

The Role of Legal and Regulatory Governance in Mitigating Risks for Renewable Energy Projects

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Abstract

This paper examines the role of legal and regulatory governance in mitigating risks associated with renewable energy (RE) investments. Drawing on recent scholarly and policy literature, it explores how governance structures, legal origins, and institutional quality influence the political, financial, and technical risks that affect RE project deployment. The review shows that strong rule of law, policy stability, and regulatory clarity significantly reduce systemic investment risks by improving transparency, investor confidence, and access to finance. Conversely, weak governance and fragmented legal frameworks amplify uncertainty and hinder project implementation. Civil law systems are found to align more closely with Environmental, Social, and Governance (ESG) priorities, while common law systems often prioritise investor protection and short-term returns.

The study highlights key legal strategies, including harmonised regulations, streamlined permitting, feed-in tariffs, and adaptive governance mechanisms such as regulatory sandboxes, as essential tools for de-risking RE investments. The paper concludes that governance quality is not a peripheral factor but a core determinant of successful renewable energy transition, underscoring the need for coherent, transparent, and adaptive legal frameworks to foster a stable and sustainable investment environment.

Keywords: renewable energy; legal governance; regulatory frameworks; investment risk; policy stability

JEL Classification: K32, K23, Q42, Q48, G38.

Introduction

The transition to renewable energy (RE) is widely seen as central to addressing climate change, energy security, and sustainable development (Obanor et al., 2025). However, numerous risks such as political, financial, technical, and regulatory, pose major barriers to investment in renewable energy projects, especially in developing countries (Javed et al., 2025; Liu et al., 2021). Effective legal and regulatory governance is increasingly recognized as a critical lever for mitigating these risks and thus enabling the more rapid deployment of renewable energy.

Political risk (e.g., instability, regulatory unpredictability) and financial risk (e.g., access to capital, cost of capital) are particularly pronounced in contexts with weak institutional frameworks. In a study of 36 developing countries over three decades, reduced political and financial risk were associated with greater energy security and increased RE adoption (Javed et al., 2025). Similarly, policy uncertainty is found to constrain RE investments, while strong environmental regulation and financial stability facilitate both RE investment and lower

emissions; these dynamics have been observed in China's provincial data (Subhani et al., 2024).

Another dimension is the effect of national legal origin (civil vs. common law systems) and governance quality on RE investment. Liu et al. (2021) analyse 236 Renewable energy companies in a cross-national sample and show that civil law systems often have lower financial constraints for RE firms, whereas in common law systems stronger investor protections exist but are accompanied by greater caution in RE due to long payback times and perceived risk (Subhani et al., 2024).

In addition to macro-level risks and legal origin, there is the role of policy and regulatory frameworks. National laws, regulations, and institutional stability can either drive investment or become bottlenecks if they are incoherent, unpredictable, or weakly enforced. For example, Liu & Feng (2023) studies over 129 countries and finds that having energy laws significantly advances RE deployment, with legal systems that are effective (strong rule of law, regulatory quality) magnifying that effect.

Given this context, this paper aims to examine how legal and regulatory governance functions as both a driver and a barrier in mitigating the various types of risks associated with renewable energy investments.

This examination is important because while much research has separately addressed political risk, finance risk, or regulatory policy, fewer studies bring together the legal/regulatory governance perspective comprehensively with various risk types. Understanding the interactions among legal origin, governance quality, regulatory policy stability, and institutional strength can help clarify which governance interventions are most promising, especially in places where RE investment could make a large sustainability impact (Liu et al., 2021).

1. Governance in Mitigating Macro-Level Risks

Key concepts along with the theoretical basis needed for analysing how legal and regulatory governance interacts with risks in renewable energy (RE) investments are defined in this section. This includes defining risk categories; presenting governance quality, legal origin, and institutional stability as governance constructs; and explaining how these influence RE investment behaviour.

To assess how governance can mitigate risks, it's important to classify the main risk types RE projects face. The literature typically identifies:

- **Macro-level (Systematic) Risks.** These are risks external to a given project or firm, affecting the investment environment generally (Bialowolski & Weziak-Bialowolska, 2014). Examples include political risk (instability, expropriation, changes in law or policy), financial risk (currency risk, inflation, access to finance, cost of capital), governance risk (weak rule of law, regulatory uncertainty), and international risks (tariffs, changing global norms or carbon policies) (Renn et al., 2022).
- **Project-level (Specific) Risks.** These are internal or localized risks that project developers can more directly influence or that are addressed by more local or technical governance. They include regulatory barriers (permits, land use), technical risks (intermittency, grid connection, performance risk), environmental and safety risks (EIAs, ecological impacts, safety of energy storage), and contractual/execution risk (construction delays, cost overruns) (Teller et al., 2014).

