts.

\textsuperscript{252} See Council of State, supra note 6.

\textsuperscript{253} See id.

\textsuperscript{254} See id.

\textsuperscript{255} See id.

\textsuperscript{256} Id.

\textsuperscript{257} These contracts are those that involve: (i) governmental entities, (ii) state-owned entities or (iii) public utilities.
tion clause was based solely on the general powers granted to it under the administrative code.258

In short, the Council of State manifested that its duty is to declare an agreement null and void in cases where such circumstance is fully proven.259 Therefore, the Council of State extended the applicability of one of its general powers to review the arbitration award at hand and disregarded the application of the grounds stated in the arbitration regulations.260 Consequently, the Council of State proceeded to review the validity of the arbitration clause, with the purpose of defending public interest pursuant to its general powers, as explained above.261

The Council of State recognized that, in general terms, the arbitration clause was created by consent.262 It admitted that it existed from the moment the parties to the clause were willing to submit their controversies to a tribunal and not to a judge.263 It also recognized that it was a separate and autonomous clause from the main agreement to which the arbitration clause was attached.264 Lastly, it recognized that the grounds to annul an arbitration award must be focused on the procedure and not on the substance of the dispute.265 However, it again accepted as an exception to the arbitration regime the possibility of its intervention as judicial authority when there was enough evidence to state that an arbitration agreement was null and void.266

2. Applicable Law to the Arbitration Clause and Arbitration Tribunal and Lack of Consent

The Council of State confirmed in its decision that there was no evidence to prove that in executing the arbitration clause, the parties wanted international arbitration, as was mandated under Article 1 of Law 315 of 1996.267 According to

258 See Council of State, supra note 6.
259 Id.
260 Id.
261 See Council of State, supra note 6.
262 Id.
263 Id.
264 Id.
265 Id.
266 Id.
267 Id.
the Council of State, the arbitration lacked the character of internationality because the parties did not expressly state so in the clause.\textsuperscript{268} In the Council of State's words, such lack of evidence made the clause null and void.\textsuperscript{269}

The Council of State further explained that institutional arbitration was restricted to cases of international arbitrations.\textsuperscript{270} On the contrary, institutional arbitration was not allowed in cases of domestic arbitrations such as the one chosen by TermoRío and Electranta. In addition, and referring to the ICC, the Council of State held that it is contrary to the laws of the Republic of Colombia to submit a dispute to a different jurisdiction from the one recognized under national laws.\textsuperscript{271} Based on the above reasoning, the Council of State declared the arbitration clause null and void and annulled the arbitration award.

Under the hypothetical that the investment of U.S. company Sithe Energies in TermoRío would have been insured by either OPIC or MIGA under a breach of contract coverage, the decision of the Council of State would have prevented the investor from claiming the insurance because the award was annulled by a court from the place where the arbitration award was rendered, taking away its effects and making it unenforceable.

From the reasoning of the Council of State, it is clear that due to the lack of clarity in the interpretation of the law, and due to the overreaching powers assumed by the Council of State, a decision affecting foreign investment, and hence international trade, was made. This situation reveals the political risk of judicial override, as will be explained in further detail below.

The following are the special features of the mentioned new risk, which are shown throughout the reasoning contained in the decision issued by the Council of State, dated August 5, 2002.\textsuperscript{272}

\textsuperscript{268} See Council of State, \textit{supra} note 6.
\textsuperscript{269} Id.
\textsuperscript{270} Id.
\textsuperscript{271} Id.
\textsuperscript{272} See Council of State, \textit{supra} note 6.
E. Special Features of New Risk

1. Grounds to Set Aside the Awards

The fact that the Council of State annulled the award on the ground that is neither provided under the applicable arbitration law, nor provided by the Law of Administrative Contracts, creates the question of what the limit for judicial intervention on the review of arbitration awards must be. Additionally, it reveals the uncertainty of not knowing the outcome of an arbitration proceeding considering that all the available grounds to set aside awards are not clear under the applicable arbitration law.

2. Lack of Internationality of Transaction and Arbitration Procedure

The international character of the transaction and of the arbitration was totally omitted by the Council of State, leaving the investor and its subsidiary unprotected and without any means to claim its rights on validly legal grounds. Going back to the requirements set forth in Article 1 of Law 315 of 1996, the Council of State not only disregarded the validity of the agreement between the parties and their consent, but it also disregarded the fact that the transaction involved international trade (as there was foreign investment through equity in one of the companies that participated in the transaction).

