The Law of Foreign Investment Insurance

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List of Abbreviations

AAA	American Arbitration Association
ABC	Australian Broadcasting Corporation
AIG	American International Group
ATI	African Trade Insurance Agency
Berne Union	International Union of Credit and Investment Insurers
BIT	bilateral investment treaty
CAO	Compliance Advisor/Ombudsman
CETA	EU-Canada Comprehensive Economic and Trade Agreement
CEO	chief executive officer
CIPM I	Capital India Power Mauritius I
COFACE	Compagnie Française d'Assurances pour le Commerce Extérieur
COSEC	Companhia de Seguro de Créditos
DHAMAN	Arab Investment and Export Credit Guarantee Corporation
DPC	Dabhol Power Company
DRC	Democratic Republic of Congo
ECGD	Export Credits Guarantee Department
EDC	Export Development Canada
EFIC	Export Finance and Investment Corporation
EIU	Economist Intelligence Unit
EU	European Union
FARDC	Forces Armées de la République Démocratique du Congo
FDI	foreign direct investment
FIAS	Facility for Investment Climate Advisory Services
ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights
ICIEC	Islamic Corporation for the Insurance of Investment and Export Credit
ICSID	International Center for Settlement of Investment Disputes
IDB	Islamic Development Bank Group
IFC	International Finance Corporation

ILC	International Law Commission
IMF	International Monetary Fund
ISDS	investor-state dispute settlement
MERC	Maharashtra Electricity Regulatory Commission
MIGA	Multilateral Investment Guarantee Agency
MITI	Ministry of Trade and Industry
MNE	multinational enterprise
MSEB	Maharashtra State Electricity Board
NAFTA	North American Free Trade Agreement
NEXI	Nippon Export and Investment Insurance
NGO	non-governmental organization
OECD	Organization for Economic Cooperation and Development
OIC	Organization of Islamic Cooperation
OPIC	Overseas Private Investment Corporation
SACE	Servizi Assicurativi del Commercio Estero
SEB	State Electricity Board
PAS	Policy and Advisory Services
PwC	PricewaterhouseCoopers
RAID	Rights and Accountability in Development
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UK	United Kingdom
UN	United Nations
US	United States of America
USA	United States of America
USAID	United States Agency for International Development

Introduction

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I. International Investment Law and Foreign Investment Insurance

International investment law is one of the fastest-growing areas of international law. Ever since the first bilateral investment treaty was concluded between Germany and Pakistan in 1959,[1] the number of such bilateral treaties rose to approximately 3000 by 2015.[2] Most countries have now concluded at least one bilateral investment treaty. In addition to bilateral investment treaties, sources of international investment law include sectoral investment treaties, such as the Energy Charter Treaty,[3] and over 300 investment chapters in bilateral or regional free trade agreements, such as the North-American Free Trade Agreement (NAFTA).[4]

International investment law has evolved from a law that governs exclusively inter-state relations to a law that focuses on the relations between investors and states.[5] The web of international investment agreements has significantly increased the protection of foreign direct investment through the provision of a set of open-ended principles that govern state behavior toward foreign investors and investor-state arbitration as a neutral forum for the resolution of investment disputes.[6] Ever since the first investor-state dispute was filed under an international investment agreement in 1987,[7] the number of publicly known treaty-based investor-state disputes grew to 696 by the end of 2015.[8]

The scholarly work on international investment law has increased correspondingly.[9] There are studies that examine international investment law as a whole, as well as comprehensive

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[1] Treaty between the Federal Republic of Germany and Pakistan for the Promotion and Protection of Investments (signed 25 November 1959, entered into force 28 April 1962).
[2] UNCTAD, *World Investment Report 2015: Reforming International Investment Governance* (New York: United Nations, 2015), p. 101.
[3] The Energy Charter Treaty, Annex I to the Final Act of the European Energy Charter Conference, 17 December 1994, (1995) 34 ILM 373.
[4] *Ibid.*, p. 101. See, North-American Free Trade Agreement (signed 17 December 1992, entered into force 1 January 1994), (1993) 32 ILM 289.
[5] Stefan W. Schill, 'W(h)ither Fragmentation?: On the Literature and Sociology of International Investment Law' (2011) 22 *European Journal of International Law* 875–908 at 878. However, foreign investment insurance deviates from this direction of the evolution of international investment law as it allows active involvement of the home state and the public insurance agency especially in the settlement of investment disputes.
[6] Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation*, Studies in international law (Oxford: Hart, 2009), p. 1.
[7] Asian Agricultural Products Ltd v. Republic of Sri Lanka, ICSID Case No. ARB/87/3, Final Award, 27 June 1990, (1991) 30 ILM 577.
[8] UNCTAD, *World Investment Report 2015*, p. 104.
[9] Schill, 'W(h)ither Fragmentation?'.

studies that cover particular issues in international investment law.[10] Over the last two decades, countless monographs, collective studies and journal articles have added to the literature on international investment law in general and specific areas thereof.[11] However, there remain several specific areas of international investment law that have not been looked at in depth. Among the specific areas of international investment law, the law of foreign investment insurance[12] is one of the areas that have received the least attention.[13] This book covers this neglected field of international investment law.

Most foreign investors rule out investment insurance as a risk mitigation tool. In 2012, in a survey conducted by the Multilateral Investment Guarantee Agency (MIGA) and the Economist Intelligence Unit (EIU) among foreign investors, only 18 % of the responding firms declared that they use investment insurance, a proportion that has changed only marginally over the last four years.[14] These statistics should be interpreted against the background that foreign investment insurance is almost exclusively used for investments in developing countries. In 2014, the global foreign direct investment flows have grown to US$1.23 trillion while the foreign direct investment flows to developing countries have increased to US$681 billion.[15] By

[10] *Ibid.*, 881.
[11] *Ibid.*
[12] Foreign investment insurance is extensively called "political risk insurance" in the literature. I prefer "foreign investment insurance" in order to emphasize what is being insured and to distinguish the type of insurance from export credit insurance and insurance of other interests against political risks. See Toby Heppel, 'Perspectives on Private-Public Relationships in Political Risk Insurance', in T. Moran and G. T. West (eds.), *International Political Risk Management: Looking to the Future* (Washington, DC: World Bank, 2005), pp. 139–57, p. 140. I use the terms foreign investment insurance and investment insurance interchangeably. Also note that, in the relevant literature investment insurance might be used interchangeably with investment guarantee. Despite similarities, investment guarantee and investment insurance are based on different legal constructs. Moreover, investment guarantee generally refers to full coverage of the value of the investment whereas investment insurance may cover only a certain percentage of the investment. See OECD, *Investing in Developing Countries*, OECD Publications, 5., rev. ed. (Paris: OECD, 1983), vol. 42.445, p. 30. Nevertheless, related public schemes are generally described as investment guarantee programs. See also Belinda Spagnoletti and Terry O'Callaghan, 'Going Undercover: The Paradox of Political Risk Insurance' (2011) 5 *Asia-Pacific Journal of Risk and Insurance* 1–23 at 3 "*Though it is the most commonly used term, the term PRI is not universal. For example, the ADB refers to its equivalent product as 'political risk guarantee' (PRG), while the UK's Export Credits Guarantee Department calls its product 'overseas investment insurance' (OII)*." Also, for technical differences between investment guarantees and political risk insurance provided by the World Bank affiliates, see Independent Evaluation Group, *The World Bank Group Guarantee Instruments 1990-2007: An Independent Evaluation* (Washington, DC, 2009) at 4-5.
[13] This is not to say that the foreign investment insurance literature is non-existent. There are numerous sources on the subject, however, they are mostly repetitive and address only a few individual investment insurance providers.
[14] MIGA, *World Investment and Political Risk 2012* (2013), 9.
[15] UNCTAD, *World Investment Report 2015*, pp. 2-3.

the end of 2014, the new underwriting by public and private investment insurers was reported as US$61.450,0 million - less than 10% of the total capital flows to developing countries.[16]

Ascari observes that foreign investment insurance is described by some as a "*relatively small business line in the overall portfolio of multi-line private insurers and re-insurers that hardly catches the attention of scholars and regulators*."[17] While it may appear as a relatively small business within the overall portfolio of the insurance sector, taken by itself, foreign investment insurance is by no means a small business line but a rather lucrative industry.[18] MIGA reports that the Berne Union members paid out US$795 million between 1996 and 2008 and that they were able to recover around 45 % in the same period, resulting in an actual payout figure of around US$437 million.[19] This figure should be compared with the premiums the industry generates annually, which is estimated by MIGA to be around US$1 billion.[20] Despite the global recession after the 2008 financial crisis, the investment insurance industry remained mature and resilient as many insurance providers have reported robust financial results.[21] MIGA has issued more than US$28 million in guarantees since its inception.[22] It has paid out only nine claims, two of which -expropriation claims- were recovered from the host states afterwards.[23] The prevalence of foreign investment insurance over the decades and the robustness of the investment insurance industry play an important role in the current debates whether insurance could be a functional equivalent of the treaty-based investor-state dispute settlement mechanisms.

One of the rare book-length studies on foreign investment insurance is Theodor Meron's monograph *Investment Insurance in International Law*, published in 1976.[24] In the main part of his book, Meron traces the establishment of national investment insurance schemes in the US, UK and Canada and examines the main elements of their charters. Although he focuses

[16] According to the data provided to the author by the Berne Union.
[17] Raoul Ascari, *Political Risk Insurance: An Industry in Search of a Business*, SACE Working Paper Number 12 , p. 6.
[18] Spagnoletti and O'Callaghan, 'Going Undercover', 4.
[19] MIGA, *World Investment and Political Risk 2009* (Washington, D.C.: World Bank Group, 2010), pp. 48-9. As noted by MIGA, this mainly consists of claims paid by public insurers since most private insurance companies were not yet members of the Berne Union in this period.
[20] Berne Union, *Yearbook 2015* (London, 2015), p. 9. Caution is warranted as this figure might include the premiums collected by the private insurance companies even though the claims paid, and amounts recovered reflect mainly the public insurers. For further information about the investment insurance industry, see Berne Union, *Yearbook 2016* (London, 2016), p. 28.
[21] MIGA, *World Investment and Political Risk 2009*, pp. 9-10.
[22] <https://www.miga.org/who-we-are/overview> accessed 23 March 2017.
[23] Based on an interview with a senior counsel from MIGA, the remaining 7 claims were due to political violence, terrorism and civil disturbance risks and these claim payments were not recovered.
[24] Theodor Meron, *Investment Insurance in International Law* (Dobbs Ferry/N.Y.: Oceana Publ, 1976).

particularly on these three national schemes, the annexes also provide information on the establishment of national schemes in Germany, France and Japan. Meron's book provides an important general perspective on the emergence of foreign investment insurance worldwide -or in the Western world. Later developments in this realm however have not yet been addressed in a comprehensive study.[25]

Most of the available studies on investment insurance are about the leading providers of investment insurance, which are MIGA and the Overseas Private Investment Corporation (OPIC), the US government agency that provides investment insurance.[26] MIGA, being an international development organization and a member of the World Bank Group, has naturally drawn more attention than other international investment insurers.[27] In 1988, Ibrahim Shihata, one of the minds behind the establishment of MIGA in the same year, published *MIGA and Foreign Investment*.[28] Shihata provides first-hand information about the rationales behind the establishment of this multilateral investment insurance institution and discusses MIGA's investment guarantee operations in the context of international investment law and development. As to OPIC, a range of issues from its establishment to operations and to the specific investment projects OPIC has been involved in as an insurer have constituted the subject matter of several scholarly articles.[29] They shed light also on global foreign investment

[25] For an early compilation by Jürgen Voss of sources on foreign investment insurance, see 'Sources on Investment Insurance' (1987) 2 *ICSID Review* 249–64.

[26] S. Linn Williams, 'Political and Other Risk Insurance: OPIC, MIGA, Eximbank and Other Providers' (1993) 5 *Pace International Law Review* 59–113.

[27] Klaus Peter Berger, 'The New Multilateral Investment Guarantee Agency Globalizing the Investment Insurance Approach Towards Development' (1988) 15 *Syracuse Journal of International Law and Commerce* 13–58; Malcolm D. Rowat, 'Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA' (1992) 33 *Harvard International Law Journal* 103–44; Christopher K. Dalrymple, 'Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause' (1996) 29 *Cornell International Law Journal* 161–89; Efraim Chalamish and Robert Howse, 'Conceptualizing Political Risk Insurance: Toward a Legal and Economic Analysis of the Multilateral Investment Guarantee Agency', in M. Audit and S. W. Schill (eds.), *Transnational Law of Public Contracts*, Droit administratif (Brussels: Bruylant, 2016), pp. 721–36.

[28] Ibrahim F. Shihata, *MIGA and Foreign Investment: Origins, Operations, Policies and Basic Documents of the Multilateral Investment Guarantee Agency* (Dordrecht: Nijhoff, 1988). Shihata wrote extensively on MIGA investment insurance. See also, Ibrahim F. Shihata, 'The Multilateral Investment Guarantee Agency' (1986) 20 *The International Lawyer* 485–97; Ibrahim F. I. Shihata, 'Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA' (1986) 1 *ICSID Review-Foreign Investment Law Journal* 1–25; Ibrahim F. I. Shihata, 'Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guarantee Scheme' (1987) 21 *The International Lawyer* 671–94.

[29] Pablo Zylberglait, 'OPIC's Investment Insurance: The Platypus of Governmental Programs and Its Jurisprudence' (1993) 25 *Law and Policy in International Business* 359–422; Vance R. Koven, 'Expropriation and the "Jurisprudence" of OPIC' (1981) 22 *Harvard International Law Journal* 269–327; Elizabeth A. Kessler, 'Political Risk Insurance and the Overseas Private Investment Corporation: What Happened to the Private Sector?' (1992) 13 *New York Law School Journal of International and Comparative Law* 203–27; James M. Zimmerman, 'The Overseas Private Investment Corporation and Worker Rights: The Loss of Role Models for

insurance practices. Also worth mentioning is "OPIC jurisprudence" compiled by Mark Kantor *et al*.[30] "OPIC jurisprudence" consists of claim determinations in which OPIC addresses the insurance claim filed by the insured investor and decides whether to pay out the investor. OPIC has settled approximately 300 insurance claims since 1971.[31] In 2011, these claim determinations were published in two volumes.

However, until recently neither MIGA's nor OPIC's investment insurance operations have been looked at from the perspective of the foundations of and the broader debates in international investment law. Most of the previous academic studies are descriptive and concerned with the establishment of national and international agencies, particularly OPIC and MIGA. The available literature hardly examines and/or discusses the position of foreign investment insurance in the larger international investment protection regime. They take for granted that investment insurance promotes foreign investment flows to developing countries by addressing the perceived political risks in these regions.

Recent studies, by contrast, situate foreign investment insurance in the broader field of international investment law and other subfields of international law such as international human rights law and international development law. This wider perspective allows scholars to locate the operation of foreign investment insurance in the contemporary disputes over the extent of investment protection and its implications on the broader society. Specifically, newer studies examine the role of foreign investment insurance in the settlement of investment disputes[32] and in the enforcement of property rights;[33] the scope of investment protection provided through foreign investment insurance;[34] political risk as a socio-cultural and legal concept;[35] and home state liability for human rights violations by their investors in the context of insured investments in host countries.[36] Likewise, this book investigates foreign investment insurance not as an isolated instance of risk management from the viewpoint of investors or as

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Employment Standards in the Foreign Workplace' (1990-1991) 14 *Hastings International and Comparative Law Review* 603–18.

[30] Kantor M. (ed.), *Reports of Overseas Private Investment Corporation Determinations* (Oxford: Oxford University Press, 2011).

[31] OPIC, *Insurance Claims Experience to Date: OPIC and its Predecessor Agency* (2015).

[32] Clint Peinhardt and Todd Allee, 'Political Risk Insurance as Dispute Resolution' (2016) 0 *Journal of International Dispute Settlement* 1–20.

[33] Marcus Chadwick, 'The Overseas Private Investment Corporation: Political Risk Insurance, Property Rights and State Sovereignty', Unpublished Thesis, University of Sydney (2006).

[34] Mark Kantor, 'Indirect Expropriation and Political Risk Insurance for Energy Projects' (2015) 8 *The Journal of World Energy Law & Business* 173–98.

[35] Celine Tan, 'Risky Business: Political Risk Insurance and the Law and Governance of Natural Resources' (2015) 11 *International Journal of Law in Context* 174–94.

[36] Markus Krajewski, 'Investment Guarantees and International Obligations to Reduce Poverty' (2012).

an instrument for the promotion of foreign investments from the viewpoint of MIGA/home states but as an embedded element of the international investment protection regime with a particular focus on the impact of investment insurance on international and domestic law-making and policy-making.

The main question this book attempts to answer is how foreign investment insurance works. I construe foreign investment insurance as a typical insurance product and focus on the operation of insurance arrangements from a legal perspective. Ideas about how insurance should be deployed in any given social, political or economic context are instrumental in the development of insurers, insurance products and insurance techniques.[37] The book examines investment insurers, the products they offer and their techniques to identify and deal with so-called political risks. Questions addressed in this thesis include: Who provides investment insurance and for what purpose? What other actors are involved in foreign investment insurance arrangements? How are insurance arrangements between these actors designed? Which law governs relationships between these actors? How are disputes between these actors resolved and how does resolution of disputes at different levels interact? I attempt to answer these questions against the background of conceptions of the benefits of investment insurance and the social, political and economic context.

Foreign investment insurance gives rise to a tripartite relationship between (1) a foreign investor and the host state where the foreign investment is set up; (2) the foreign investor and the investor's home state or an international insurance provider like MIGA; (3) the host state and the home state or an international insurance provider. Foreign investment insurance resembles a typical insurance arrangement in terms of its technical legal foundations. Insurance is provided by the insurer to the investor in exchange for premiums paid by investors. An insurer pays compensation when a covered risk event occurs and takes over the rights and claims of the investor up to the amount of compensation against the third party to whom the risk event is attributed, which is mostly the host state. As such, foreign investment insurance is situated at the intersection of domestic, international, public and private legal systems. For instance, the insurance contract between the investor and the insurance agency of the home country might constitute a private contract that is subject to domestic law while international law governs the interstate relationship between the home and the host state. It is essential to understand the

[37] Tan, 'Risky Business', 178; Baker T. and Simon J. (eds.), *Embracing Risk: The Changing Culture of Insurance and Responsibility* (Chicago: University of Chicago Press, 2002), pp. 8-9; Francois Ewald, 'Insurance and Risk', in M. Foucault and G. Burchell (eds.), *The Foucault Effect: Studies in Governmentality; with Two Lectures by and an Interview with Michel Foucault* (Chicago: Univ. of Chicago Press, 1991), pp. 198-9.

interconnection of these relationships and legal systems they are based on in order to understand how foreign investment insurance operates legally.