Governance Quality and Legal Origin theory

Governance Quality refers to the broader institutional environment: how reliably laws are enforced (rule of law), how effective regulatory agencies are (regulatory quality), how free and accountable governments/institutions are (voice & accountability), the level of corruption control, and other measures (Breakey et al., 2016). Several empirical works show that higher governance quality is positively associated with greater RE deployment. For example, a recent study in sub-Saharan Africa found that governance quality (via indicators like rule of law, corruption control, governance effectiveness, etc.) significantly moderates the impact of foreign direct investment (FDI) on RE development (Dossou et al., 2023).

Legal origin theory posits that countries with different historical legal system heritages (for example civil law vs common law) show different behaviour in business regulation, investor protection, contract enforcement, transparency etc., which in turn influence economic outcomes. The study by Liu et al. (2021) shows that Renewable energy firms in civil law countries tend to face fewer financial constraints, while in common law systems firms are more sensitive to growth opportunities but also more cautious due to perceived risk and long payback periods.

How Governance and Legal Origin Influence Risk and Investment Behaviour

Theoretical pathways linking governance/legal origin to risk mitigation and RE investment are outlined in Table 1. Liu et al. (2021), using data from 236 RE companies globally (2000–2017), they find that firms in common law systems respond more strongly to growth opportunities but face greater financial constraint; in civil law systems, governance mechanisms (rule of law, regulatory quality, voice & accountability) reduce financing constraints. Shang et al. (2023) uses data for 103 developing countries over 21 years; finds that governance quality is positively related to clean energy supplies, with stronger effects in Africa.

Table 1: Theoretical pathways linking governance / legal origin to risk mitigation and RE investment

Governance Dimension	Mechanism of Influence on Risks	Expected Effect on RE investment	Reference
Good Rule of Law / Regulatory Quality	Improves enforcement of contracts, reduces risk of expropriation or arbitrary policy changes; increases transparency; lowers information asymmetries.	Lowers cost of capital; increases investor confidence; encourages long-term investment	Liu et al. (2021)
Legal Origin (Civil vs Common Law)	Civil law systems emphasize detailed administrative and ESG-oriented regulation supporting public welfare, while common law systems focus on investor protection and market efficiency, often demanding stronger evidence of returns due to higher perceived risk.	Civil law settings may easier adopt RE under ESG motivation; common law settings may demand clearer financial returns or stronger incentives	Shang et al. (2023); Liu et al. (2021)
Institutional Stability & Policy Predictability	Stable policies, predictable permitting, coherent regulation help reduce uncertainty risk; abrupt changes or unclear regulations increase risk premiums and can stop or delay projects.	Better stability leads to more investment; uncertainty reduces investment or shifts it to safer geographies/ projects	Liu et al. (2021); Chen et al. (2024)

Chen et al. (2024) shows that Institutional Quality acts as a moderator when governance is above certain threshold levels, green innovation and energy efficiency are more likely to succeed.

2. Governance in Mitigating Macro-Level Risks

This section examines how legal and regulatory governance helps reduce macro-level (systemic) risks, particularly political and financial risk, and thereby supports renewable energy (RE) investment.

Political risk refers to instability in governance, unpredictability of policy, corruption, weak rule of law, and other institutional failings (Javed et al., 2025). According to Shimbar & Ebrahimi (2020), such risks discourage long-term investment in RE which often requires long payback periods. A cross-country panel study covering 36 developing countries (1990-2022) shows that reducing political risk significantly enhances energy security and supports transitions to renewable energy (Javed et al., 2025). Political stability improves investor confidence, reducing risk premia, and enabling capacity commitments in RE sectors.

In OECD countries, higher institutional quality and lower political risk are strongly associated with greater renewable energy consumption in the long run. This suggests that political risk not only affects where investment flows but also how consumers and governments prioritize clean energy (Wang et al., 2022).

Dossou et al. (2023) study focused on Sub-Saharan Africa found that governance quality (control of corruption, rule of law, effectiveness of institutions, voice and accountability) significantly moderates the effect of foreign direct investment (FDI) on renewable energy deployment. Poor political/institutional quality reduces the positive effect of FDI on RE.

Financial risk includes limited access to affordable finance, high cost of capital, currency instability, and financial development deficits (Javed et al., 2025). Governance can reduce these risks by improving transparency, regulatory oversight, and investor protection.