In some sense, and pursuant to Article 1 of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the Council of State was not bound to apply this regime. This article states that the convention applies to:

[T]he recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought (...). It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.273

Since the dispute among TermoRío and Electranta was considered a domestic dispute rather than an international one, the

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New York Convention could not be applied to the case. Also, in general, this fact implies a clear political risk for the parties involved in arbitration, not only because the consensual nature of the arbitration was ignored, but also because the decision of the Council of State ignored that foreign capital was involved in the transaction and that more interests besides national ones were intermingled in the dispute.

3. Authority of the Parties to go to Arbitration and Setting Rules

The Council of State ignores the fact that arbitration is a product of the parties' consent. It ties their consent to the technicalities of the applicable laws and not to the autonomy of the parties involved by declaring that the arbitration clause is null and void. Even when the enforceability of the arbitration clause was possible, (provided that the arbitration regime had an express provision on such regard and that the applicable law of contracts for stated-owned entities also allows them to settle their disputes through arbitration),\(^{274}\) it was not clear under the applicable law whether parties were entirely free to choose the applicable rules of procedure. As stated above, unless the arbitration was international,\(^{275}\) parties were able to choose applicable procedural rules. In the case at hand, the parties probably assumed that this transaction could meet the requirements of an international arbitration. However, in the interest of Electranta as the state-owned entity, such information was omitted. In the end, the intervention of the judicial entity erased any effort by the parties to maintain the disputes far from the national courts, which is also a manifest political risk for foreign investors, given the uncertainty in the outcome of an arbitration procedure chosen by both parties.

When analyzing the conduct of the Council of State, it could be said that its decision amounts to a denial of justice to the

\(^{274}\) See Law 80 of 1993, arts. 13 and 70.

\(^{275}\) See Law 315 Diario Oficial 4287, art. 2 (Sept. 1996) (Colom.), supra note 198 (stating that parties to an international arbitration agreement may choose both the governing law and the rules of procedure applicable to a particular dispute. Article 1 of the same law states that for an arbitration to be international, parties must agree on such character. The article also states several conditions related to the character of the dispute, and includes as a condition that the dispute must affect international commercial interests).
investor under a broad interpretation of such principle. Following that thought, the misapplication of the Colombian arbitration rules by the Council of State, which is openly contrary to international practice, could be taken by some as a mere error, thus not covered under the denial of justice principle. Yet, the manifest disregard of the arbitration regime and the consent of the parties could be used by the investor as grounds to allege the breach of such principle in order to demand from the insurer the payment of the breach of contract coverage.

In spite of this reasoning, the TermoRío case does not fall under the provision contained in the political risk insurance contract as it exists today. To make a breach of contract coverage suitable for a situation similar to the TermoRío case, it would be required to modify the scope of the coverage or to apply a broader interpretation of the principle of denial of justice.

V. Proposals

Under the Colombian arbitration regime, if parties to an agreement decide to opt for an international arbitration, the clause must comply with the special requirements contained in the regime in order to be valid and enforceable. As a proposal, the following is a draft which, in principle, complies with the legal requirements. This draft is based on the ICC standard arbitration clause.

Arbitration clause: Pursuant to Article 1 of the Law 315 of 1996, the parties expressly agree to resolve their disputes through the mechanism of international arbitration, considering the international commercial interests involved in the dispute. Thus, all disputes arising out or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with said rules.

Despite the proposed clause, and keeping in mind the risk identified in the decision of the Council of State, two proposals should be made on both national and international levels. Such proposals will help to avoid uncertainties as to the outcome of consented arbitration when carried out in Colombia, and will

276 See MIGA INVESTMENT GUIDE, supra note 3, at 261.
277 See Law 315 of 1996, art. 1.
leave an open door to insurers to enhance their coverage as to political risk and promote flexibility in the interpretation of the existing conditions of the coverage.