Another important question concerns the notion of political risk. What are considered political risks in the context of investment insurance and how are they conceptualized by investment insurance providers? Investment insurers have largely adopted a business-oriented political risk definition which denotes governmental intervention in foreign investment as political risk without regard to the objectives of government actions. Descriptive studies explain political risk by replicating investment insurers' categorization of basic coverages that include expropriation, currency inconvertibility and remittance transfer restrictions, political violence and breach of contract.[38] Yet recent studies have increasingly provided in-depth analyses on the notion of political risk as well as on the specific categories of political risk, particularly expropriation. The book draws on these studies to critically discuss the concept of political risk as it is used by investment insurance providers.

I focus on foreign investment insurance provided by OPIC and MIGA due to their mandate to promote economic development in the capital-importing countries and for their historical role as the major providers of investment insurance. The analyses provided in this book are based on the information made publicly available by the providers of investment insurers. OPIC and MIGA appear to be the most transparent insurers compared to other public providers of investment insurance. In addition to annual reports that most public investment insurers publish, OPIC and MIGA provide information on current and -in MIGA's case- previous projects that they have supported through investment insurance. OPIC makes virtually all of its claim determinations publicly available. These claim determinations are central to the analyses in this study. The arbitral decisions for the settlement of disputes between OPIC and investors are also publicly available, and one can find both MIGA's and OPIC's standard insurance policy online. Unfortunately, MIGA prefers to keep its claim determinations confidential due to the MIGA-host state dialogues included in the determinations.[39]

While focus is on MIGA and OPIC, the book offers a general account of the operation of foreign investment insurance by incorporating the available information on investment insurance industry and the international governance of investment insurance. The central issues explored in this book such as the principle of subrogation and the notion of political risk help

[38] See, for example, Noah Rubins and N. Stephan Kinsella, *International Investment, Political Risk and Dispute Resolution: A Practioner's Guide* (New York: Oceana, 2005).

[39] Based on an interview with a senior counsel from MIGA, publication of insurance determinations was discussed in-house in consultation with host states and decided not to be carried out.

me generalize the study as these issues are characterized similarly with respect to each and every public investment insurance provider.

The case studies and most examples in this book are based on expropriation risk insurance. The book looks mainly into the legal and socio-political interaction between the actors directly involved in the investment insurance arrangements; the insurer (and the home state), the investor and the host state. Unlike other typical coverages such as inconvertibility, remittance transfer restrictions or political violence, expropriation risk insurance epitomizes the interaction between these actors to the greatest extent since it is directly associated with the regulatory space in the host country. According to a survey conducted by the Economist Intelligence Unit on behalf of MIGA in July and August 2013 among 459 senior executives from multinational enterprises investing in developing countries, investors are mostly worried about "adverse regulatory changes" which might be interpreted to constitute "indirect expropriation" by insurance agencies.[40] Therefore, expropriation risk insurance might affect the ability of the host state to regulate foreign investments. Expropriation risk insurance also differs from other coverage types in a manner that it allows explanation of moral hazards associated with investment insurance. Investors are more likely to contribute in the occurrence of expropriation. Hence, focusing on expropriation cases allows me to explain the role of the investors within the tripartite relationship generated by investment insurance arrangements. Moreover, a total expropriation would terminate the investment project completely and have serious repercussions for the host state economy whereas other coverage types do not necessarily have the same effect.

Another important notion addressed in this thesis is that of "investment climate" because the notion of political risk is generally defined by insurers on the basis of "good investment climate expectations". In a good investment climate, governments are expected by investors and insurers to provide the economic and legal factors that help investors to maximize the returns on the investment throughout its lifetime. These expectations generally confine governments' regulatory power to protection of investors' private rights. Therefore, the deterrence effect of insurers on the host country governments can be better explained against the background of debates on the investment climate.

To conclude, the purpose of this thesis is to achieve two highly interconnected yet distinct tasks. On the one hand, the book explains how foreign investment insurance works by focusing

[40] See MIGA, *World Investment and Political Risk 2013* (Washington, D.C.: World Bank Group, 2014), p. 68.

on the law governing the relationships between involved actors. On the other hand, it provides a critique of the operation of foreign investment insurance as an investment protection instrument by mainly drawing on critical studies of the investment protection regime.

II. Outline of the Book

The book contains two parts and five chapters. *Part I* investigates the operation of foreign investment insurance arrangements. By investigating the emergence of public investment insurance schemes in their historical context, *Chapter 1* introduces the legal status and mandates of major insurers including not only OPIC and MIGA but also the insurers from the member countries of the Organization for Economic Cooperation and Development (OECD) in a comparative manner. The chapter argues that the legal status of national investment insurers has certain implications for the design and operation of investment insurance arrangements. Leading national investment insurers are categorized according to their legal status in order to connect the shaping of the investment insurance industry under liberal economic principles with the way investment insurance operates.

Chapter 2 focuses on the law that governs the operation of foreign investment insurance. It highlights the intersection between domestic law and international law that is created through insurance arrangements by disaggregating the tripartite relationship between actors involved in an insurance arrangement, i.e. home states (along with insurers), host states and investors, into bilateral legal relationships. A case study that centers on a project that was insured by OPIC clarifies the distinct yet integrated relationships between parties and sheds light on the operation of foreign investment insurance. The Dabhol Power Project case exemplifies the main components of foreign investment insurance from the provision of investment insurance to the payment of compensation and the recovery process. The case study on the Dabhol Power Project also helps to distinguish between law in action and law in the books since it clarifies the flexibility of the parties with respect to the operation of foreign investment insurance. The most relevant aspects to be examined are the role of each party, the principle of subrogation and recovery process and the law that governs these relationships. The relevant content of insurance contracts and interstate agreements are presented to this end.

Chapter 3 investigates MIGA investment promotion and protection by focusing on MIGA investment insurance and complementary instruments MIGA uses to promote and protect foreign direct investments. The emphasis in this chapter is not on the operation of investment insurance per se but on MIGA's mandate.

Part II focuses on the implications of foreign investment insurance arrangements for the broader society. *Chapter 4* offers an analysis of the notion of political risk and discusses how the dominant approach to the notion of political risk insurance is profoundly business-oriented. The chapter argues that the business-oriented political risk conception affects the operation of foreign investment insurance in a manner that leads to an expansionary protection of foreign investments, which is further discussed in Chapter 5.

Connected to the developmental mandates of public investment insurance providers, *Chapter 5* focuses on the moral hazards triggered by the foreign investment insurance arrangements. This chapter discusses how moral hazards culminate in a conflict between the developmental mandates of investment insurers and their function to protect investments. Moreover, the chapter expands on why providers of insurance need to address investors' demands and how this causes the expansionary protection of foreign investments. The causality is explained with reference to the operation of OPIC investment insurance. Corporate social responsibility is offered in this context as a risk mitigation tool to reduce the moral hazards in foreign investment insurance arrangements. Related to this, community safeguards are addressed in this chapter as an element of the developmental mandate of investment insurance providers. The internal community safeguards adopted by investment insurers, particularly OPIC and MIGA, are presented to this end.

Part I Operation of Foreign Investment Insurance

Chapter 1 Foreign Investment Insurance: An Overview

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Promotion of foreign investment flows to developing countries is the main reason and the overarching justification for the emergence of public investment insurance schemes. Putting aside the various public policies and objectives that may be formulated in various ways in the charters of public investment insurance providers, the underlying reason for the emergence of public investment insurance schemes is to facilitate foreign investment flows. Therefore, one should look into the history of foreign investment insurance against the background of this endeavor to promote foreign investment both at the domestic and international level. In the first section of this chapter, I describe the history of foreign investment insurance with reference to the endeavors to promote foreign investment for the economic development of host countries. It is not a query about whether or not public investment insurance schemes have been successful in the promotion of foreign investments to developing countries or whether foreign investment would have flown in equal measure to developing countries had it not been covered by insurance against so-called political risks. Instead, the query centers on the emergence of public investment insurance schemes, their expansion and evolution in general and their justification given that they operate on tax-money.

Against this background, the second and third sections of this chapter provide a review of the public providers of foreign investment insurance. The second section focuses on the governance and legal status of national investment insurance providers and explains the legal construction they operate on. The third section examines the emergence and current operation of multilateral and regional providers of foreign investment insurance. The last section addresses public and private investment insurance industry in a comparative manner.

I. Insurance for the Promotion of Foreign Direct Investment

Foreign direct investment (FDI) is generally defined as the tangible or intangible assets transferred from one country to another for the purpose of using them in the generation of wealth under the total or partial control of the owner of the assets.[1] International political economy of investment policy has been dominated by conflicting theories on the real benefits

[1] M. Sornarajah, *The International Law on Foreign Investment*, 3. ed. (Cambridge: Cambridge University Press, 2010), p. 8. For an early study distinguishing FDI from other forms of foreign investment, see Stephen H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment* (Cambridge: The MIT Press, 1976).

of foreign direct investment for the host country economy.[2] On the one hand, classical economic theory takes the view that foreign direct investment is wholly beneficial to the host state.[3] Contrary to this position, the dependency theory asserts that foreign direct investment will not lead to meaningful economic development.[4] These conflicting economic theories on foreign direct investment have had an impact on the articulation of competing legal principles.[5] This section lays out the economic theory on the benefits of foreign direct investment and the legal principles upon which foreign investment insurance as an international instrument for promotion of foreign direct investment has hitherto been based.

In the context of classical economic theory, foreign investment is a key element of economic development in both poor and rich countries. Beneficial aspects of foreign direct investment include transfer of technology that is not available in the host state; creation of employment; and qualification of the labor force through the acquisition of new skills associated with the technology transferred.[6] In case of building or upgrading infrastructure facilities, such as transport, health or education, foreign investment will be immediately beneficial to the host society as a whole.[7] Moreover, capital flows from another country ensure that the domestic capital available may be allocated to other uses for the public benefit.[8]

Especially in the 1990s, in the aftermath of the end of the Soviet Union, the classical economic theory on foreign investment gained ground.[9] At the same time, the international financial institutions endorsed the role of the private sector in the process of development and urged developing countries to adopt policies in the most liberal manner in order to promote industrialization through private enterprise.[10] While still today the developed countries are the major private capital owners, the share of developing countries either as recipient or source of

[2] The studies on the political economy of foreign direct investment generally focus on two distinct theories on the benefits of foreign direct investment; the classical theory and the dependency theory. See, Theodore H. Moran (ed.), *Multinational Corporations: The Political Economy of Foreign Direct Investment* (Lexington, Mass.: Heath, 1985).

[3] Sornarajah, *The International Law on Foreign Investment*, p. 48.

[4] *Ibid.*, p. 53; Sornarajah observes also a "middle path" that points to the benefits of foreign direct investment while identifying potential harmful effects for the host country economy, see p. 55.

[5] *Ibid.*, 47.

[6] *Ibid.*, 48.

[7] *Ibid.*

[8] *Ibid.*

[9] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford: Oxford University Press, 2008), p. 5.

[10] *Ibid.*, 5; Sornarajah, *The International Law on Foreign Investment*, 48. See for instance, World Bank, *The Economic Development of Nigeria* (Baltimore: The Johns Hopkins Press, 1955), chapter 13; World Bank, *The Economic Development of Tanganyika* (Washington, DC: World Bank, 1961); Davis H. D. (ed.), *The Economic Development of Uganda* (Baltimore: The Johns Hopkins Press, 1962); World Bank, *The Economic Development of Kenya* (Baltimore: The Johns Hopkins Press, 1963), chapter 3.

foreign direct investment has been growing ever since the 1980s.[11] The expansion of foreign direct investment throughout the developing countries is mainly associated with the potential benefits of FDI inflows.[12]

The notion of "investment climate" is generally used in the context of development orthodoxy to describe the level of attractiveness of developing countries to multinational firms. A good investment climate for multinational firms embodies factors such as low cost of producing and distributing products, i.e. low labor cost, low tax rates and absence of local content requirements, and the provision of other types of economic incentives.[13] These factors affect investment decisions. A distinctive feature of foreign direct investment is that it generally generates returns long after the investors commit assets to the host country. Since it involves the investors' lasting interest in transnational operations, foreign direct investment is particularly exposed to political changes that affect the operating conditions, thereby forcing foreign enterprises to take risk management measures. Policy advice on how to achieve a better investment climate generally stresses the forward-looking nature of the investment activity.[14] Predictability and stability of investment conditions are deemed central to a good investment climate. In fact, it is argued that stability of conditions may be more important than the conditions themselves.[15] The underlying suggestion is that government intervention endangers the stability of the investment climate, renders it less predictable and therefore needs to be restrained.[16] In this context, governments are encouraged to focus on 'delivering the basics', such as security of property rights, contract enforcement, better infrastructure and a skilled workforce.[17]

The importance of a favorable investment climate that fosters "stability" for investment decisions is especially emphasized in times of low capital flows to less developed countries; because stability, according to prevailing paradigms, is a prerequisite for the much needed foreign capital. It is argued that the uncertainty as opposed to stability with respect to investment

[11] UNCTAD, *World Investment Report 2014: Investing in the SDGs: An action plan* (New York: United Nations, 2014), p. xiii.
[12] Nathan M. Jensen, Glen Biglaiser, Quan Li, Edmund Malesky, Pablo Pinto, Santiago Pinto and Joseph L. Staats, *Politics and Foreign Direct Investment* (Ann Arbor: University of Michigan Press, 2012), pp. 3-4.
[13] World Bank, *World Development Report 2005: A Better Investment Climate for Everyone* (New York: World Bank and Oxford University Press, 2004).
[14] *Ibid.*, 2.
[15] Pablo T. Spiller, Ernesto Stein and Mariano Tommasi, 'Political Institutions, Policymaking, and Policy: An Introduction', in E. Stein, M. Tommasi and P. T. Spiller (eds.), *Policymaking in Latin America: How Politics Shapes Policies* (Washington, DC: IDB, 2008).
[16] Mick Moore and Hubert Schmitz, *Idealism, Realism and the Investment Climate in Developing Countries*, Working Paper 307 (2008).
[17] World Bank, *World Development Report 2005*, p. 77.

climate in the less developed countries is the main reason for the lack of adequate capital flows to these countries. Uncertainty is the high probability of occurrence of events that drastically change the investment climate. Increase in taxes, increase in minimum wage, government policy changes in particular sectors, imposition of performance requirements may be such events of uncertainty. Such changes in the investment climate as well as the lack of a settled legal system that protects property rights may discourage investors to invest in particular countries.

The narratives on investment climate postulate that private firms are central to economic development. Private firms are seen as "*the engine for growth and poverty reduction*" as they create opportunities and jobs for people; produce goods and provide services at reduced costs to the benefit of consumers; and constitute a sustainable source of tax revenues to be used for other important social goals.[18] It is also argued that a good investment climate will not only serve to "attract" investors but also provide for direct benefits to people by virtue of many essential features necessary to improve living standards, such as efficient infrastructure, courts and financial markets.[19] The World Bank has served as one of the central hubs for the development of ideas, institutions and procedures to facilitate the flow of private investment capital to developing countries through improving the investment climate in these countries.[20] This role was apparent in the establishment of MIGA in 1988.[21]

Such neoliberal views have been also espoused by other international economic institutions like the International Monetary Fund (IMF) and the OECD.[22] It is often argued that poor investment conditions are the primary reason for the relatively lower rate of capital flows to developing countries.[23] Political risk insurance is offered, in this context, as a means of investment promotion for economic development.

From the perspective of investors, foreign investments are exposed to special problems inherent in developing countries.[24] Principally, the risk of expropriation, remittance transfer

[18] *Ibid.*, 19.
[19] *Ibid.*
[20] Theodor Meron, 'The World Bank and Insurance' (1975) 47 *British Yearbook of International Law* at 301.
[21] For the further risk-sharing activities of the World Bank with the U.S. private funds, see Marina von Neumann Whitman, *Government Risk-Sharing in Foreign Investment* (Princeton: Princeton University Press, 1965).
[22] Sornarajah, *The International Law on Foreign Investment*, p. 50.
[23] Shihata, 'Factors Influencing the Flow of Foreign Investment', 677.
[24] Jürgen Voss, 'The Protection and Promotion of Foreign Direct Investment in Developing Countries: Interests, Interdependencies, Intricacies' (1982) 31 *International and Comparative Law Quarterly* 686–708 at 688. "*An active investment protection and promotion policy exists only in relations with Third World countries. In all the industrial countries there is a comparable and sufficiently stable protection framework so that investments flow freely to their optimal economic use.*"

restrictions or inconvertibility[25], political violence and breach of investment contracts by the host state have been categorized as political risks against which investors in developing countries should be granted financial protection. Providing financial protection against such specific problems would lead investors to make investment decisions exclusively on the basis of economic considerations, such as the availability of raw materials, production cost structure, proximity to sales markets, and other economic cost-return analysis.[26] Foreign investment insurance has been offered as a panacea to this specific problem. It is an instrument that foreign investors employ for risk management. In addition, it has been argued that investors choose safer countries to invest in and some insurers also emphasize their role to improve the "investment climate" in developing countries where investors' perception of political risks are high.[27]

Compared to other risk management methods, investment insurance is relatively expensive. However, it has been increasingly offered by government agencies from both developed and now developing countries since the end of the Second World War. The creation of MIGA as well as other international investment insurance agencies was also based on the assumption that such agencies would complement the national providers of investment insurance in the promotion of investment flows to developing countries.[28]

The contemporary public investment insurance emerged first in the United States in 1948 as part of the Economic Cooperation Act through which the United States emphasized the role of private enterprise in the reconstruction of the war-torn European countries.[29] The focus of the Economic Cooperation Act was on the facilitation of the use of private channels in a number of ways, including investment insurance: "…*guaranties to any person of investments in connection with projects approved by the Administrator and the participating country concerned as furthering the purposes of this title*…".[30] Until the geographical limitation ended in January 1, 1960, the countries eligible for investment insurance included Western European countries and Japan.[31] One convertibility insurance was granted by the end of 1948 for an

[25] Wu asks crucial questions about the role of practice of transfer and convertibility risk coverage already in his study dated 1950 when the political risk insurance as government guarantees started recently to be provided. These questions have become answerable after six decades through the examination of this insurance type. See Yuan-Li Wu, 'Government Guarantees and Private Foreign Investment' (1950) 40 *The American Economic Review* 61–73 at 63-7.
[26] Voss, 'The Protection and Promotion of Foreign Direct Investment', 687-8.
[27] Shihata, 'Factors Influencing the Flow of Foreign Investment', 678.
[28] *Ibid.*, 690; Rowat, 'Multilateral Approaches'; Berger, 'The New Multilateral Investment Guarantee Agency' .
[29] Whitman, *Government Risk-Sharing in Foreign Investment*, p. 69.
[30] *Economic Cooperation Act of 1948, Pub. L. 472 (enacted 3 April 1948).*
[31] Whitman, *Government Risk-Sharing in Foreign Investment*, pp. 83-4.