Liu et al. (2021) shows that firms in civil law countries face fewer financial constraints than in common law ones, partly because civil law systems often embed greater regulatory oversight and stakeholder protections, which reduce investor uncertainty. In emerging markets, the combined effect of financial development and low geopolitical risk is found to boost renewable energy consumption. Where financial institutions are not well developed, or where finance markets are unstable, RE adoption is slower (Alsagr & Van Hemmen, 2021).

In the MENA region (Middle East & North Africa), institutional and political factors are found to play a critical long-run role in enabling RE transition, particularly through improving confidence in financing frameworks. The study found that in the short run, financial development has mixed or negative effects unless governance quality is also improved (Saadaoui, 2022).

Role of Governance Quality

Governance quality refers to the strength of institutions. It deals with how well laws are enforced; regulatory quality; control of corruption; government effectiveness; rule of law; voice and accountability (Johnston, 2006). Good governance reduces systemic uncertainty and builds investor trust.

- The Sub-Saharan Africa study by Dossou et al. (2023) involving 37 countries within the time frame of 1996-2020, shows that improvements in governance quality (control of corruption, regulatory quality, rule of law) are directly associated with increases in RE

generation capacity/deployment. In addition, governance amplifies the effectiveness of FDI in the energy sector.

- Kassi et al. (2023) in their paper find that governance quality has threshold effects: below certain governance levels, the positive impact of finance on RE growth is weaker; once governance quality improves past a threshold, finance contributes much more strongly to renewable energy consumption and growth.
- Kolawole et al. (2024) study finds that institutional quality is a key factor in ensuring that financial resources and government revenue contribute effectively to sustainable energy supply. Weak institutional quality blunts the impact of both finance and revenue.

Legal Origin and Investment Behaviour

Legal origin frames some of the macro governance structures, who has rights, how contracts are enforced, what protections investors have, which in turn affect risk perceptions, cost of capital, and speed of deployment. Liu et al. (2021) demonstrate that common law systems tend to lead to greater sensitivity to cash flow and more cautious investment in RE, due to higher perceived risks, whereas civil law systems tend to reduce financial constraints via regulatory structures and more stakeholder-oriented institutions.

In many developing countries, legal systems with weaker enforcement (regardless of nominal legal origin) translate into higher financial risk and political risk for investors (Khoury et al., 2015). This is seen in the MENA region and Sub-Saharan Africa, where even if the legal framework exists, governance quality mediates whether legal origin becomes a strength. For instance, a legal origin may provide formal investor protection, but if rule of law is weak, such formal rights may not be enforceable, thereby preserving risk (Dossou et al., 2023).

How Legal & Regulatory Governance Work at Macro Level

From the evidence above, several mechanisms emerge for how governance helps reduce macro-level risks in RE investment as shown in table 2.

Table 2: Synthesis of how legal and regulatory governance work at macro level

Governance Mechanism	Risks Mitigated	Effect on RE Investment / Indicators
Strong rule of law & judicial enforcement	Political risk, expropriation risk, policy instability	Reduces uncertainty -> lowers risk premium -> increases investment/ expenditure in RE deployment (e.g., FDI increases)
Regulatory quality & clarity	Regulatory uncertainty, cost overruns, approval delays	Reduces transaction costs and delays, improves predictability for investors
Control of corruption & transparency	Arbitrary decision-making, misallocation of subsidies, illicit rent capture	Increases confidence, ensures incentives/policies work as intended
Legal origin / investor protection frameworks	Financial risk (through external finance), contract risk	Enables lower cost capital, easier access to finance; reduces sensitivity to cash flow constraints

Empirical findings suggest that in regions or countries with already moderate to high governance quality, improvements have compounding positive effects. But in very weak governance contexts, improvements may first need to be institutional/infrastructural (legal reform, enforcement capacity) before other governance improvements yield full returns.

3. Legal and Regulatory Strategies for Risk Mitigation

The effectiveness of renewable energy (RE) investment hinges not only on recognising the risks inherent in projects but also on the proactive adoption of legal and regulatory strategies to mitigate them. Contemporary literature suggests that structured governance and coherent legal frameworks provide the enabling environment necessary to attract capital, reduce uncertainty, and sustain investor confidence (Abolhosseini & Heshmati, 2014; Narassimhan et al., 2018). Complex administrative procedures often result in project delays and higher transaction costs. Scholars argue that simplification of permitting through one-stop regulatory frameworks is a key governance strategy to lower risk (Narassimhan et al., 2018). For example, the European Union's Renewable Energy Directive (RED II) mandates streamlined approval for renewable projects, which has been associated with greater private sector participation (Campoccia et al., 2019).