A. National Level: Amendments to Existing Legislation

Despite the amount of arbitration procedures that are being held in Colombian territory, the TermoRío decision revealed some gaps in the national legislation that should be filled in order to prevent the occurrence of similar situations. In this sense, it is necessary to provide a clearer regulation and to promote a consequent interpretation regarding the following issues:

1. International Arbitration

When we are facing an international arbitration, how can parties evidence such character in the arbitration clause? Although Law 315 of 1996 recognizes the existence and validity of international arbitration, the interpretation of the law has not been clear as to whether the arbitration clause should contain the word "international" or if the fact that the underlying transaction involves international commerce (by means of the participation of foreign capital), implies the possibility of opting for such arbitration. The latter seems to be the most logical and sensitive way to interpret the legal mandate, following the trends adopted in the international arena. In such sense, and in case the particular agreement involves one foreigner who acts as an investor, the international arbitration regulation should be applied. That way it would be easier for both parties to predict the outcome of the dispute resolution procedure chosen by them via agreement and to have the certainty that their agreement will be respected and enforced.

\textsuperscript{278} In this sense, Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974), is a landmark decision of a U.S. court that evaluates the internationality of a dispute. It states that such characteristic must be reviewed in light of the needs of international commerce and its protection, as well as of the protection and the wellness of international relations. Such doctrine was adopted within the U.S. ever since, and has helped to set the grounds in the international arena for the analysis of the internationality of a dispute. The Colombian Constitutional Court, in the decision C-347 of 1997, indicated that the parties to an agreement to arbitrate should be free to opt for an international arbitration procedure, as long as one of the parties is foreign. But, even under this interpretation, a company that is incorporated in Colombia with foreign capital will not fulfill the requirement stated by the court.
2. Party Autonomy to Choose Procedural Rules

When can the parties to an arbitration clause choose their arbitration rules? This issue is tied to the issue reviewed above. Currently, if the arbitration is international, parties are allowed to choose the rules of their preference. On the other hand, if the arbitration is domestic, as was assumed by the Council of State in the TermoRío case, the procedural law applicable in Colombia cannot be substituted unless the rules chosen by the parties are those of a recognized institution that operates in Colombia. Again, in a case in which foreign capital is involved, it is obvious that parties should be free to choose neutral rules that fit best in the context of international commerce.

3. Grounds to Review Awards

What are the grounds under which a local court can review an award and consequently set it aside? This seems to be the issue that requires the most thorough and sensitive review. When reviewing the decision of the Council of State, and without regard as to whether the arbitration was international or national, the legal grounds to set aside the award were not taken into account while other grounds were applied. This dangerous situation could be repeated in the future unless an effort to unify the grounds to annul awards and provide a clarification in their interpretation in this area of the law is implemented.

B. International Level: Enhanced Coverage of Political Risk Insurance

Considering that a situation such as the one present in the TermoRío case is not foreseen as a risk by either OPIC or MIGA, it would be advisable to modify the current scope of breach of contract coverage, allowing investors to make a claim as long as they can prove there has been a denial of justice on behalf of local courts or arbitral awards, and not until after enforcement is sought.

The TermoRío case revisits some of the situations that are most feared by investors, such as delays in the procedure, unpredictability in the outcome of an arbitration dispute, and the fact that the award can be subject to annulment by local courts.
before the investor attempts to enforce it.279 Under the perspective of the TermoRío case, the only way the investor could make a claim under the breach of contract coverage would be by starting a new domestic judicial procedure in order to request the declaration of breach of contract. This would make the process much more burdensome for the investor and disregards his interest in settling disputes away from the local courts.

By means of an enhanced coverage, both MIGA and OPIC could provide investors with the possibility of making a claim once an arbitration comes to an end justified under the principle of denial of justice. Through such process, investors can avoid delays arising from intentions by the host country to appeal the arbitration tribunal’s decision, and investors will be given some degree of certainty as to the possibility of obtaining the amounts insured once a dispute resolution mechanism has come to an end.

VI. CONCLUSION

The efforts of governmental entities and legislators to improve the foreign investment conditions in developing countries are not sufficient if investors cannot manage and allocate commercial and political risks properly, even with the help of international entities that provide insurance. In this sense, synergy must exist among the domestic applicable legislation to the foreign investment, from corporate laws to alternative dispute resolution mechanisms and arbitration. Needless to say, the risks covered by the insurers must mirror current market needs in order to satisfy the requirements of the investors in the international arena. Otherwise, we will be facing the same problems and gaps of the TermoRío decision, nurturing uncertainties related to foreign investment in developing countries and denying the possibility for such countries to grow with the help of foreign capital.

279 See Moran, supra note 7, at 52.