US$850,000 investment in a carbon-black plant in Great Britain and there were 12 other applications totaling over US$5 million were pending.[32] By the end of the following year the Program included 26 contracts with a combined value of US$24.9 million, of which more than half was accounted for by the US$14.5 million guarantee issued to Standard Oil for investment in an Italian subsidiary.[33] The Federal Republic of Germany joined the list of participating countries in 1950 and the first expropriation guaranties were issued in 1951 for two investments in Germany.[34]

Similar investment insurance schemes were enacted mainly by other capital-exporting developed countries in the 1950s.[35] Today, emerging economies like China, Russia and India provide public investment insurance as well. However, foreign investment insurance is relatively less popular among investors from developing countries.[36] According to a 2008 study, it was estimated that less than 5 per cent of global foreign investment is insured whereas around 30 per cent of foreign investment to the developing countries was insured.[37]

The role of foreign investment insurance in the promotion of foreign investment into "risky" regions of the world is not only about addressing the risk perception of investors but also about facilitating funding. When a project is covered against political risks, it becomes likelier to be funded by banks. Also, banks and other international lenders take up insurance to cover their investments in project finance. For OPIC, the definition of investment is so wide that it includes not only purchase of a share of ownership in a project but also loans by financial institutions. MIGA's investment definition is also very wide and includes loans.

Financiers utilize foreign investment insurance directly or indirectly for a number of reasons. Firstly, commercial bank investors, which are required by the regulatory bodies to provide against their cross-border exposure in project finance, utilize foreign investment insurance to transfer the risk to the insurer.[38] This is particularly applicable to most European

[32] *Ibid.*, 91.
[33] *Ibid.*
[34] *Ibid.*
[35] Congressional Research Service-Foreign Affairs Division, *OPIC-Type Programs in Germany, France, Japan, Sweden, and the United Kingdom in The Overseas Private Investment Corporation: A Critical Analysis* (1973). The study is reproduced in Meron, *Investment Insurance in International Law*.
[36] David Collins, *An Introduction to International Investment Law* (New York, NY: Cambridge University Press, 2017), p. 315.
[37] *Ibid.*, 316.
[38] Robert H. Malleck, 'Political Risk Insurance, International Banks, and Other International Lenders', in T. H. Moran (ed.), *Managing International Political Risk* (Malden, Mass.: Blackwell Publishers, 1998), pp. 173–8, p. 173.

banks that are subject to strict regulation regarding their cross-border exposure.[39] As for the US banks, investment insurance helps to leverage scarce risk capital, as the demand for risk capital to be invested in emerging markets is high compared to supply.[40] In the same vein, investment insurance also supports large fund-raising exercises among international lenders.[41] A multi-billion project is unlikely to be funded by one single lender, however, investment insurance helps lenders to come up with a financial plan that optimizes the sources while minimizing the weighted average cost of debt.[42] Also, investment insurance allows international lenders to extend credit to bond investors or traditional commercial bank lenders at tenors that is generally off-market.[43]

OPIC and MIGA do not necessarily prioritize projects that directly contribute to the social development of the host country, such as projects in education, health services, housing or agribusiness.[44] Their aim is to promote investments in any form to create economic activity, to help construction of necessary infrastructure that may lead further industrial enterprises. Moreover, while OPIC and MIGA assert that they aim to prioritize promoting foreign investment flows into the least developed countries, research shows that their activities are not focused on such regions.[45] Their role is less like a participant in large scale development efforts but more like an insurer that provides insurance for private investors seeking to operate projects in developing countries.[46]

II. National Investment Insurance Schemes: Governance and Legal Status of Public Investment Insurers

While public investment insurance has been supported by the neoliberal rhetoric about the promotion of foreign direct investment for economic development, it also contradicts the tenets of neoliberal philosophy. Public investment insurance schemes are government programs that are backed by state treasury for the benefit of a selected group in society. Moreover, their existence is likely to obstruct the private sector that provides the same type of services or products. These concerns have affected the design of public investment insurance schemes and the way they operate.

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[39] *Ibid.*, 173. Malleck states that the overwhelming majority of the commercial bank investors are European.
[40] *Ibid.*
[41] *Ibid.*
[42] *Ibid.*
[43] *Ibid.*, 175.
[44] Adam L. Masser, 'The Nexus of Public and Private in Foreign Direct Investment: An Analysis of IFC, MIGA, and OPIC' (2008) 32 *Fordham International Law Journal* 1698–743.
[45] *Ibid.*, 1715.
[46] Meron, *Investment Insurance in International Law*.

2.1. Tripartite Relationship

Foreign investment insurance gives rise to a tripartite relationship between a foreign investor and the host state where the foreign investment is set up; the foreign investor and the investor's home state; the home state and the host state.[47]

From the perspective of investors, foreign investment insurance is a risk management tool that they can take up to shift the perceived "political" risks to the insurer.[48] In terms of the relationship between the investor and the investor's home state, the home state -through its agency- acts as an insurer and the investor as an insurance holder. The home state provides coverage for the investment against so-called "political risks", such as expropriation, currency inconvertibility, remittance transfer restrictions and political violence, while the investor pays risk premiums to its home state in return for coverage. The insurance contract between the investor and the home state is governed by the municipal law of the home state. The basic premises of insurance law apply to this insurance contract. When the investor is exposed to loss or damage that is covered by the insurance provided by the home state, the latter pays due compensation to the investor.

In the terminology of insurance law, the host state is the third party liable for the damage or loss, the "wrongdoer" or "tortfeasor".[49] When the insurer pays compensation to the investor, it subrogates the rights and claims of the investor and seeks to recover its losses, i.e. the compensation it paid to the investor, from the host state. As to the relationship between the home state and the host state, foreign investment insurance operates principally on the basis of interstate agreements that regulate certain issues, such as scope of investment protection, the recognition of the home state's subrogation right and the settlement of interstate disputes.[50]

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[47] "Tripartite" is also the portrayal Mann used to describe the relationships constituted through government guarantees in the context of international government lending between two states as debtor and guarantor separately and a bondholder from the guarantor state. See F. A. Mann, 'The Law Governing State Contracts' (1944) 21 *The British Year Book of International Law* 11–33 at 32.

[48] Franklin Root was among the first scholars to describe transfer of risks to others through insurance as a response of foreign investors to political risks. See Franklin R. Root, 'U. S. Business Abroad and Political Risks' (1968) 10 *The International Executive*. The relationship between foreign investors and host states has been a subject of an extensive literature. See Jean Boddewyn, 'Early US Business-School Literature (1960-1975) on International Business-Government Relations: Its Twenty-First-Century Relevance', in R. Grosse (ed.), *International Business and Government Relations in the 21st Century* (Cambridge: Cambridge University Press, 2005), pp. 25–47.

[49] This does not apply to the political violence risk unless the violent event that resulted in the loss or damage can be attributed to the host country government.

[50] T. M. Ocran, 'International Investment Guarantee Agreements and Related Administrative Schemes' (1988) 10 *University of Pennsylvania Journal of International Business Law* 341–70 at 346. See also *Convention Establishing the Multilateral Investment Guarantee Agency* (adopted 1985, entered into force 1988), art 18 and art 57.

As for the law that governs the tripartite relationships, it is important to note that foreign investment insurance is located at the intersection of international and national legal systems. Public international law governs the interstate relationship while the relationships between investors and host and home states are mainly governed by national law.

Figure 1 illustrates the tripartite relationship and basic roles of actors involved in foreign investment insurance. The figure also highlights the prominent issues investment insurance gives rise to among the parties, including risk management by foreign investors through insurance, the insurance contract with the home state, and the claims between the home state and the host state for recovery and settlement of interstate disputes that arise from investment insurance. The insurance agency is separated from the home state in order to emphasize, throughout this thesis, its particular duties and competences.[51]

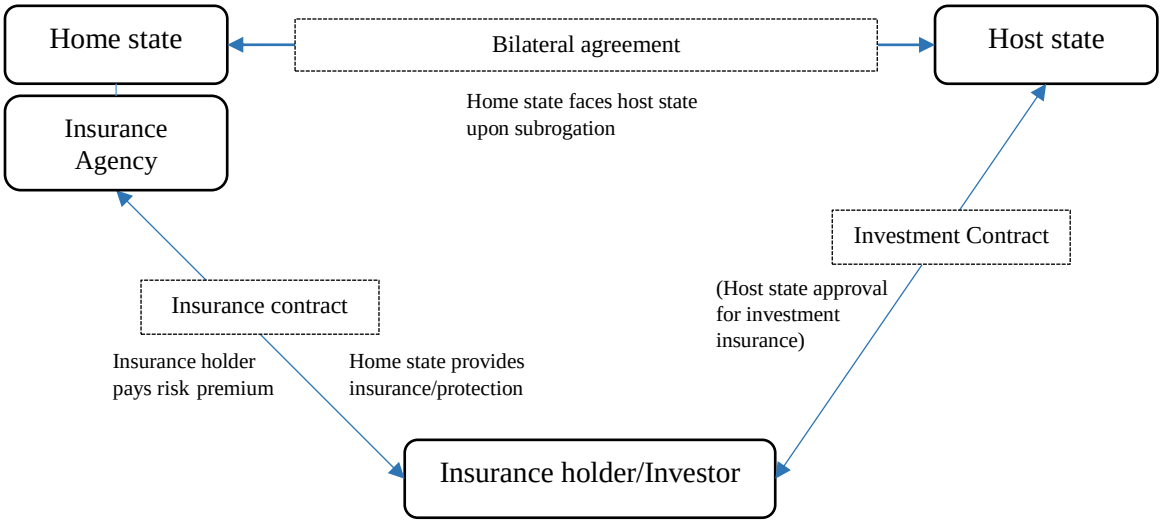

Figure 1: The tripartite relationship between the investor, investor's home state and the host state with respect to foreign investment insurance

2.2. Investment Insurance in Bilateral Agreements

The principle of subrogation is central for public investment insurance schemes to operate on a self-sustaining basis. The principle of subrogation serves to transfer existing rights and/or claims from an investor to the insurer in case the insurer pays out the investor, thereby enabling the insurer to claim recovery from the host state.[52] The public provision of investment insurance

[51] A separate analysis of the relationship between the home state, particularly home government and the public insurance agency goes beyond the purposes of this chapter. For a comprehensive analysis that centers on the public investment insurance providers, see Tugba Karagöz, 'The Influence of Investor-Centered Values in the Operation of Political Risk Insurance' (2018) 19 *The Journal of World Investment and Trade* 118–53.

[52] The implementation of the principle of subrogation is examined comprehensively in Chapter 2 and Chapter 5 explores its implications for the investment insurance arrangements.

would amount to a subsidy of private foreign investment, if the home state used investment insurance to induce private enterprises to invest abroad without any serious intention to invoke the principle of subrogation to call the host state to account when the host state actions or omissions constitute risk events covered by the insurance policy.[53]

The subrogation clause is a common provision in bilateral investment treaties.[54] The first bilateral investment treaty, which was signed between Germany and Pakistan in 1959, was concluded *inter alia* to serve the operation of the German investment insurance scheme. Adequate investment protection in the host country is a condition for the operation of the German scheme.[55] The BIT between Germany and Pakistan satisfied this condition while also including the principle of subrogation.

However, it is useful to state at the outset that the principle of subrogation is an instance of diplomatic protection. Pursuant to Article 1 of the ILC's Draft Articles on Diplomatic Protection:

"*[D]iplomatic protection consists of the invocation by a State, through diplomatic action or other means of peaceful settlement, of the responsibility of another State for an injury caused by an internationally wrongful act of that State to a natural or legal person that is a national of the former State with a view to the implementation of such responsibility.*"[56]

The principle of subrogation that is applicable in foreign investment insurance arrangements does not restrict the home state's rights to assert a claim with respect to its national under international law. In the absence of subrogation clauses, the home state would be able to claim compensation from the host state for the alleged damage or loss endured by its national(s). In that sense, subrogation is a universal principle that stands even in the absence of bilateral agreements that contain a subrogation clause.

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[53] Wu, 'Government Guarantees and Private Foreign Investment' at 70.

[54] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (New York and Geneva, 2007), p. 114.

[55] Adequate investment protection has to be provided by the legal order of the host state or by other means such as bilateral agreements (See General conditions for investment guarantees of the FRG-programme, para. 2 subpara. A. See, Gerhard Loibl, 'Foreign Investment Insurance Systems', in D. C. Dicke (ed.), *Foreign Investment in the Present and a New International Economic Order: [Symposium on April 13. and 14. 1987 in Vienna]*, Progress and undercurrents in public international law (Fribourg: Univ. Pr. Fribourg Switzerland, 1987), p. 107. Such an agreement could either be a bilateral investment treaty or bilateral investment insurance agreement like the agreements between Germany and Saudi Arabia. See, Jochen Salow, *Bundesgarantien für Kapitalanlagen im Ausland und internationaler Investitionsschutz* (München: Florentz, 1984), p. 62.

[56] International law Commission, Draft Articles on Diplomatic Protection with Commentaries 24 (2006).

The principle of subrogation is an instance of diplomatic protection not only because of the deployment of diplomatic instruments and mechanisms but also because the home state relies on the dependence of investment protection scope on its political or economic leverage over the host state.[57] Even though the scope of investment protection is pre-determined in a BIT, most investment protection clauses are vaguely written and open to relatively narrower or wider interpretation. However, this sort of diplomatic protection is not a complete expression of diplomatic protection under customary international law. Most importantly, in practice, investors are not necessarily required to exhaust local remedies to file an insurance claim with the public insurer whereas the customary diplomatic protection is provided only after the exhaustion of local remedies. The lack of this conditionality in the settlement of subrogated claims represents an evolution of customary international law under the influence of BITs as BITs do not require an investor to exhaust local remedies before the investor invokes investor-state dispute settlement clauses. In the *Case Concerning Ahmadou Sadio Diallo*, the International Court of Justice stated that:

"*in contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments, such as treaties for the promotion and protection of foreign investments […] and also by contracts between States and foreign investors. In that context, the role of diplomatic protection has somewhat faded, as in practice recourse is only made to it in rare cases where treaty regimes do not exist or have proved inoperative.*"

What is the function of subrogation clause, if it is already enshrined in international law?[58] Above all, the principle of subrogation creates an illusion of depoliticization of the diplomatic protection exercised with respect to insured investors by making it appear as a bilateral agreement between the states. As Professor Crawford noted "*one might argue that bilateral investment treaties in some sense institutionalize and reinforce (rather than replace) the system of diplomatic protection […]*"[59] Related to the depoliticization function, as a universally

[57] The alleged vagueness of investment protection standards in customary international law

[58] In response to B. Juratowitch, 'The Relationship between Diplomatic Protection and Investment Treaties' (2008) 23 *ICSID Review* 10–35, p. 26, "*If States agree that they may be subrogated to the rights that one of their nationals holds against the other contracting State, then that right cannot be one primarily held by the State. If it were, a State would allow an individual to be subrogated to the State's right and the State would then, in circumstances of political risk insurance, be subrogated into a right of which it was already the primary right-holder. That makes no sense*."

[59] James Crawford, 'The ILC's Articles on Responsibility of States for Internationally Wrongful Acts: A Retrospect' (2002) 96 *American Journal of International Law* 874, pp. 887-8.

accepted principle of insurance law, subrogation makes foreign investment insurance appear as a typical insurance product that works on the basis of risk management principles instead of political and economic power relations between two states. Also, foreign investment insurance is provided by non-state actors such as regional and multilateral public insurers, and private insurance companies. The principle of subrogation enables non-state public providers to recover from the host states. In the absence of the principle of subrogation, regional and multilateral insurance providers would not be able to assert a claim towards the host state with respect to recovery. Finally, the principle of subrogation also facilitates reinsurance and coinsurance arrangements between different public and private investment insurance providers.

The US investment insurance program is required by law to operate under bilateral investment insurance agreements. These agreements provide not only for the principle of subrogation but also other rules and principles that govern the relationship between the USA as the home state and the respective host state concerning the investment insurance, such as rules regarding the settlement of disputes and host state approval for investment insurance. Similarly, French, Swedish and Canadian programs were also required to operate under such agreements. While the requirement for a bilateral investment insurance agreement is still in effect for the operation of the US program, other national programs no longer require the conclusion of such agreements any longer. The bilateral investment insurance agreements concluded by Canada and France are superseded by bilateral investment treaties.

As for the clauses in the bilateral investment insurance agreements, there is a dual process involved in the principle of subrogation.[60] Firstly, when the insured investor is indemnified, the host state shall recognize the transfer by the investor to the insurer (and the home state) of any currency, credits, assets or investment for which payment was made under the insurance contract, such as dividends, compensation in local currency, physical assets, and so on.[61] Secondly, the host state shall recognize the succession of the insurer (and the home state) to any related right, title, claim, privilege, or cause of action that the investor may have against the host state.[62] For instance, Art. 2(c) of the US-Egypt investment insurance agreement lays down that:

"*If the Issuer makes a payment to any person or entity, or exercises its rights as a creditor or subrogee, in connection with any Investment Support, the Government of the Arap Republic*

[60] Ocran, 'International Investment Guarantee Agreements' at 355.
[61] *Ibid.*
[62] *Ibid.*

of Egypt shall recognize the transfer to, or acquisition by, the Issuer of any cash, accounts, credits, instruments, or other assets in connection with such payment or the exercise of such rights, as well as the succession of the Issuer to any right, title, claim, privilege or cause of action existing, or which may arise, in connection therewith."[63]

However, bilateral investment insurance agreements do not specify the rights and claims of the investor to be assigned to the insurers.[64] These rights are rather the subject of "*bilateral investment treaties, multilateral conventions, general principles of international law, the national investment codes, investment-related legislation, and constitution of the host states*".[65]

Some bilateral investment insurance agreements contain certain conditions concerning the exercise of subrogation clauses.[66] For example, the investment insurance agreement between the USA and China makes the insurer's subrogation right explicitly subject to the deduction of the investor's debts to the host state:

"*If the Issuer makes payment to any investor under Coverage, the Government of the People's Republic of China shall, subject to the provisions of article 4 hereof, recognize the transfer to the Issuer of any currency, credits, assets, or investment on account of which payment under such Coverage is made, as well as the succession of the Issuer to any right, title, claim, or cause of action existing, or which may arise, in connection therewith, subject to existing legal obligations*."[67]

The US-Romania investment insurance agreement is even more express in this respect.[68] It requires the home state to make payments of legal taxes and fulfill all other contractual obligations of the investor as it takes over investor's rights and claims:

"*If the Issuing Government makes payment to any investor under coverage issued pursuant to this Agreement, the Host Government shall recognize the transfer to the Issuing Government of the rights and obligations of the covered investor, with respect to the claim for which payment is made, derived from the contract of association, the statutes of the joint venture or any applicable laws of the Host Government. The Issuing Government shall with respect to any*

[63] Investment Incentive Agreement between the Government of the United States of America and the Government of the Arab Republic of Egypt (1 July 1999).
[64] *Ibid.*, 354.
[65] *Ibid.*
[66] *Ibid.*, 356.
[67] Exchange of Notes Constituting an Agreement between the United States of America and China Relating to Investment Guarantees, (3 October 1980) in UNTS, art. 3 (a).
[68] United States of America and Romania, Exchange of Notes Constituting an Agreement Relating to Investment Guaranties (28 April 1973) in UNTS.

rights transferred or succeeded to under this paragraph assert no greater rights than those of the covered investor derived from the approved investment and shall acquire such rights subject to the payment of legal taxes and the fulfillment of other obligations ensuing from the contract of association. The Issuing Government does, however, reserve its rights to assert a claim in its sovereign capacity under international law."[69]

Even though the subrogated claim arises out of state obligation to protect the insured investment, interstate dispute settlement allows host state counterclaims. Hence, subrogation should be subject to such deduction even without express clauses to this effect in the bilateral investment insurance agreements or BITs.