Fragmented regulations across jurisdictions create uncertainty for investors. Harmonisation of standards, particularly grid codes and interconnection requirements, is essential for ensuring predictability. International Renewable Energy Agency (IRENA) reports highlight the importance of adopting standardised Power Purchase Agreements (PPAs) to reduce contractual risk, a recommendation echoed in recent empirical studies of African RE projects (Olanrewaju et al., 2021).

Financial risks can be mitigated through stable policy instruments that guarantee returns. Feed-in Tariffs (FiTs), Renewable Portfolio Standards (RPS), and tax incentives are widely cited as effective tools to reduce the high capital costs of RE projects (Couture & Gagnon, 2010; Huenteler et al., 2016). In Germany, FiTs have significantly increased investor confidence by ensuring predictable revenue streams, while in emerging economies, similar instruments have been instrumental in securing financing for solar and wind projects (Polzin et al., 2019).

Emerging technologies such as microgrids, battery storage, and hydrogen pose regulatory challenges due to their novelty. Adaptive governance frameworks, including "regulatory sandboxes" that allow controlled experimentation, have been identified as critical to balancing innovation with risk management (Sarker et al., 2020). By allowing flexibility within a bounded legal framework, sandboxes reduce uncertainty for developers while enabling regulators to learn and adjust policies iteratively.

Ultimately, legal strategies are only as effective as the institutions that implement them. Weak enforcement undermines otherwise well-designed policies. Studies on sub-Saharan Africa underscore that rule of law, contract enforcement, and transparency in procurement are essential to mitigating political and financial risks (Rana et al., 2020). Building institutional capacity not only lowers investment risk but also creates long-term stability for RE deployment.

In sum, legal and regulatory strategies, from procedural reforms to adaptive policy innovations, represent the bridge between recognising risks and enabling a supportive investment climate. The evidence underscores that governance quality is not only a moderator of risk but also an active driver of renewable energy growth.

Conclusion

This paper has examined the pivotal role of legal and regulatory governance in mitigating risks for renewable energy (RE) investments. The review highlights that risks in RE projects span both macro-level factors (such as political instability, financial market constraints, and weak institutional frameworks) and project-level challenges (including regulatory uncertainty, grid integration barriers, and environmental or safety concerns). In each case, the quality of governance and the robustness of legal frameworks determine whether such risks are amplified or mitigated.

Evidence from both developed and developing contexts demonstrates that strong rule of law, regulatory quality, and policy stability are fundamental to reducing uncertainty and unlocking investment flows into renewable energy. Conversely, outdated regulations, fragmented jurisdictional mandates, and weak enforcement mechanisms remain significant barriers. The comparative insights between civil law systems, which tend to embed Environmental, Social, and Governance (ESG) priorities, and common law systems, which emphasise investor protection and market logics, underscore the complexity of aligning legal origin with sustainable investment pathways.

Importantly, proactive legal and regulatory strategies provide a roadmap for overcoming these challenges. Streamlined permitting procedures, harmonised regulations, and stable financial incentives such as feed-in tariffs and renewable portfolio standards offer powerful tools for reducing project risks. Furthermore, adaptive governance models, including regulatory sandboxes for new technologies, ensure flexibility in addressing emerging risks without undermining investor confidence.

The findings also underscore a broader implication: governance is not a passive background factor but an active determinant of renewable energy success. In contexts where institutions are weak, building regulatory capacity, strengthening the rule of law, and promoting transparency in procurement are as important as technical or financial reforms. This makes legal and regulatory governance a critical policy lever for countries seeking to accelerate their energy transition while balancing risks.

Future research should deepen the comparative analysis of governance models across regions, particularly examining how policy innovations diffuse between jurisdictions and how adaptive governance mechanisms can address risks in emerging technologies such as hydrogen, carbon capture, and smart grids. For policymakers, the key takeaway is that legal clarity, regulatory stability, and institutional capacity-building are indispensable in creating the enabling environment required to attract sustainable investment in RE.

Credit Authorship Contribution Statement

Enoch I. Obanor was solely responsible for the conception and design of the study, data collection and analysis, and the interpretation of findings. He prepared the original manuscript draft, conducted the literature review, and completed all revisions and editing. The author approved the final version of the manuscript and agrees to be accountable for all aspects of the work.

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Conflict of Interest Statement

The author declare that the research was conducted in the absence of any commercial or financial relationships that could be construed as a potential conflict of interest.

Data Availability Statement:

No new data were created or analysed in this study. Data sharing is not applicable to this article.

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