The relationship between foreign investment insurance and bilateral investment treaties is largely under-researched[70] and that leads to suggestions for the replacement of BITs by foreign investment insurance. In 2007, Joseph Stiglitz suggested the creation of investment insurance funds by countries that negotiate BITs.[71] Arguing that BITs lead to unbalanced investment protection vis-à-vis public interests in the host country, Stiglitz asserted that an insurance market could increase economic efficiency by transferring risks from the public to an insurance fund to which investors contribute with insurance premiums. Recently, Chalamish and Howse wrote that MIGA is equivalent of such a fund.[72] Similarly, scholars including Poulsen and Yackee suggest that investment insurance may substitute BITs that allegedly have potential costs and regulatory chilling effect on host states while they have no proven effect on the promotion of FDIs.[73]

Even though the US scheme operates on the basis of bilateral investment insurance agreements, BITs constitute the basis of investment protection regime with respect to operation of foreign investment insurance, principally because they document how host states have

[69] United States of America and Romania, Exchange of Notes Constituting an Agreement Relating to Investment Guaranties (28 April 1973) in UNTS, para. 3.
[70] See generally, Robert Ginsburg, 'Political Risk Insurance and Bilateral Investment Treaties: Making the Connection' (2013) 14 *Journal of World Investment & Trade* 943–77; Pieter Bekker and Akiko Ogawa, 'The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the "BIT Bang"' (2013) 28 *ICSID Review* 314–50.
[71] Joseph E. Stiglitz, 'Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights with Responsibilities' (2007) 23 *American University International Law Review* 451–558.
[72] Chalamish and Howse, *Conceptualizing Political Risk Insurance*.
[73] Lauge N. Skovgaard Poulsen, 'The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence', in K. P. Sauvant (ed.), *Yearbook on International Investment Law and Policy 2009/2010* (New York: Oxford University Press, 2010), pp. 539–74; Jason Webb Yackee, 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' (2010) *Virginia Journal of International Law* 397–442.

pledged to treat foreign investments. While the scope of coverage is principally determined between an insurer and an insured in an insurance contract, the outer limit of scope of coverage, i.e. investment protection, is framed in a BIT between a home and a host state. A subrogation clause in a bilateral investment treaty can apply only if the insured investment is within the scope of the investment definition in the same treaty, regardless of its eligibility under the home state investment insurance scheme.[74]

A conflict may arise if the criteria for eligible investments under national investment insurance schemes on the one hand and bilateral investment treaties on the other differ to some extent. Generally, eligibility is wider under the national investment insurance schemes and this might culminate in the inapplicability of the subrogation clause in the related investment treaty to some projects covered by insurance.[75] Similarly, a subrogation clause is inapplicable, if the BIT does not include a clause on the individual political risk covered by the insurance contract. In fact, whereas most BITs include expropriation clauses, only a limited number of BITs extend protection for inconvertibility and transfer restrictions.[76] In other words, only if the host state is found in breach of the investment protection standards in the BIT, would it be requested to reimburse the home state.[77] However, if the insurer has received host state approval for greater protection than the applicable BIT, then the insurance contract between the insurer and the insured would be also arguably applicable.

As stated above, one of the functions of subrogation clause in the BITs is to depoliticize settlement of subrogated claims (in the absence of a subrogation clause in bilateral agreements, subrogation can still occur pursuant the insurance contract between an insurer and an insured). This is not to say that political and legal struggle about the scope of insurance coverage is undesirable. In contrast, a diplomatic protection and follow-up political struggles would lead to a more democratic determination of investment protection standards by making this

[74] Loibl, *Foreign Investment Insurance Systems*.
[75] *Ibid.*, p. 106.
[76] Expropriation and inconvertibility/transfer restriction are typical political risks covered by investment insurers. Whereas most BITs include expropriation clauses, only a limited number of BITs extend protection for inconvertibility and transfer restrictions. On a different note, foreign investment insurance does not substitute BITs due to the differences in scope between these two instruments. BITs extend protection also for discrimination and breach of fair and equitable treatment. For an extensive comparison see, Mark Kantor, 'Comparing Political Risk Insurance and Investment Treaty Arbitration', in D. Wallace, B. Ṣabāḥī, N. J. Birch, I. A. Laird and J. Rivas (eds.), *A Revolution in the International Rule of Law: Essays in Honor of Don Wallace, Jr* (New York: Juris, 2014), pp. 455–74.
[77] Ginsburg, 'Political Risk Insurance and Bilateral Investment Treaties'.

determination subject to public scrutiny. Currently, investment insurance lacks transparency and it is not well-known even by scholars in the field of international investment law.

A BIT may be also relevant to the operation of foreign investment insurance in practice. The extent of insurance coverage against the political risks is directly determined in the insurance contracts between insurers and insured investors. However, the clauses that frame the individual political risk coverages in an insurance contract do not stand alone. Perhaps the other clauses that assign obligations and duties on the insured party are equally important to determine whether the investor merits compensation. Additionally, insurance contracts generally contain exclusions and exceptions which may be used as defense by investment insurers (i.e. which may limit the coverage). Insurers may request insured investor to exhaust the available remedies including international arbitration mechanisms and practically limit the insurance coverage to the non-payment of arbitral awards.[78]

2.3. Legal Status

In order to ensure compatibility with the liberal philosophy, the major investment insurance schemes have been designed for atypical government interventions.[79] Gordon's survey has demonstrated four different types of legal status among OECD-based and other major national investment insurers.[80] Except for the Turkish investment insurance scheme, each of these variations in the design and functioning of public investment insurance schemes represent an attempt to address concerns about state intervention in its classical meaning. Turkey's investment insurance scheme which is administered by a government department that is funded as part of the annual budget process, constitutes a rare case.[81]

2.3.1. Self-Financing Government Agencies

The principal feature of the schemes in the first group is that while they rely on the national budget most of the schemes are managed on a self-sustaining or profit-oriented basis. Being operative on a self-sustaining basis means that these agencies do not depend on public spending unless they exhaust their own financial resources. In other terms, these agencies do not expend tax money but generate income to finance themselves. However, if they fail to pay out an

[78] Dabhol power project provides for such a case. See, Chapter 2.
[79] For the case of US investment insurance scheme see, Jonathan G. S. Koppell, *The Politics of Quasi-Government: Hybrid Organizations and the Control of Public Policy*, Theories of institutional design (Cambridge: Cambridge University Press, 2003), p. 3.
[80] Kathryn Gordon, 'Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development', in *OECD Investment Policy Perspectives 2008* (Washington, Palo Alto: OECD Publishing, 2009), p. 97.
[81] *Ibid.*

investor due to scarce financial resources of their own, the investor is paid out directly by the state. Countries including Australia, Belgium, Japan, Korea, the United Kingdom and the United States require their public investment insurers to finance themselves on the basis of risk management principles.[82]

The main characteristic of self-financing government agencies is their hybridity, they are generally regarded as quasi-governmental agencies.[83] On the one hand, self-financing government agencies are mandated to pursue public interests and the insurance coverage provided by them is backed by the state. On the other hand, they are required to operate upon the risk management principles that are typical for firms in the private sector.[84] OPIC exemplifies this type of schemes.

The USA

The US investment insurance scheme was created as part of the Foreign Assistance Act of 1948 that aimed "*to promote world peace and the general welfare, national interest, and foreign policy of the United States through economic, financial, and other measures necessary to the maintenance of conditions abroad in which free institutions may survive*".[85] The Economic Cooperation Administration was authorized to insure US investments in eligible countries in Europe against the risk of currency inconvertibility.[86]

The investment insurance program, while modest in scope at its inception, was expanded in small increments over the next few years through the inclusion of new political risk types and new investment types to be covered and the extension of the program's geographic reach.[87] In the mid-1950s, the program started to gain broader corporate support mirrored in the increase of sales of insurance policies.[88] Following the nationalization of the Suez Canal by Egypt in 1956 and the socialist revolution in Cuba in the late 1950s, demand for insurance increased

[82] *Ibid.*; see also Michael W. Gordon, 'The Overseas Private Investment Corporation: Risk Management Principles' (1973-1974) 48 *Tul. L. Rev.* 480–523.
[83] Koppell, *The Politics of Quasi-Government*; Zylberglait, 'OPIC's Investment Insurance'.
[84] Gordon, 'The Overseas Private Investment Corporation: Risk Management Principles'.
[85] *Economic Cooperation Act of 1948*, s. 111 (b) (3). Economic Cooperation Act is Title I of the *Foreign Assistance Act of 1948*.
[86] *Economic Cooperation Act of 1948*, s. 111 (b) (3). Economic Cooperation Act is Title I of the *Foreign Assistance Act of 1948*.
[87] Charles Lipson, 'The Development of Expropriation Insurance: The Role of Corporate Preferences and State Initiatives' (1978) 32 *International Organization* 351–75 at 356; Whitman, *Government Risk-Sharing in Foreign Investment*, p. 73 and 79.
[88] Lipson, 'The Development of Expropriation Insurance', 360.

drastically.[89] By 1961, corporate support for the investment insurance program had notably solidified.[90]

Consequently, the Kennedy Administration proposed a major extension of the program recommending the inclusion of risks of insurrection, revolution, civil strife; less stringent eligibility requirements; new provisions to make bilateral investment insurance agreements acceptable to less developed countries; settlement of investor claims against the insurer by arbitration; and experimental use of guarantees to cover all kinds of risks, including ordinary business risks, in selected, high-priority cases.[91] With some minor exceptions, the proposed extension of the investment insurance was enacted in the Foreign Assistance Act of 1961.[92]

The new legislation led to a sharp increase in insurance policy sales in the 1960s.[93] While the outstanding coverage had amounted to US$500 million in 1960, by the end of the decade it had risen to US$9.8 billion.[94] At the same time, business growth brought about discussions on the reorganization of the program. The US Agency for International Development (USAID), the agency responsible for the management of the investment insurance program at the time, was considered to be ill-equipped to administer such a large number of business transactions.[95] Instead of a public institution like USAID that was said to cause bureaucratic inertia and whose primary purpose was the administration of government-to-government assistance, a *corporate form* was suggested for the prompt and effective administration of the investment insurance program.[96] A panel of business and banking experts, each member being an executive from a large multinational firm, suggested in a report entitled 'The Case for a US Overseas Private Enterprise Development Corporation' the establishment of a corporation for the administration of the investment insurance program.[97] As a result, OPIC was founded in 1969 as a separate

[89] Whitman, *Government Risk-Sharing in Foreign Investment*, pp. 94-5.
[90] Lipson, 'The Development of Expropriation Insurance', 358.
[91] *Ibid.*, 361-2.
[92] *Ibid.*, 362; *Foreign Assistance Act of 1961*, Pub L 87-195 (enacted 4 September 1961); see also Charles F. Lipman, 'Overseas Private Investment Corporation: Current Authority and Programs' (1980) 5 *North Carolina Journal of International Law and Commercial Regulation* 337–62 at 338.
[93] Lipson, 'The Development of Expropriation Insurance', 362.
[94] *Ibid.*
[95] Peter A. Hornbostel, 'Investment Guaranties: Bureaucracy Clogs the Flow' (1969) 4 *Columbia Journal of World Business* 37–47 at 37.
[96] *Ibid.*, 43-4.
[97] Lipson, 'The Development of Expropriation Insurance', 363; see also Zylberglait, 'OPIC's Investment Insurance', 361.

business-oriented agency in order to provide more effective support for US firms investing abroad.[98] It began operations in 1971.[99]

OPIC's mandate has been to promote US direct investments by means of providing not only investment insurance and reinsurance but also financing in the form of direct credits or credit guarantees, support for private equity investment funds and other services.[100] It is included in the federal budget and an appropriations request is required for OPIC's yearly credit reserve, even though OPIC is typically a net positive on the budget as it brings in more revenues than outlays.[101] In other terms, all of OPIC financial commitments to be made during the budget year must be included in the budget reserve.[102] This also creates a limit on OPIC's activity for the budget year.[103]

2.3.2. Private Provision of State Sponsored Foreign Investment Insurance

Some public investment insurance schemes have been designed to be operated by private companies, such as the public investment insurance schemes of Germany, France, Austria and the Netherlands. Governments in these countries authorize a private company to conduct their investment insurance programs. Management of public investment insurance programs by private firms is generally described as state-backed investment insurance. Apart from PwC that manages the German investment insurance scheme, these private companies were often founded as public companies and privatized later.

Germany

In 1949, the German Federal Ministry of Finance authorized a consortium of two private companies to provide export credits and to issue export credit insurance on behalf of the Federal Government.[104] The consortium was composed of Euler Hermes AG, a credit insurance company; and Treuarbeit AG, an accountancy firm which has later coalesced into the

[98] *Ibid.*
[99] Shayerah Akhtar, *The Overseas Private Investment Corporation: Background and Legislative Issues* (2013) at 2. OPIC was created by the US *Foreign Assistance Act of 1969*, Pub L 91-175 (enacted 30 December 1969), s. 231 and commenced operations upon promulgation of Exec Order No 11579 of 19 January 1971.
[100] *Foreign Assistance Act of 1961*, as amended, § 231 (3) (a)-(j).
[101] Koppell, *The Politics of Quasi-Government*, p. 64.
[102] *Ibid.*
[103] *Ibid.*
[104] According to Art. 115 (1) of the *German Basic Law* and Art. 3 (1, 1, 2, b) of the *Budget Law (2013)*, Federal Ministry of Finance is authorized to provide export credits, export credit insurance and investment insurance. The Ministry devolved its authority upon the consortium in 1949 through an agreement. See, *30 Jahre Interministerieller Ausschuß für Ausfuhrgarantien und Ausfuhrbürgschaften*, p. 7. (See also *Die Richtlinien für die Übernahme von Garantien für Kapitalanlagen im Ausland*, section X (1)].

PricewaterhouseCoopers AG (PwC).[105] The consortium had no authority to issue investment insurance on behalf of the German Federal Government until government investment guarantees were introduced in 1960. PwC is in charge of the investment insurance while Hermes has been mainly responsible for export credits and export credit insurance.[106]

Since its establishment as the responsible body for export credit and investment insurance schemes, the consortium has been administered by an inter-ministerial committee that consists of members representing the consortium, the related Ministries, and the members representing various associations and private sectors, such as the banking and the export industry.[107] Ministries that are represented in the inter-ministerial committee are the Federal Ministry of Economics and Technology, the Federal Ministry of Finance, the Federal Ministry of Economic Cooperation and Development, and Federal Foreign Office.[108] As stated above, PwC is the member of the consortium that is responsible for the handling of investment insurance. PwC accepts investment insurance applications; however, it is the inter-ministerial committee that decides whether the investment in question should be granted coverage or not.[109]

France

The French export credit agency COFACE (Compagnie Française d'Assurances pour le Commerce Extérieur) was created in 1946.[110] With a decree of April 12, 1967, COFACE was made responsible for the insurance of French private overseas loans and credits against non-commercial risks.[111] In 1970, COFACE was further authorized to provide investment insurance for equity investments in the franc area that was composed of fourteen countries.[112]

In 1971, the official aid agency of France, Caisse Centrale de Coopération Économique (CCCE, now Agence Française de Développement), launched a more general investment insurance product against non-commercial risks like expropriation and war for investments not only in the franc area but also in other developing countries.[113] However, its authority to issue

[105] For the tasks assigned upon Hermes and Treuarbeit, see *30 Jahre Interministerieller Ausschuß*, p. 12.
[106] *Die Richtlinien für die Übernahme von Garantien für Kapitalanlagen im Ausland*, section X (1).
[107] *Ibid.*, section IX (2), See for further information, *30 Jahre Interministerieller Ausschuß*, p. 10-11.
[108] *Die Richtlinien für die Übernahme von Garantien für Kapitalanlagen im Ausland*, section IX (2).
[109] *Ibid.*, section IX (1).
[110] Samir Saul, 'La COFACE: Des Opérations avec Garantie de l'État au Risque Pays' (2010) 6 *Les cahiers Irice* 169–95 at 169.
[111] Congressional Research Service-Foreign Affairs Division, *OPIC-Type Programs* reproduced in Meron, *Investment Insurance in International Law*, p. 282.
[112] *Ibid.*
[113] *Ibid.*

investment insurance was later transferred to COFACE, and COFACE became the only body that is in charge of handling the investment insurance programs of the French Government.

COFACE was privatized in 1994[114]; however, it remains in charge of the French government guarantees.[115] COFACE, therefore, is involved in proper market activities on its account and acts on behalf of the French government in managing government guarantees.[116]

2.3.3. State-Owned Companies

A third category of public investment insurance providers are public limited companies that are either fully state-owned or limited liability public agencies.[117] Canada, India, Italy and South Africa are among the countries that have either public limited companies or limited liability public agencies that manage public investment insurance schemes.

Canada

The Canadian government has granted investment guarantees through its agency Export Development Canada (EDC) that was established by the Export Development Act in 1969 as Export Development Corporation, (i.e. Export Development Canada is the operating name of the Export Development Corporation).[118] Originally, the purpose of the Corporation was to facilitate and develop international trade capacities of Canada by means of financial and other powers given in the same act; currently, it has also a mandate to support Canadian nationals to engage in domestic trade.[119] To this end, EDC provides products that range from consulting services to export credits and to investment insurance.[120]

III. Multilateral and Regional Investment Insurance Agencies

The role of private investment in economic growth, especially in less developed areas of the world has been valued by the international community, including developed and developing countries as well as international development institutions such as the World Bank. Private investment has been considered a more efficient catalyst for development than foreign aid which usually declines when economies in developed countries contract. The role of

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[114] Since 2004, NATIXIS (a French bank) holds 100% of the shares of COFACE.
[115] Saul, 'La COFACE', 181.
[116] See French Senate 2007 Report: *Les Procédures Publiques de la COFACE: du Soutien au Commerce Extérieur aux Exigences de la Comptabilité de l'Etat*. How COFACE operates the French government's investment guarantee scheme is defined in the articles from L. 432-1 to L. 432-4 of the *French Insurance Code*. See also French Senate 2007 Report, op. cit.
[117] Gordon, *Investment Guarantees and Political Risk*, p. 97.
[118] *Export Development Act of 1969*; Meron, *Investment Insurance in International Law*, p. 121.
[119] *Export Development Act (R.S.C., 1985, c. E-20)*, art. 10.
[120] *Ibid.*, art. 10 (1.1) (a)-(k).

governments, is to create investment incentives for private investors rather than to engage in economic activities themselves. Foreign investment insurance has been one of the international instruments designed to serve this end.[121]

While, in the context of the neoliberal economic paradigm, the existence of national investment insurance schemes is primarily justified on the ground that they fill an existing market gap or complement the private sector, the motivation that lies behind the establishment of multilateral or regional investment insurers is generally to complement the services of national insurance agencies as well as to complement the private sector, so that every investor seeking investment insurance would be satisfied without regard to the existence of public and private investment insurance market in their home country. The ultimate objective is to increase investment flows especially into the less-developed, more "risky" areas of the world. This idea was primarily espoused by the founding minds of MIGA prior to its establishment in 1988.[122] Indeed, they proclaimed that national guarantee schemes may have *sui generis* limitations that can result in the exclusion of otherwise eligible investments from the schemes, not to mention that not every country has national guarantee schemes.

National schemes are asserted to fall short due to their eligibility criteria that are based on their respective national mandates and objectives.[123] For instance, the national approach generally favors the encouragement of investment flows to preferred countries and sectors. Consequently, the risk diversification potential is rather limited for national investment insurance agencies.[124] Eligibility is linked to the nationality of the investor. Consequently, national agencies usually possess only limited underwriting practices along with limited financial resources. It is asserted, for these reasons, that national investment insurance agencies lack the capacity to meet investors' demand for insurance.[125] According to Shihata, the founding father of MIGA, these kinds of limitations can be overcome by international –and regional- investment insurers.[126]

A multilateral agency would complement national investment insurance agencies by providing insurance in a more comprehensive and effective manner.[127] Multilateral investment insurance would be more effective as it would be able to aggregate investments from many

[121] Sornarajah, *The International Law on Foreign Investment*, p. 50.
[122] Shihata, 'Factors Influencing the Flow of Foreign Investment'.
[123] *Ibid.*, 690.
[124] *Ibid.*
[125] *Ibid.*
[126] *Ibid.*
[127] *Ibid.*, 689.

countries and offer uniform protection regardless of the nationality of the investors and national mandates. As a result, it would offer a more diversified and depoliticized protection along with a higher capacity to provide investment insurance. While being able to provide long-term coverage like national investment insurers, a multilateral agency would also be distinguished from private investment insurance for its emphasis on the soundness of investments and their developmental impact.[128] Moreover, a global agency would complement existing investment insurance providers through reinsurance and coinsurance arrangements, thereby contributing to broader and more effective coverage.[129] A multilateral agency could also prevent capital flight from developing countries by extending coverage to investors who wish to invest funds from abroad in their home countries.[130]

Shihata also points to the symbolic importance of a multilateral investment insurance agency for demonstrating the will of the world community to increase the flow of productive foreign investments.[131] Investment insurance provided by a multilateral agency would constitute a world policy instrument to pursue this objective on a systematic and continuous basis.[132] Availability of investment insurance from an international institution for a specific -member- country is expected to enhance the confidence of investors as it would be perceived as a positive signal for the host country's receptiveness to foreign investment. [133] Beyond investor perceptions, Shihata asserts that the involvement of a multilateral agency would improve the investment conditions in the host country by reducing the possibilities of arbitrary action on the part of the host government, thereby sometimes preventing the loss from occurring at all or mitigating the extent of loss when it occurs.[134] In addition, involvement of an international agency would also increase the confidence of host governments. Compared to national investment insurance which may often be politically oriented, multilaterally provided investment insurance would be more acceptable to host countries.[135]

International investment insurance is extended also by regional development banks and regional investment insurance agencies.[136] Asian Development Bank offers insurance generally for financial service investments or infrastructure investments against the standard political

[128] *Ibid.*, 690.
[129] *Ibid.*
[130] *Ibid.*, 691.
[131] *Ibid.*, 689.
[132] *Ibid.*
[133] *Ibid.*, 691.
[134] *Ibid.*
[135] *Ibid.*
[136] Collins, *An Introduction to International Investment Law*, p. 314.

risks as well as against the denial of justice in judicial or administrative proceedings. It provides coverage up to 40 per cent of the project value or US$400 million, whichever is less. The Inter-American Development Bank extends coverage up to 50 percent of the project value or US$150 million, whichever is less. The African Development Bank does not provide investment insurance; however, it supports the investment insurance program of the African Trade Insurance Agency. The objectives of the New Development Bank (NDB) operated by the BRICS consortium of states (Brazil, Russia, India, China and South Africa) include the provision of guarantees in support of public and private projects.[137] On 13 June 2017, NDB signed a Memorandum of Understanding with the BRICS export credit insurance agencies to develop technical and operational cooperation, and share experience and knowledge in areas that include investment, risk evaluation and insurance.[138]

The next sections look more closely at MIGA and major regional actors including the African Trade Insurance Agency (ATI), the Arab Investment and Export Credit Guarantee Corporation (DHAMAN), and the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC).

3.1. A Multilateral Investment Insurance Scheme: MIGA

The establishment of a multilateral agency that provides investment insurance was on the agenda of the international community as early as 1948. A number of proposals were made by groups of industrialists and policy-makers worldwide.[139] Similar to the involvement of bankers in the establishment and development of the U.S. investment insurance scheme, bankers and business representatives were also participated in the discussions for the establishment of a multilateral scheme in the 1960s.[140] The Dutch banker E.H. Van Eeghen's proposal made at the meetings of the International Chamber of Commerce in 1960 and 1961 led to one such discussion among industrialists.[141] These proposals were considered to be alternatives to the making of a multilateral investment agreement, which was not regarded as viable for the time

[137] *Articles of Agreement of the New Development Bank*, Art. 3.
[138] https://www.ndb.int/press_release/ndb-brics-export-credit-insurance-agencies-sign-memorandum-understanding/ (last visited 20 December 2017) BRICS Export credit agencies are Brazilian guarantee agency Agência Brasileira Gestora de Fundos Garantidores e Garantias S.A. (ABGF), Russian Agency for Export Credit and Investment Insurance (EXIAR), Indian ECGC Ltd., China Export & Credit Insurance Corporation (SINOSURE), Export Credit Insurance Corporation of South Africa Ltd. (ECIC).
[139] William Conant Brewer, JR., 'The Proposal for Investment Guarantees by an International Agency' (1964) 58 *American Journal of International Law* 62–87; Edwin M. Martin, JR., 'Multilateral Investment Insurance: The OECD Proposal' (1967) 8 *Harvard International Law Journal* 280–338.
[140] For analysis of these proposals, see Brewer, JR., 'The Proposal for Investment Guarantees'.
[141] *Ibid.*, 72; E. H. van Eeghen, 'Multilateral Investment Guarantees' (1961) 5 *Section of International and Comparative Law Bulletin* 36–46.

being.[142] A multilateral fund for investment guarantees by contrast seemed to be an appropriate way of endorsing investment protection.[143] The World Bank considered the issue since 1948 and prepared several studies on a multilateral investment insurance scheme between 1961 and 1981.[144] In a 1962 report, the World Bank concluded that an actual improvement of the investment climate by a multilateral investment insurance scheme was not demonstrable.[145] In 1965, the Deputy Secretary General of the OECD, along with the support of the International Chamber of Commerce, submitted to the World Bank the "Report on the Establishment of an International Investment Guarantee Corporation", based on which the "Articles of Agreement of the International Investment Insurance Agency" were drafted in 1966, redrafted in 1968, and 1972.[146] However, the draft sank into oblivion after subsequent discussions.[147]

These early attempts of the World Bank failed mainly due to the remaining disagreement over the operational structure of the agency.[148] As Berger explains, the main objections were related to "*the linkage between the agency and the [World] Bank; the distribution of voting rights between developing and developed countries; the nature of financial participation by developing countries; subrogation as a means of recovery by the agency; and arbitration as a means of dispute settlement*."[149]

In the early 1980s, the issue was taken up again by the then President of the World Bank, A. W. Clausen and the then General Counsel, Heribert Golsong.[150] In 1985, the draft MIGA Convention was presented to members of the World Bank and to Switzerland for their approval.[151] Governments of five capital-exporting and fifteen capital-importing countries had ratified the MIGA Convention by April 1988. Their subscription amounted to one-third of MIGA's total authorized capital.[152] MIGA has full legal personality. It became operative in the fiscal year 1989-1990 after the subscription of the U.S. amounting to twenty percent of MIGA's

[142] Berger, 'The New Multilateral Investment Guarantee Agency', 22.
[143] Brewer, JR., 'The Proposal for Investment Guarantees', 66 and 70-1.
[144] Berger, 'The New Multilateral Investment Guarantee Agency', 22; James C. Baker, *Foreign Direct Investment in Less Developed Countries: The Role of ICSID and MIGA* (Westport: Quorum Books, 1999), p. 106.
[145] Berger, 'The New Multilateral Investment Guarantee Agency', 22-3; *International Bank for Reconstruction and Development, Multilateral Investment Insurance*, Staff Report (1962).
[146] Martin, JR., 'Multilateral Investment Insurance'; Meron, *Investment Insurance in International Law*, p. 31.
[147] *Ibid.*
[148] Berger, 'The New Multilateral Investment Guarantee Agency', 23.
[149] *Ibid.*, 24.
[150] *Ibid.*, 23.
[151] Baker, *Foreign Direct Investment in Less Developed Countries*, p. 107. MIGA membership is open to members of the World Bank. See *MIGA Convention*, Art. 61.
[152] Baker, *Foreign Direct Investment in Less Developed Countries*, 107.

authorized capital.[153] It was established in accordance with the World Bank's established policy to promote private investment for development.[154] Pursuant to Art. 2 of the MIGA Convention, its purpose is to "*encourage the flow of investments for productive purposes among member countries, and in particular to developing countries, thus supplementing the activities of the International Bank for Reconstruction and Development, the International Finance Corporation and other international development finance institutions*."[155]

MIGA was to provide more comprehensive guarantees than were available from national and private investment insurance providers. The Convention expressly covers four categories of political risk: currency transfer restrictions and inconvertibility; expropriation; breach of contract; and the risk of war or other civil disturbance. In addition, the Agency's Board of Directors can extend coverage to non-commercial risks that beyond these four categories if the investor and the host country submit a joint application.

MIGA also enters into bilateral agreements with its developing member states.[156] These agreements generally contain two provisions; one designates the government authority with which MIGA is to communicate in connection with matters arising under the MIGA Convention, and the other provides that MIGA shall be accorded treatment no less favorable than the most favorable treatment accorded to any other investment guarantee agency or state.[157] These agreements do not include subrogation clauses as the principle of subrogation is enshrined in the MIGA Convention.

3.2. Regional Investment Insurance Agencies

The idea of insuring investments against non-commercial risks on a multinational basis paved the way for the establishment of regional insurance agencies as well. One of the first schemes of this kind was proposed in 1957 by a working group of the Council of Europe's Consultative Assembly.[158] The proposal was later reconsidered in a report of the Economic Committee of the Council of Europe in 1959, limiting the eligibility to European investments

[153] *Ibid.*
[154] Shihata, 'The Multilateral Investment Guarantee Agency' at 487.
[155] *MIGA Convention*, Art. 2.
[156] Only developing member states are eligible to host an investment insured by MIGA.
[157] See, MIGA Convention, art. 23(b)(ii) "The Agency also shall: … endeavor to conclude agreements with developing member countries, and in particular with prospective host countries, which will assure that the Agency, with respect to investment guaranteed by it, has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement relating to investment, such agreements to be approved by special majority of the Board …"
[158] Berger, 'The New Multilateral Investment Guarantee Agency', 22.

in African countries.[159] This limitation was based on previous discussions on the economic union between European and emerging African nations (Europe's former colonial territories in Africa).[160] A European investment guarantee agency, however, has never come into existence. Instead, individual European countries have established public agencies to provide their nationals with investment insurance.

Currently, major regional investment insurance agencies are the African Trade Insurance Agency (ATI), the Arab Investment and Export Credit Guarantee Corporation (DHAMAN) and the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC).

3.2.1. African Trade Insurance Agency

In addition to MIGA, the World Bank Group initiated the establishment of the African Trade Insurance Agency as part of the Trade Finance Facilitation Project in order to promote investment flows to Sub-Saharan Africa.[161] ATI was created in January 2001 through a multilateral agreement that was initially signed and ratified by Malawi, Burundi and Kenya.[162] African states that are eligible to become members of the African Union[163] (former Organization of African Unity) or public entities representing these states may acquire membership of the ATI.[164] Ever since it was established, the membership was extended to seven other African states.[165] The Agency is headquartered in Nairobi, Kenya and has local offices in Rwanda, Tanzania, Uganda and Zambia.

The purpose of the ATI, as it is laid down in its constitutive Agreement, is to "*facilitate, encourage and develop the provision of, or the support for, insurance, including coinsurance and reinsurance, guarantees, and other financial instruments and services, for purposes of trade, investments and other productive activities in Africa in supplement to those which may be offered by the private sector, or in cooperation with the private sector*."[166] In line with this purpose, the Agency provides above all investment insurance against political risks and export credit insurance against political and commercial risks.[167] Types of political risks that may be

[159] *Ibid.*
[160] Brewer, JR., 'The Proposal for Investment Guarantees', 70.
[161] *Africa Trade Insurance Agency: Impact Assessment, by International Financial Consulting Ltd.* (2011), p. 2.
[162] *Agreement Establishing the African Trade Insurance Agency* (2000). [Hereafter ATI Agreement].
[163] *Charter of Organization of African Unity* (1963) The OAU was disbanded in 1999 and replaced by African Union. *Constitutive Act of the African Union* (2000).
[164] *ATI Agreement*, Art. 5.
[165] Members of ATI are Burundi, Malawi, Kenya, Benin, Democratic Republic of Congo, Madagascar, Rwanda, Tanzania, Uganda and Zambia.
[166] *Ibid.*, Art. 4 (1).
[167] *Ibid.*, Art. 4 (2).

covered by the Agency, eligible investors and eligible investments are not stated directly in the Agreement establishing ATI. Eligibility criteria as well as other terms and conditions of the insurance policy are subject to rules and regulations to be adopted by the General Assembly.[168] Major political risks including expropriation, political violence and war, convertibility and transfer restrictions, breach of contract have been hitherto covered by the ATI investment insurance.

In March 2011, ATI's performance with respect to its purposes was assessed by an independent consulting firm. The assessing consulting firm reached the conclusion in their report that ATI has a positive impact on trade and investment in Africa and has fulfilled its purposes.[169] Although ATI struggled in the first two years of its establishment, issuing only four policies in total, it has lately become more effective in the region.[170] ATI has been self-sufficient since its inception.[171]

3.2.2. Arab Investment and Export Credit Guarantee Corporation (DHAMAN)

DHAMAN's origins can be traced back to the 1960s. The establishment of such a corporation that provides investment insurance for development projects in Arab countries was initially recommended at the Arab Countries' Industrial Development Conference in 1966.[172] During a meeting of Arab Financing Experts in November 1967, the Kuwait Fund for Arab Economic Development was mandated to conduct preliminary research and to draft a convention for the establishment of such a corporation. The Arab Financing Experts convened again in March 1970 to discuss the draft convention that had been prepared by the Fund and distributed to the Arab governments. Having proposed a number of amendments, the Arab Financing Experts assigned the Fund to finalize the draft convention, to prepare an explanatory note that explains the general principles the project was based on and to proceed with the necessary steps for the establishment of the corporation. The same year, the Convention was approved by the Council of Arab Economic Unity and by the Economic and Social Council of the Arab League.[173] The Convention was deposited with the Ministry of Foreign Affairs in the

[168] *Ibid.*, Art. 8 (2) (a), the General Assembly consists of one representative and one alternate that is appointed by each member of the Agency. All the powers of the Agency are vested in the General Assembly. See, Art. 11 (1) and (2) (a).
[169] *Africa Trade Insurance Agency: Impact Assessment, by International Financial Consulting Ltd.*, p. 6
[170] *Ibid.*, 2
[171] ATI, in particular its ability to meet its financial commitment to policy holders, was rated „A" by the Standard & Poor's rating agency in 2018.
http://www.ati-aca.org/index.php/about-ati/rating (last visited 11 December 2018)
[172] Arab Countries' Industrial Development Conference, Kuwait, March 1966.
[173] *Convention Establishing the Arab Investment and Export Credit Guarantee Corporation*, entered into force in April 1974 (hereinafter DHAMAN Convention).

State of Kuwait in May 1971 and it came into force by April 1974 when it had been ratified by twelve Arab countries that subscribed up to 70% of the Corporation's capital.[174] DHAMAN is headquartered in Kuwait with a regional office in Riyadh, Saudi Arabia.

The membership to the Corporation is open to Arab countries and Arab public and semi-public organizations.[175] All Arab countries except Comoros became members of the Corporation soon after its establishment and four public organizations, subscribing to Corporation's capital, became members in 2004.[176]

The purpose of the Corporation is to promote investments in the contracting countries. To this end, it provides primarily investment insurance and reinsurance thereof.[177] The Corporation endeavors to promote investments also through other means, such as research on investment opportunities and investment conditions in the contracting countries, factoring operations as financier and insurer, founding or co-founding of private investment funds in contracting countries and playing a role in the establishment of national public or private investment insurers in contracting countries.[178]

As concerns eligibility criteria for investors, DHAMAN is less strict than MIGA. Eligible investors for the DHAMAN insurance are nationals from the contracting parties and nationals from other countries for their investments in the contracting countries. MIGA by contrast does not issue any insurance to nationals of non-member countries.[179] Investors from contracting countries can be granted insurance for their investments in the same country provided that the funds necessary for the investment are repatriated from abroad including other members and non-member countries while for MIGA, repatriation of funds from other member countries is essential.[180] Investments that are eligible for insurance are identified according to the guidelines of the International Monetary Fund on the definition of long term assets and liabilities.[181] Except for the reinsurance provided for the insured investments that have been already installed,

[174] *Ibid.*, Introduction.
[175] *Ibid.*, Art. 7 (1) and (2).
[176] Current members of the Corporation are: Hashemite Kingdom of Jordan, United Arab Emirates, Kingdom of Bahrain, Republic of Tunisia, Democratic People's Republic of Algeria, Republic of Djibouti, Kingdom of Saudi Arabia, Republic of Sudan, Syrian Arab Republic, Democratic Republic of Somalia, Republic of Iraq, Sultanate of Oman, State of Palestine, State of Qatar, State of Kuwait, Republic of Lebanon, The Great Socialist People's Libyan Arab Jamahiriya, Arab Republic of Egypt, Kingdom of Morocco, Islamic Republic of Mauritania, Republic of Yemen, The Arab Fund for Economic and Social Development, The Arab Monetary Fund, The Arab Bank for Economic Development in Africa, The Arab Authority for Agricultural Investment and Development.
[177] *Ibid.*, Art. 2 (1).
[178] *Ibid.*, Art. 2 (2) and (3).
[179] *Ibid.*, Art. 15 (1) and (2) (a).
[180] *Ibid.*, Art. 15 (2) (b).
[181] *Ibid.*, Art. 15 (3).

only new investments meet the eligibility criteria of the Corporation.[182] Insurance is subject to host state's approval of the investment.[183]

The Corporation, in line with most of the other investment insurers, provides insurance against certain political risk types, namely expropriation risk, transfer and convertibility risk, breach of contract risk, and war and civil disturbances risk.[184] Commercial risks are not covered by DHAMAN investment insurance.[185]

3.2.3. Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC)

ICIEC is a member of the Islamic Development Bank Group (IDB), which is a specialized institution of the Organization of Islamic Cooperation (OIC, formerly Organization of the Islamic Conference).[186] The establishment of such a corporation by the OIC through the Islamic Development Bank was initially laid down in Article 15 of the Agreement for the Promotion, Protection and Guarantee of Investment that was ratified by the members of the OIC.[187] Consequently, the Board of Directors of the IDB approved the Draft Articles of the Agreement of ICIEC in February 1992 and the Agreement entered into force in August 1994.[188] The Corporation is headquartered in Jeddah, Kingdom of Saudi Arabia. Membership of the ICIEC is open to the IDB and to the member states of the OIC or to the entities or agencies that represent any of its member states.[189] The members of the ICIEC encompass the majority of the members of the OIC.[190]

The purpose of the Corporation is to "*enlarge the scope of trade transactions and the flow of investments among member states*"[191] in conformity with the *sharia*. It provides investment insurance as well as export credit insurance products to fulfill this purpose. Nationals of the members of the OIC, with no regard to membership in the ICIEC are eligible for insurance for their investments in members of the ICIEC.[192] Nationals of the host state are eligible for

[182] *Ibid.*, Art. 15 (5).
[183] *Ibid.*, Art. 15 (7).
[184] *Ibid.*, Art. 18 (1) (A), (B), (C) and (D).
[185] *Ibid.*, Art. 18 (3).
[186] OIC is an inter-governmental organization which has membership of fifty-seven states. It was established in September 1969 for the purposes of strengthening the solidarity and cooperation among the member states. See, Charter of the Organization of Islamic Cooperation.
[187] *Agreement for the Promotion, Protection and Guarantee of Investment*, Art. 15.
[188] *Articles of Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit* (hereinafter ICIEC Articles of Agreement).
[189] *Ibid.*, Art. 6.
[190] By 2013, thirty-nine of fifty-seven members of the Organization have become members to the Corporation.
[191] *Ibid.*, Art. 5.
[192] *Ibid.*, Art. 17 (1).

insurance as long as the assets to be invested are repatriated from other members of the OIC.[193] Except for reinsurance, investments must be categorized as new investments, including the modernization of existing investments.[194]

Types of covered political risks are expropriation risk, transfer and convertibility risk, breach of contract risk, and lastly war and civil disturbance risk. Further types of political risks may be covered according to a decision by the Board of Directors of the ICIEC. Commercial risks, including devaluation or depreciation of the currency, are not covered by investment guarantees.[195]

IV. Private Investment Insurance

Actors

Private investment insurance against political risks has gradually evolved from marine insurance, which had been provided by specialist insurers to exporters and shipping lines since the 18th century.[196] In the 1930s, Lloyds of London started to provide coverage for political and other "contingency" risks and aggressively expanded into the field in 1971 through a reinsurance agreement with OPIC.[197] Other private insurance firms begun to provide investment insurance after World War II.[198] In the United States, the first meaningful entrance into the private investment insurance market was undertaken in 1978 by a subsidiary of the American International Group (AIG).[199] Lloyds itself is not an insurer but an insurance syndicate of brokers that provide investment insurance.[200] Similarly, AIG is also comprised of a large number of member insurance companies that underwrite, among others, specific policies covering foreign direct investments.[201] This makes Lloyds and AIG major private sources for the investment insurance seekers. Among the primary private political risk insurers have been also Sovereign Risk Insurance Limited, Zurich, Chubb, PanFinancial, Citicorp International

[193] *Ibid.*, Art. 18 (3).
[194] *Ibid.*, Art. 17 (2).
[195] *Ibid.*, Art. 19 (2), (3) and (4).
[196] Kessler, 'Political Risk Insurance' at 213; Douglas A. Paul, 'New Developments in Private Political Risk Insurance and Trade Finance' (1987) 21 *The International Lawyer* 709–18 at 710.
[197] Jennifer M. DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind? Suggestions for a New Direction for Government Coverage' (2005) 45 *Virginia Journal of International Law* 737–87.
[198] Kessler, 'Political Risk Insurance', 213.
[199] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?'.
[200] Kessler, 'Political Risk Insurance', 213.
[201] *Ibid.*, 216.

Trade Indemnity, Inc., Universal Investment Consultants, Ltd. and Pool d'Assurance des Risques Internationaux et Specieux.[202]

Capacity

Private insurers are subject to laws governing cash reserve requirements for insurance companies, which in turn may affect the availability of investment insurance.[203] More importantly, the private investment insurance market has been subject to capacity fluctuations.[204] Private investment insurers are, above all, affected by rigidity in credit markets.[205] Given the heavy losses business has suffered during the international debt crisis that followed the devaluation of the Mexican Peso in 1982, it has been argued that the private sector is not stable and susceptible to occasional recession.[206] Throughout the 1980s, it is estimated that the availability of the private underwriting capacity shrank by almost forty percent.[207] The private investment insurance market has gone through a contraction not only due to debt rescheduling and the reduced amount of trade and investment flows to developing countries but also due to their overall financial losses. As stated by Jürgen Voss in a 1987 note, "*[a]fter experiencing remarkable growth alongside national investment guarantee agencies, the private market is frequently shrinking as a result of underwriting losses sustained in other areas of insurance.*"[208] Also, decreased confidence in the ability of private insurers to understand and assess political risks contributed to the contraction.[209] Main competencies of private insurers lie in the reinsurance market for investment insurance.[210] As a result of the international debt crisis, private investment insurance disappeared for a certain period.[211] Yet 2008 financial crisis did not have similar consequences.[212]

[202] *Ibid.*, 214; DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 739.
[203] MIGA, *World Investment and Political Risk 2011* (2012)
[204] James J. Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance Policies with Strategic Applications for Risk Mitigation' (2015) 25 *Duke Journal of Comparative and International Law* 361–84 at 381.
[205] *Ibid.*
[206] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 743.
[207] Maura B. Perry, 'A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation' (1995-1996) 36 *Virginia Journal of International Law* 511–88 at 533.
[208] Jürgen Voss, 'The Multilateral Investment Guarantee Agency: Status, Mandate, Concept, Features, Implications' (1987) 21 *Journal of World Trade* 5–23 at 17.
[209] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 743.
[210] John J. Salinger, 'Guarantees and Insurance: Future Directions for Public Agencies', in *Conference: Private Infrastructure for Development: Confronting Political and Regulatory Risks* (Rome, Italy, 1999).
[211] *Ibid.*
[212] MIGA, *World Investment and Political Risk 2011*, p. 43.

In the mid-1990s, the size of the entire private investment insurance market was barely larger than OPIC's business alone in the mid-1990s.[213] However, despite capacity fluctuations, private investment insurance has grown drastically since the mid-1990s.[214] As of 2001, public insurance accounted for 52% while the remaining 48% was covered by private insurance companies (with AIG garnering 15%, Lloyd's 16%, Sovereign 7%, Zurich 7%, and other private insurers accounting for the remaining 3% of the market).[215]

4.1. Comparison between Public and Private Investment Insurers

Public investment insurance is often justified on the ground that there is a gap in the private insurance market that renders state intervention necessary. It has been argued that the private insurance sector does not suffice to provide foreign investment insurance and promote foreign direct investment. Under these circumstances, it is the role of public investment insurance schemes to complement the private sector. Certain measures are taken to assure that public investment insurance agencies do not compete with private insurance firms and rather function as a last resort for investment insurance seekers. Cooperation in the form of coinsurance, reinsurance and through other means has been emphasized to justify the existence of public investment insurance agencies. However, investment insurance markets have been persistently dominated by public players. It has been argued that national investment insurance schemes are better situated in the political risk insurance market due to their inherent strengths compared to private insurance firms.

Long Term Contract vs. Short Term Contract

In comparison with the public sector, private investment insurers generally provide policies for shorter terms and for smaller amounts.[216] Most private insurers provide coverage for terms of three to five years with a total capacity of just over US$3 billion while having only barely US$1 billion for terms of ten to fifteen years.[217] Moreover, the majority of private insurers only insure individual investments for less than US$100 million. Yet, some larger players, such as AIG, Sovereign and Zurich, offer investment insurance for longer terms and for bigger investments than their public counterparts.[218]

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[213] Perry, 'A Model for Efficient Foreign Aid', 536.
[214] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 746.
[215] Christina Westholm-Schroder, 'The Expanding Role of Private Insurers in Covering Political Risks' (2001) 822 *PLI/COMM* 42.
[216] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 373.
[217] *Ibid.*
[218] *Ibid.*; DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 750.

Comparing the OPIC insurance policies with private political risk insurance policies, Deleonardo concludes that both types of insurance policies are remarkably similar as concerns the covered events.[219] Both OPIC and private sector policies cover the risk of expropriation, inconvertibility and transfer restrictions, and political violence. The approach the private insurers adopt toward the definitions of these risks, as it seems, is significantly shaped by OPIC's jurisprudence.[220]

Global Policies

Private investment insurers not only compete with each other, but they are also in competition with public insurers. Even though their role is perceived to be secondary in the investment insurance market, compared to public players, private investment insurers are better positioned to offer global risk policies.[221] A global policy generally covers a multinational investor's exposures across a range of countries.[222] Global policies are generally more costly as they cover more geographic risk, however, they lead to substantial transaction cost savings compared to individual insurance policies for each investment in different countries.[223] The flexibility in the private investment insurance market in terms of lack of certain legal requirements, national mandates and requirements for social and environmental standards enable private insurance companies to offer innovative and tailored insurance products such as global policies.[224]

Despite the substantial evolution of private firms in the investment insurance business, their role has been seemingly complementary or secondary compared to the public investment insurance providers. National and multilateral public insurers dominate by far the investment insurance sector. Given the fact that some public investment insurers are making profits out of their underwriting business, it has been questioned why private insurance firms do not underwrite more investment insurance policies.[225] This can be partly answered by the existence of public investment insurers, i.e. national as well as multilateral providers of investment insurance.

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[219] *Ibid.*
[220] *Ibid.*
[221] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 380.
[222] David James, 'Cooperation, Competition, and the „Science of Pricing" in the Political Risk Insurance Marketplace', in T. H. Moran (ed.), *International Political Risk Management: Exploring New Frontiers* (Washington, D.C., 2001), pp. 170–9, p. 175.
[223] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 380.
[224] *Ibid.*
[225] Kessler, 'Political Risk Insurance', 204.

Information Asymmetries

It has been long argued that one of the inherent strengths of public investment insurance providers is their greater access to information on the political situation of a country that is necessary for the assessment of political risks.[226] In fact, public insurers have access to information gathered, for instance, by their countries' ambassadors in a certain country or by the national intelligence units whereas the private sector lacks similar tools to gather the necessary information to properly measure risks.[227] For instance, OPIC is guided by the US State Department and receives broader intelligence information about the actions and intentions of host state actors.[228] Thus, one can argue that public insurers like OPIC are better positioned to decide whether to offer insurance for a specific country and meaningfully price their insurance products.[229] There is evidence confirming that the public investment insurance premiums are generally lower than those in the private sector.[230]

However, certain developments have reduced the differences between public and private investment insurers in terms of their access to information. Factors like openly documented commitments by host countries to liberal policies, improvements in technology, increasing ease of travel, and the internationalization of the media have facilitated the flow of information regarding political situations in different regions of the world.[231] Willingness to sign a BIT or join an international arbitration convention and honoring previous arbitral awards may act as signals of host state commitment to a positive investment environment and international investment protection standards.[232] It is now asserted that the increasing availability of information for the purpose of measuring political risks helps private sector participants to provide coverage at similar terms to those of public insurers.[233] Moreover, the proliferation of private consultants and risk companies that offer risk analysis, such as Stratfor, Global Intelligence Alliance and the Economist Intelligence Unit, makes it possible for private companies to access the sort of information available to public insurers.[234] Thus, private

[226] Salinger, *Guarantees and Insurance*, p. 533.
[227] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 751.
[228] *Ibid.*, 752.
[229] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 375-6.
[230] Bekker and Ogawa, 'The Impact of Bilateral Investment Treaty Proliferation', 323.
[231] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 753.
[232] *Ibid.*
[233] *Ibid.*, 755.
[234] *Ibid.*, 753.

insurers are no longer at the same disadvantage regarding access to information and assessment of political risks.[235]

Transparency

A key condition of many insurance policies in the private sector is that the insured must not reveal the existence of a policy without the consent of the insurer.[236] As Kantor points out a typical investment insurance policy issued by a private underwriter will state that:[237]

"*the Insured shall not disclose the existence of this insurance policy to any third party, with the exception of the Insured's bankers and other professional advisors on a confidential basis, without the prior written consent of the Underwriter*."

Scholars generally offer two possible explanations for this clause. First, it is perceived as a strategy to eliminate moral hazard on the part of the host states. If a host state is aware that an investment within its borders is covered by an insurance policy, it might rationalize its interference with the investment by the fact that the firm would not be adversely affected by its actions because it will be compensated. This applies especially in the case of private insurance, as private insurers can deter government interference only in exceptional cases. Second, it purposely deprives the insured investor of information regarding other investors' experiences with investment insurance that may be useful in a legal dispute with the insurer.[238] Kantor argues that "*the protections of privacy are also its perils. In an environment of confidential dispute resolution, little practical information exists to inform insured parties of prior claims practice with respect to a regulatory expropriation claim*".[239] In both cases, the lack of transparency seems to place the insured at a clear tactical disadvantage.[240] If the main rationale for an investor to take out an insurance policy is to protect against losses, then foreign investment insurance seems to support an opposing goal which is to ensure the insurer does not suffer losses.[241]

Intergovernmental Relations, Deterrence Effect and Recovery

[235] *Ibid.*
[236] Spagnoletti and O'Callaghan, 'Going Undercover', 8.
[237] Mark Kantor, 'Are You in Good Hands with Your Insurance Company? Regulatory Expropriation and Political Risk Insurance Policies', in T. H. Moran, G. T. West and K. Martin (eds.), *International Political Risk Management: Needs of the Present, Challenges for the Future* (Washington, D.C., 2008), pp. 137–70, p. 139.
[238] Spagnoletti and O'Callaghan, 'Going Undercover', 8.
[239] Kantor, *Are You in Good Hands*, p. 139.
[240] Spagnoletti and O'Callaghan, 'Going Undercover', 8.
[241] *Ibid.*, 8.

Government entities can capitalize on inter-governmental relationships to reduce or to eliminate risk through, for example, persuading the host country government not to expropriate the investment or to take actions to reduce the loss. The deterrence effect is apparent in the operation of MIGA. However, private sector insurers can also increase their political influence to meaningfully negotiate with governments.[242] For instance, it was reported that AIG created a separate company to issue investment insurance with several former diplomats and government officials sitting on its board.[243] Being a Berne Union member also helps private insurers to increase their political influence on governments. As a side note, the deterrence effect is naturally lower for investors concerned with political violence rather than expropriation or transfer restrictions.[244] Expropriation and transfer restrictions are attributed to the host government, which in turn might be deterred by the involvement of a public insurer. By contrast, those individuals or groups causing political violence are not likely to be influenced by that fact.

Perhaps more importantly, government entities have advantages with respect to the recovery of compensation paid to the insurance holder.[245] Yet, the prevalence of bilateral investment treaties enabling investors to invoke arbitration has culminated in an environment where the private insurers today are more likely to recover compensation payments than they were about three decades ago.[246] DeLeonardo even argues that under these circumstances, private insurers may also invoke international arbitration against host governments.[247] However, it is not possible for private insurers to invoke the subrogation clause in the BITs. They may subrogate pursuant to insurance contract, but that subrogation would not put them in the shoes of investors under public international law. If the insured investor receives compensation from the host state for the same action that led to insurance claim payment as a result of an arbitral award, the investor may be requested by the insurer for reimbursement.

It is reported that insurance claims have lately "*tended to be paid out more by private than public providers*",[248] which may be a sign of the strength of the private sector. Compared to public insurers that use a net book value valuation method to determine the amount of

[242] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 779.
[243] *Ibid.*
[244] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 381.
[245] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 743.
[246] *Ibid.*
[247] *Ibid.*
[248] MIGA, *World Investment and Political Risk 2011*, p. 40.

compensation, private companies generally use the discounted cash flow valuation method which would compensate investors adequately.[249]

Financial Strength-Backed by the State-No Profit Pressure

It has been also argued that public investment insurers are inherently better situated for the investment insurance business due to their financial strength. Investment guarantees are backed by the full faith and credit of governments, which enable national insurers to provide insurance with broader resources and without the need to seek reinsurance.[250] They are generally statutorily required to operate on a break-even basis with no pressure to make profit.[251] This enables them to offer policies with lower insurance premiums. Furthermore, public insurers generally have programs to promote small businesses that are likelier to be forced out of the investment insurance market due to high transaction costs of underwriting insurance for small investments.[252] By contrast, publicly-traded investment insurance companies have fiduciary duties to their shareholders to pursue profits.[253]

Flexibility

Private companies are more flexible and independent as they do not have to comply with a national mandate.[254] Perhaps the main comparative advantage of private sector investment insurance is that it is not subject to any limitations concerning the eligibility of investors or investments.[255] As a result, private insurers are able to offer insurance policies that are quickly and efficiently tailored to an investor's specifications.[256] For instance, private insurance is available for investments in host countries that refuse to sign an investment protection agreement or investment insurance agreement. While this would eliminate eligibility to obtain MIGA or OPIC insurance, such investments can be insured by private source insurers, though they may be subject to higher premiums.[257] Existing investments are also generally excluded from eligibility for public insurance. These investments too may be insured by private insurers.

More importantly, while public investment insurance is provided on certain statutory conditions, private insurers are not subject to the same limitations. For instance, every OPIC

[249] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 380.
[250] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 743.
[251] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 376.
[252] *Ibid.*
[253] *Ibid.*
[254] Paul, 'New Developments in Private Political Risk Insurance', 712.
[255] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 378-9.
[256] Dolzer and Schreuer, *Principles of International Investment Law*, p. 208.
[257] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 378-9.

insurance contract contains a list of social and environmental conditions.[258] Investors purchasing OPIC investment insurance must guarantee a right to collective bargaining and a right to association for workers.[259] OPIC is prevented from covering investments that would eliminate US employment and move production overseas.[260] For certain investments, investors are required to submit an environmental impact assessment.[261] Categorical prohibitions include infrastructure projects that would disrupt rainforests or require the resettlement of more than 5,000 inhabitants.[262] MIGA imposes similar conditions. Moreover, investors taking out MIGA insurance are mandated to furnish MIGA with any information it reasonably requests.[263] In fact, social and environmental regulations contribute in the investors' risk mitigation. However, the obligation to prove compliance may be a time-consuming and resource intensive process.[264] Investors taking out private investment insurance may reduce the cost of proving compliance with social and environmental regulations.[265]

Moreover, private investment insurance can be more quickly tailored to an investor's specifications.[266] Contrary to public investment insurance, for instance, investors may negotiate with private insurers use of the discounted cash flow method that is apparently more favorable compared to the net book value valuation method used by public insurers; it may be contracted with a set discount rate and established metrics with which to estimate future cash flows.[267]

4.2. Cooperative Co-Existence of Public and Private Investment Insurers

The existence of public investment insurance agencies has been justified with their additionality, or their actual benefit in promoting foreign direct investment and contributing to a more attractive international investment environment.[268] The emphasis of public investment insurance providers on the soundness of investments and developmental impacts would also differentiate their role from that of private investment insurance providers.[269] The fact that the free market mechanism, when it is left to itself, may not always lead to the most desirable allocation of capital among developing countries renders government intervention necessary.[270]

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[258] *Ibid.*, 377-8.
[259] *Ibid.*
[260] *Ibid.*, 379.
[261] *Ibid.*
[262] *Ibid.*
[263] *Ibid.*
[264] *Ibid.*, 378.
[265] *Ibid.*
[266] Bekker and Ogawa, 'The Impact of Bilateral Investment Treaty Proliferation', 323.
[267] Waters, 'A Comparative Analysis of Public and Private Political Risk Insurance', 380.
[268] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 741.
[269] Shihata, 'Factors Influencing the Flow of Foreign Investment', 690.
[270] Whitman, *Government Risk-Sharing in Foreign Investment*, p. 8.

Nevertheless, public investment insurance infringes the essence of economic liberalism. In order to address this infringement, it has been emphasized that public investment insurance providers should not compete with private insurance companies but cooperate with them.

In fact, in its early life, the U.S. investment insurance agency, OPIC, was required to transfer its insurance underwriting business completely to the private sector. In 1973, the U.S. Congress reauthorized OPIC on the condition that the agency endeavors to phase out and transfer its programs to the private sector by 1981.[271] Under its authorizing legislation, OPIC was required to be an insurer of last resort, which means that OPIC coverage is to be granted only in the event of a gap in the market for the specific insurance demand.[272] Congress' intention was that OPIC would support the development of the private investment insurance sector and be replaced eventually by those private companies. However, the transfer of OPIC's insurance underwriting to the private sector has never been realized. Instead, OPIC has endeavored to operate in cooperation with the private sector, notably in the form of reinsurance, coinsurance and parallel insurance underwriting. More formally, in late 2001, OPIC launched a strategic plan to ensure that the agency would complement, not compete with, the private sector.[273]

It has been asserted that a total replacement of public agencies by private insurance companies has not been realized mainly due to the disinclination or inability of private companies to provide investment insurance on conditions or terms similar to those available under public schemes. In fact, cooperation is also required on the part of the private insurers. A practitioner, the then vice-president of the AIG, confirmed the recession in the private political risk insurance market in the 1980s and emphasized the need for cooperation with the public sector: "*We would regard our coverages as both competitive with, and complementary to, those programs. The private sector obviously lacks the resources to provide the long-term commitments of the national programs and is constrained also by the need to be profitable, an objective well beyond the reach of the national schemes today. … Our goal, over time, is to find ways to generate more cooperation with the public sector to the benefit of all concerned.*"[274]

The private and public investment insurance providers are highly interconnected in the reinsurance market. As of 2012, for instance, MIGA received reinsurance coverage through

[271] Dan Haendel, *Foreign Investments and the Management of Political Risk* (Colorado: Westview Press/Boulder, 1979), p. 56.
[272] Theodore H. Moran and C. Fred Bergsten, *Reforming OPIC for the 21st Century*, Number PB03-5, International Economics Policy Briefs (2003), p. 4.
[273] OPIC, *Annual Report 2011* , p. 23.
[274] Paul, 'New Developments in Private Political Risk Insurance', 711-2.

twenty-seven public and private insurers,[275] while it provided reinsurance coverage to two investment insurers in Belgium and Slovenia in 2012 alone.[276] Reinsurance arrangements and further collaborative approaches are generally considered to signal the lack of fierce competition in the investment insurance markets as they allow public and private insurers to diversify their risks across different industries and countries. Indeed, cooperation would serve every participant insurer to better leverage their resources through the additional protection that comes with coinsurance and reinsurance. In the context of foreign investment insurance, cooperation between public and private insurance providers through reinsurance and coinsurance was also emphasized for a broader and more effective coverage that would help public agencies to fulfill their purposes regarding the promotion of foreign investments.[277]

[275] MIGA, *Annual Report 2012* p. 115.
[276] *Ibid.*
[277] Shihata, 'Factors Influencing the Flow of Foreign Investment', 690.

Chapter 2 OPIC Investment Insurance in Operation: The Dabhol Power Project

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It is essential to review the tripartite relationship in order to understand how foreign investment insurance works. A case study that centers on a project that was insured by OPIC helps clarify the distinct yet integrated relationships between parties and sheds light on the operation of foreign investment insurance. The Dabhol Power Project case exemplifies the main components of foreign investment insurance from the issuance of insurance to the settlement of disputes. The case study on the Dabhol Power Project helps also to distinguish between law in action and law on the books since the flexibility of the parties with respect to the operation of investment insurance becomes evident in practice.

The case concerns a power generation project of three U.S. investors constructed in the 1990s in Maharashtra, a state of India. It is an infamous example for foreign direct investment involving various controversies concerning among others (allegations for) a series of human rights violations, adverse environmental impacts, disputes among project stakeholders and a litigious workout process that resulted in the termination of the project contracts. The project may be viewed from different angles and in fact it has been the subject matter of various studies approaching the case from different perspectives.[1] In this chapter, we shall have a closer look at the case with respect to foreign investment insurance as the case helps to understand how foreign investment insurance operates from the early stages of an investment when insurance is taken up to the later stages when disputes arise and culminate in insurance claims.

In order to outline the tripartite relationship properly, I break it down into the bilateral legal relationships. By focusing on the relationship between the investors and the Indian government and the government entities listed above, the first section provides the factual background of the project. Particular attention is paid to the risk management objective of the foreign investors. This section draws on the extensive literature on the international business and government

[1] Preeti Kundra, 'Looking Beyond the Dabhol Debacle: Examining its Causes and Understanding its Lessons' (2008) 41 *Vanderbilt Journal of Transnational Law* 907–35; Deeptha Mathavan, 'From Dabhol to Ratnagiri: The Electricity Act of 2003 and Reform of India's Power Sector' (2008-2009) 47 *Columbia Journal of Transnational Law* 387–417; Jeswald W. Salacuse, 'Renegotiating International Project Agreements' (2000) 24 *Fordham International Law Journal* 1319–70; Gus van Harten, 'TWAIL and the Dabhol Arbitration' (2011) 3 *Trade, Law and Development* 131–63; Waquar Ahmed, 'Neoliberalism, Corporations, and Power: Enron in India' (2010) 100 *Annals of the Association of American Geographers* 621–39; Waquar Ahmed, 'From Militant Particularism to Anti-neoliberalism? The Anti-Enron Movement in India' (2012) 44 *Antipode* 1059–80.

relationships. In the second section I turn to the relationship between the investors as the insurance holders and the U.S. government in general and OPIC as the insurer in particular. It is important to emphasize at the outset that the relationship between investors and OPIC as a U.S. government agency is principally based on the insurance contract that is governed by municipal law; however, this does not prejudice the rights of the U.S. government with respect to its nationals under public international law. That is, the U.S. government is free to grant American investors diplomatic protection that goes beyond the coverage provided through the investment insurance. Finally, in the third section, I turn to the relationship between the U.S. government and the government of India with respect to foreign investment insurance that is typically based on a bilateral treaty. This section mainly concerns the stage when the project and the insurance contracts have been terminated following a series of disputes that had arisen from project contracts between the investors and the Indian government entities as well as from the insurance contracts between the investors and OPIC.

I will explain the legal framework of each relationship and outline the connection among them with particular attention to the governing law and the legal system they are situated in.

I. Investor-Host State Relationship

1.1. Risk Management in the Dabhol Power Project: The Factual and the Legal Background

The open policy transition toward foreign direct investment in the 1980s applies also to the Indian energy sector. For four decades after gaining independence in 1947, India essentially followed statist policies in its power sector as it did throughout its entire economy.[2] The Ministry of Power of the central government was responsible for the generation of electricity along with the State Electricity Boards (SEBs) or other governmental departments in the states.[3] The State Electricity Boards were the sole purchasers of electricity generated by the private sector -that was composed of a small number of companies- and they administered the licenses granted to the companies.[4] The State Electricity Boards were also responsible for the transmission and distribution of electricity within the states.[5] These state departments were

[2] World Bank Operations Evaluation Department, *Reforming India's Energy Sector (1978-99)* (2001), p. 206 PRECIS 1.

[3] Mathavan, 'From Dabhol to Ratnagiri' at 389.

[4] *Ibid.*, 389. *Akil Hirani, 'Power: India's Unquenched Thirst!' (1995) 7 International Legal Perspectives 263–8* at 263-4 "Since 1947, except for five private sector electricity generation and distribution companies, the business of power generation and distribution has been concentrated in the public sector through the State Electricity Boards ('SEBs')."

[5] Mathavan, 'From Dabhol to Ratnagiri', 389.

commonly criticized for being politicized and operating inefficiently.[6] Starting from the end of the 1980s, however, economic reforms opened up India's energy sector to investors, domestic and foreign, in an attempt to liberalize and privatize the sector.[7] More particularly, a series of laws passed in 1992 aiming at the encouragement of foreign investors to invest in the Indian power generation sector in order to meet growing demand for electricity and to spur economic growth.[8] Reforms included among others de-licensing in some areas of the industry, adoption of full currency convertibility and reduction of trade barriers.[9]

The Indian government's campaign and the legal reforms managed to attract foreign investors. The U.S. energy company Enron became interested in investing in India's energy sector.

At the time Enron proposed the Dabhol project, it was an integrated electricity and natural gas company based in Houston, USA, with approximately US$9 billion in revenues and US$453 million annual net income.[10] Its vision was "*to become the world's leading energy company-creating innovative and efficient energy solutions for growing economies and a better environment worldwide*".[11] Enron representatives visited India in June 1992 to explore power plant development fields and they identified within days a potential site for a gas-fired power plant in Dabhol, a port town in the State of Maharashtra.[12]

Enron, along with General Electric and Bechtel, both American companies (collectively "sponsors"), entered into discussions with the central as well as the state government, and in June 1992 signed a non-binding Memorandum of Understanding with the Maharashtra State Electricity Board (MSEB) which resulted in the formation of a new project company called Dabhol Power Company (DPC).[13] DPC was a special purpose entity incorporated under Indian law to manage and operate the Dabhol Power Project. The sponsors invested in DPC through various subsidiaries including Bechtel Enterprises International (Bermuda) Ltd., Ben Dabhol Holdings, Ltd. (collectively "Bechtel"), Enron Development Corporation and Capital India Power Mauritius I (CIPM I). Enron had the largest interest in the DPC amounting to 80% of

[6] *Ibid.;* Hirani, 'Power', 264.
[7] For an analysis of privatization in the Indian energy sector, see, Mathavan, 'From Dabhol to Ratnagiri'.
[8] *Ibid.*, 390.
[9] V. Kasturi Rangan, Krishna G. Palepu, Ahu Bhasin, Mihir A. Desai and Sarayu Srinivasan, *Enron Development Corporation: The Dabhol Power Project in Maharashtra, India (A)*, Case 596-099 (1996-Revised 1998).
[10] *Ibid.*, 2.
[11] *Ibid.*
[12] Andrew Inkpen, *Enron and the Dabhol Power Company 2* (2002), p. 4.
[13] *Ibid.*, p. 4. See also, *History of Enron's Dabhol Power Plant* (2001) *REUTERS*.
http://www.rediff.com/money/2001/apr/26enron1.htm (04 May 2015) (last visited 11 December 2018).

the shares while Bechtel and General Electric owned 10% each. Relevant agreements laid down that General Electric would supply the gas turbines while Bechtel would serve as the general contractor.[14]

Following the signing of the Memorandum of Understanding and establishment of the project company, Enron received the necessary government approvals in March 1993 and began negotiating the financial structure of the project.[15] The principal asset of the DPC was the Power Purchase Agreement (dated 8 December 1993) entered into with the MSEB, the only purchaser of the electricity to be produced by the project.[16] Pursuant to the Power Purchase Agreement, MSEB would buy 90% of the power generated regardless of market demand for electricity and at a cost above that of other available energy sources.[17] The tariff was calculated in US dollars to shift the devaluation risk from investors to MSEB.[18] In the event of termination of the Power Purchase Agreement, the project including the entire facilities would be transferred by DPC to MSEB in return for a lump-sum payment to be made by MSEB.[19]

The project consisted of two phases. Phase I involved the construction of an approximately 700 megawatt power-generating plant to be either run by fuel oil distillate or naphtha while Phase II was envisaged for a larger gas-fired facility that would have increased the capacity of the project to 2,184 megawatt and converted the whole facilities to use liquefied natural gas.[20] By the time it was planned, the project was to be the largest foreign investment project among several other major energy projects approved by the Indian Government in the 1990s and it was also to be the largest privately-owned electricity generation plant in the world.[21]

The project was financed through the debt finance technique pursuant to which the repayment of borrowed funds primarily depends upon the revenue generated by the project itself.[22] A lenders committee consisting of a large number of banks and export credit agencies that included both India based financial institutions and numerous non-Indian lenders

[14] Inkpen, *Enron and the Dabhol Power Company 2*, p. 4.
[15] *Ibid.*, 4-5.
[16] *Ibid.*, 5.
[17] P. Purkayastha, 'Enron: The Drama Continues' (1995) 30 *Economic and Political Weekly* 2042–4; Kundra, 'Looking Beyond the Dabhol Debacle' at 918.
[18] van Harten, 'TWAIL and the Dabhol Arbitration' at 139.
[19] See, OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 836.
[20] *Ibid.*, 835.
[21] Human Rights Watch, *The Enron Corporation: Corporate Complicity in Human Rights Violations* (1999) available at http://www.hrw.org/reports/1999/enron/ (last visited May 4, 2015); There were seven other power projects established in India around the same time as the Dabhol project. See also, *Private Power Project Scrapped* (1995) 25 *The Ecologist*; *So Many Dabhols* (1995) 30 *Economic and Political Weekly*, p. 2023.
[22] Kundra, 'Looking Beyond the Dabhol Debacle', 909.

contributed approximately US$2 billion to the project for Phases I and II while the sponsors contributed over US$799 million.[23] Since the project was financed mainly through debt, the lenders were the largest shareholders in the project and the project income and assets were the only sources for the repayment of their loans.[24]

As stated before, the Power Purchase Agreement was DPC's principal asset and the success of the project mainly depended on the payments MSEB would make for the electricity generated by the project. In an attempt to hedge the cash flow, DPC entered into a guaranty agreement with the Government of Maharashtra on 20 February 1994, pursuant to which the Government of Maharashtra guarantied MSEB's payment obligations under the Power Purchase Agreement.[25] DPC and the Government of Maharashtra entered also into a State Support Agreement that bound the latter to provide support and assistance in developing the project and protect it from adverse conduct or actions.[26] The State Support Agreement was governed by English Law and provided for the arbitration of disputes in London pursuant to UNCITRAL rules and for waivers of sovereign immunity in connection with any proceedings brought against the Government of Maharashtra or its assets.[27] Furthermore, the Government of India issued a counter-guaranty to DPC on 15 September 1994, whereby it guarantied the payment of "any sum of money validly due" under the Power Purchase Agreement that had not been paid by MSEB or the Government of Maharashtra.[28] The guaranty issued by the Government of Maharashtra covered all amounts that came due under the Power Purchase Agreement while the Government of India Guaranty was subject to various exposure limits.[29] The latter was governed by Indian law but also provided for UNCITRAL arbitration in London and for a waiver of sovereign immunity in connection with any enforcement proceedings brought against the Government of India or its assets.[30]

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[23] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02* (03 September 2003), pp. 4-5. As will be stated later, OPIC was also in the Lenders Committee. It contributed some US$160 million for Phase I and Phase II. Bank of America, whose loan was insured by OPIC against political risks, joined the Lenders Committee to finance Phase II.

[24] *Ibid.*, 5.

[25] *Ibid.*, 6.

[26] *Ibid.* The original State Support Agreement was entered into on June 24, 1994 and was subsequently amended by a Supplemental State Support Agreement dated July 27, 1996. See OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 836.

[27] *Ibid.*

[28] *Ibid.*

[29] *Ibid.*

[30] *Ibid.*

In connection with the financing of Phase II, DPC also entered into an Escrow Agreement with MSEB and a central government-owned Canara Bank on 19 September 1998, pursuant to which MSEB promised to establish escrow accounts for the collection of receivables from MSEB's electricity sales as a form of security for MSEB's payment and performance obligations under the Power Purchase Agreement.[31] The Escrow Agreement provided for UNCITRAL arbitration even though it was governed by Indian Law.[32] Furthermore, to satisfy the request of the offshore lenders for security, Canara Bank issued DPC a letter of credit for up to US$1.36 billion rupees, which was then assigned by DPC as collateral to the onshore trustee.[33] The letter of credit could be drawn on by DPC (or Lenders) in the event MSEB failed to make timely payments.[34]

In addition to these internal measures depending generally on the host state commitment, such as the government guaranty agreements, escrow agreements and letter of credit, project sponsors and the Bank of America that provided a loan for the financing of the second phase of the project turned to their home state -the United States- and asked OPIC to support the project "*as a lender, as an insurer, and as a United States Government development agency*".[35] Subsequently, OPIC agreed to insure their respective investments and Bank of America's loan against political risks. Moreover, OPIC, as a lender, provided US$160 million to DPC for the construction in both Phase I and Phase II. None of these measures, however, helped to protect the intrinsically risky project from failure.

1.2. Project Fragility, Investment Disputes and Settlement Attempts

1.2.1. Project Fragility

The Dabhol project seems to have been born fragile, giving rise to controversies on a range of grounds, such as the process that led to the project, the substance of the deal and the allegedly adverse impacts on society and the environment.[36] It was strongly criticized by academics, trade unions, political opposition parties, non-governmental organizations, and the media.[37] The project was criticized for being initiated with an unusual speed. The Maharashtra State Electricity Board and Enron (along with Bechtel and General Electric) signed the Memorandum

[31] *Ibid.* Escrow Agreement was amended on 27 March 1999.
[32] *Ibid.*
[33] *Ibid.*, 837.
[34] *Ibid.*
[35] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 4.
[36] This part draws mainly on the critical approach to the Dabhol project provided in van Harten, 'TWAIL and the Dabhol Arbitration'.
[37] Human Rights Watch, *The Enron Corporation*.

of Understanding within a few days after Enron's first visit to India to find a possible location for the project and its decision to install the project at Dabhol.[38] The process was also criticized for being secretive since Enron's proposal did not undergo the standard competitive bidding process.[39] Allegations of corruption surrounded the project as soon as the terms of the deal were disclosed.[40] According to the testimony of an Enron official before a U.S. Congressional Committee in 1995, Enron had spent US$20 million on "educational gifts" for the project which were considered by many to contribute bribes.[41]

The substance of the deal was criticized for being one-sided. MSEB promised in the Power Purchase Agreement to buy 90 per cent of the electricity generated by the DPC regardless of market demand and at a cost above that of other available energy sources.[42] The tariff was calculated in U.S. dollars shifting the currency risk to MSEB. The project depended on liquefied natural gas to be imported from Qatar, where Enron had made an investment to develop liquefied natural gas.[43]

Compared to MSEB's liabilities, it was argued that Enron was subject to modest penalties or even rewards for performance failures.[44] A detailed economic analysis of the deal came to the conclusion that the DPC had not undertaken substantial performance guarantees and related penalties constituted only a modest burden on the DPC. Its estimated profitability, i.e. real, post-tax, international rate of return of 28%, was way higher than that prescribed by Indian government consultants, i.e. 17 to 21%.[45] Moreover, viability of the project depended upon MSEB increasing the average tariff at a rate of more than 14.5% per year over a 20-year period.[46] For these reasons, Indian commentators found that the deal was highly unfavorable in terms of the national energy policy and shifted a substantial burden to consumers, taxpayers and other local interests.[47]

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[38] Salacuse, 'Renegotiating International Project Agreements' at 1347; Kirit S. Parikh, 'Thinking through the Enron Issue' (2001) 36 *Economic and Political Weekly* 1463–72 at 1463.
[39] Hirani, 'Power', 267.
[40] *So Many Dabhols* (1995) 30 *Economic and Political Weekly*, p. 2023 at 2024.
[41] Subodh Wagle, 'TNCs as Aid Agencies? Enron and the Dabhol Power Plant' (1996) 26 *The Ecologist* 179–84 at 180; Tony Allison, 'Enron's Eight-Year Power Struggle in India', Asia Times Online, 18 January 2001.
[42] Purkayastha, 'Enron'; Kundra, 'Looking Beyond the Dabhol Debacle', 918.
[43] Salacuse, 'Renegotiating International Project Agreements', 1347.
[44] Girish Sant, Shantanu Dixit and Subodh Wagle, 'Dabhol Project PPA: Structure and Techno-Economic Implications' (1995) 30 *Economic and Political Weekly* 1449–55 at 1455.
[45] *Ibid.*, 1454.
[46] *Ibid.*, 1449.
[47] *Lessons from Dabhol* (2001) 36 *Economic and Political Weekly*, p. 427; Parikh, 'Thinking through the Enron Issue'.

It is worth noting that in 1993, the World Bank, consulted by the government of India, criticized the project for being too big and too expensive.[48] It described the deal as one-sided in favor of Enron.[49] Subsequently, the World Bank declined to finance the Dabhol project on the ground that the project was not economically viable. As concerns financing, U.S. investors received considerable political support from the Clinton Administration. For instance, the U.S. Commerce Secretary, Ron Brown wrote, in October 1994, personally to his Indian counterpart urging 'support in facilitating financial closure' of the project so that it could be celebrated during his next visit to India.[50] Subsequently, DPC loan agreements were signed in January 1995 in the presence of Enron's CEO, Ken Lay; Commerce Secretary, Ron Brown; and representatives from OPIC and the Export-Import Bank of the United States.[51]

As the social and environmental impacts of the project became apparent, public opposition increased. Affected communities protested against land acquisitions and encroachments on fishing and water access.[52] Ecologists reported that the project threatened the livelihood of about 10,000 people, mainly fishers and farmers.[53] Those protests were suppressed by Indian authorities leaving Enron and the U.S. government complicit in human rights violations associated with the project, as reported by Human Rights Watch in 1999.[54]

1.2.2. Cancellation of the Project

Public outcry against the Dabhol power project played a crucial role in the Maharashtra state elections in 1995, which led to the election of a coalition government of two parties (Bharatiya Janata Party and Shiv Sena) that had pledged to cancel the project.[55] Consequently, the new government established a high-level Cabinet Committee, known as "Munde Committee", to review the project.[56] The Munde Committee's report was critical of the terms of the project. It confirmed the irregularities the deal involved, e.g. that the cost of the project

[48] Salacuse, 'Renegotiating International Project Agreements', 1348.
[49] Human Rights Watch, *The Enron Corporation*, at Part II, citing a letter from Joëile Chassard, World Bank Senior Financial Analyst, Energy Operations Division, India Country Department to U. K. Mukhophadhyay, Maharashtra State Secretary for Energy and Environment (July 8, 1992).
[50] David Ivanovich, 'Financing for Indian Plant Secured', The Houston Chronicle, 17 January 1995.
[51] U.S. House of Representatives, *Background on Enron's Dabhol Project* (2002), pp. 1-20. See also, Chadwick, 'The Overseas Private Investment Corporation'*Ibid.*, p. 138.
[52] Human Rights Watch, *The Enron Corporation*, at Part III.
[53] *Private power project scrapped*, vol. 25.
[54] Human Rights Watch, *The Enron Corporation*.
[55] *Ibid.*, Part II.
[56] See, Purkayastha, 'Enron', 2042. Purkayastha argues that decision to review the project instead of canceling it outright earned Enron time to inflate its costs and liabilities in anticipation of litigation (that would arise out of cancellation) from US$100 million to US$300 million, making it more expensive for the government of Maharashtra to cancel the project.

would impose heavy losses on the Maharashtra State Electricity Board; that the 90 per cent purchase mark would lead the Maharashtra State Electricity Board to dismantle its own cheaper power generation plants; and that the tariff being calculated in US dollars and the dependence of the project on imports of diesel/liquefied natural gas would expose the Indian economy to severe balance of payments problems.[57] Following the recommendations of the Munde Committee, the Government of Maharashtra took steps to cancel the project.[58]

1.2.3. Renegotiation

In response to local government's intention to cancel the project, Enron immediately exercised its right to international arbitration under the dispute settlement clause of the Power Purchase Agreement between the DPC and the Maharashtra State Electricity Board and commenced an arbitration proceeding in London while the Indian government entities filed a suit in domestic courts in India to have the Power Purchase Agreement declared void.[59] However, Enron and the government of Maharashtra eventually agreed to end the litigious process and renegotiated the deal in 1995. The terms of the renegotiation were finalized in early 1996.[60] The revised agreement brought about modest changes in the size of the project, payment terms and tariffs, environmental monitoring and ownership of the project.[61] Public opposition to the project, however, continued in India with renewed allegations of corruption.[62]

1.2.4. Project Breakdown

The construction of Phase I of the project was completed in May 1999 and the project began to operate successfully.[63] The completion of Phase II was due to following year.[64] However, by the end of 2000, financial difficulties emerged for MSEB, given that the energy demand had not grown as estimated and the price of power generated by the project was beyond affordable.[65] MSEB failed to make the payments due for power from the project in October 2000 and

[57] *Ibid.*, 2042. Previously, India's Parliamentary Standing Committee on Energy also prepared a report with similar findings about the economics of the Dabhol power project. The report was excerpted in Human Rights Watch, *The Enron Corporation*, at Appendix C.
[58] Kundra, 'Looking Beyond the Dabhol Debacle', 917.
[59] *Ibid.*, 917-8. The arbitration clause in the Power Purchase Agreement provided for the settlement of disputes through arbitration in London under the UNCITRAL Rules. It is reproduced in Kannan Srinivasan, 'Indian Law and the 'Enron Agreement'' (1995) 30 *Economic and Political Weekly* 1153–4 at 1153.
[60] Kundra, 'Looking Beyond the Dabhol Debacle', 918.
[61] Parikh, 'Thinking through the Enron Issue', 1463; Salacuse, 'Renegotiating International Project Agreements', 1352-6.
[62] van Harten, 'TWAIL and the Dabhol Arbitration', 142; Human Rights Watch, *The Enron Corporation*, Part II.
[63] Parikh, 'Thinking through the Enron Issue', 1463.
[64] *Ibid.*, 1463.
[65] Kundra, 'Looking Beyond the Dabhol Debacle', 919.

partially defaulted on four capacity payments between October 2000 and January 2001, which amounted to approximately US$49 million.[66]

Difficulties led the government of Maharashtra to form an Energy Review Committee, known as the Godbole Committee, to review the power situation in the State of Maharashtra in general and specifically to review the Dabhol power project.[67] The committee concluded that the MSEB was "financially incapable of meeting its payment obligation" under the Power Purchase Agreement and proposed a further renegotiation of the project to restructure the tariff (to delink the tariff from the dollar/rupee exchange rate), to restructure the fuel supply arrangements (particularly to separate the facility that uses liquefied natural gas), to cancel the escrow arrangements, to increase the term of the project debt and finally to enhance the financial support from the governments of Maharashtra and India.[68] In addition, the Committee proposed a general reform in the operation of Maharashtra State Electricity Board.[69]

In February 2001, the MSEB ceased its payments to DPC, alleging that the DPC had breached the Power Purchase Agreement by misdeclaring the amount of available capacity for one hour on 28 January 2001 and since there had been capacity shortfalls on at least two occasion (a situation in which the plant was shut down for over twelve hours).[70] Subsequently, DPC requested the government of Maharashtra and the government of India to make the capacity payments pursuant to the guarantee and counter-guarantee they had granted.[71] These requests were not honored by the governments, given that the guarantee conditions allegedly had not been met.[72]

Difficulties in the capacity payments continued in the following months. Eventually, on 7 April 2001, DPC issued to MSEB a notice of "Political" Force Majeure pursuant to the Power Purchase Agreement, citing among others MSEB's failure to make due payments for the power and government of Maharashtra's failure to honor its obligations under the State Support Agreement.[73] A few days later, investors served the MSEB arbitration notices pursuant to the Power Purchase Agreement; the government of Maharashtra pursuant to the Guaranty and the

[66] See, OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 837.
[67] *Ibid.*
[68] *Ibid.*, 838.
[69] *Ibid.*
[70] *Ibid.*
[71] *Ibid.*
[72] *Ibid.*
[73] *Ibid.*, 838-9.

State Support Agreements; and the government of India pursuant to the Counter-Guaranty Agreement.

Enron went bankrupt in December 2001. With the financial assistance of OPIC, Bechtel and General Electric bought the shares owned by Enron and took up control of DPC.[74] Subsequently, Bechtel and General Electric pursued a wide range of international legal claims against the government of India, the government of Maharashtra and related government entities in order to recover their losses.[75] In addition to the arbitration claims based on project agreements, investors reportedly initiated arbitration based on the dispute resolution clauses in relevant bilateral investment treaties to which India was a party.[76] Moreover, they filed an insurance claim with OPIC, asserting that the acts of the Indian government and government entities were expropriatory and that the consequent losses were covered by the insurance policy from OPIC. OPIC eventually paid the maximum amount of compensation payable to investors under the insurance policy.[77]

Apart from one claim that Bechtel and General Electric had initiated before an ICC arbitral tribunal in September 2003, all other claims before arbitral tribunals were later withdrawn (as the parties reached an overarching settlement in summer of 2005). The ICC arbitration proceeding had been initiated against the Maharashtra Power Development Corporation Limited, the Government of Maharashtra and MSEB based on the arbitration clause in the DPC Shareholders Agreement.[78] The tribunal decided in favor of the claimant and ordered the Government of Maharashtra to pay damages up to US$95 million to compensate Bechtel's equity investment in the project.[79] In September 2003, Bechtel and General Electric filed claims

[74] This transaction is known as "Enron Lite". See for more information, Kenneth Hansen, Robert C. O'Sullivan and W. Geoffrey Anderson, 'The Dabhol Power Project Settlement: What Happened? And How?' (2005) 3 *Infrastructure Journal* 1–6 at 3.

[75] The only award that is publicly available was brought by a Bechtel subsidiary under a contract with the respondent, see *Capital India Power Mauritius I and Energy Enterprises (Mauritius) Company v. Maharashtra Power Development Corporation Limited, Maharashtra State Electricity Board and the State of Maharashtra,* ICC Case No. 12913/MS, available at https://www.italaw.com/other-investment-cases (last visited 11 December 2018).

[76] John J. Kerr and Janet Whittaker, 'Dabhol Dispute: Legal Questions Remain Unresolved' (2006) 1 *Construction Law International* 17–20; Ronald J. Bettauer, 'India and International Arbitration: The Dabhol Experience' (2009-2010) 41 *George Washington International Law Review* 381–7.

[77] The insurance claim is covered in the next section.

[78] General Electric withdrew its claim soon after the initiation of the arbitration proceedings. See, CIPM I and Energy Enterprises (Mauritius) Company v. The State of Maharashtra, ICC International Court of Arbitration, Final Award, 21 April 2005. For an analysis of the ICC arbitral decision from the perspective of the TWAIL (Third World Approaches to International Law) see van Harten, 'TWAIL and the Dabhol Arbitration'.

[79] CIPM I and Energy Enterprises (Mauritius) Company v. The State of Maharashtra, ICC International Court of Arbitration, Final Award, 21 April 2005. It is clear in the ICC Award that the compensation the investors received from OPIC was not handled in the calculation of loss. However, whether this could have been used as

also under the Mauritius-India bilateral investment treaty for their interests in the DPC that amounted to 20% of the shares. In 2004, they filed claims under the Netherlands-India bilateral investment treaty, this time claiming for the shares transferred from Enron. Ultimately, in summer 2005, the Government of India and the investors as well as lenders of the project reached a comprehensive deal for the settlement of the remaining investment disputes, pursuant to which General Electric and Bechtel sold their eight-five per cent stake to MSEB, and DPC was replaced by the Ratnagiri Gas and Power Private Limited.[80]

II. Investor-Home State Relationship

2.1. Issuance of Foreign Investment Insurance

2.1.1. Enron, Bechtel and General Electric

When Enron Corporation, Bechtel Enterprises Holdings, Inc. and General Electric Capital Corporation (collectively "sponsors") asked OPIC to support the Dabhol Power Project in the early 1990s, the OPIC management conducted an analysis of the benefits and risks associated with the project and set forth the analysis in a memorandum to the OPIC board of directors.[81] The main issues addressed in the memorandum were the eligibility of the project for coverage by the US investment insurance program and the treatment of foreign investments and investors by the government of India. The management concluded that the project would be substantially beneficial both for the USA and India and considered the project consistent with OPIC's mission to facilitate the participation of the U.S. private sector in the economic development of less developed countries.[82] The memorandum also noted that the government of India has never defaulted on its foreign debt or rescheduled it and that the attraction of foreign investment is crucial to the Indian government's economic reform program.[83] Subsequently, in the summer of 1994, the OPIC board of directors approved the issuance of investment insurance and decided to also provide financing for the project.[84]

The insurance contract constitutes the legal relationship between OPIC and the investor concerning investment insurance. OPIC and its predecessors have carried out the U.S. foreign investment insurance program on the basis of standardized contracts.[85] OPIC has developed a principal standard contract as well as customized standard insurance contracts to accommodate

a defense by the defendant state is not clear as the defendant state declined to participate in the proceedings and the Investment Incentive Agreement does not provide for a provision.

[80] Mathavan, 'From Dabhol to Ratnagiri', 395.

[81] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, 8.

[82] *Ibid.*

[83] *Ibid.*, 9.

[84] *Ibid.*

[85] Koven, 'Expropriation and the "Jurisprudence" of OPIC', 274.

different types of investments and projects, such as contract forms for coverage of loans, leases of oil or extraction projects.[86] The principal contract form OPIC currently uses is the contract form 234 KGT 12-85 (Revised).[87] The standard contracts consist of general terms and conditions and special terms and conditions to accommodate the particular investor, investment and project.[88] While the standard provisions are generally used, OPIC is flexible to tailor the contract according to particularities of the projects or pursuant to negotiations with the policy holders.[89]

The insurance contract concluded by OPIC with the sponsors of the Dabhol Power Project was based on the principal standard policy form. In August 1994, OPIC issued a "Commitment Letter" with which it pledged coverage against political risks for a six-month period up to US$200 million in return for the sponsors' payment of a US$200,000 commitment fee. [90] A copy of the standard OPIC policy covering the risks of expropriation, political violence and currency inconvertibility was attached to the Commitment Letter.[91] Following the six-month period, substantive policy negotiations started in late spring 1995.[92] Among the issues negotiated between OPIC and the sponsors was the sponsors' request for a revision of the clause relating to the exclusion of acts taken by the host country government in its capacity as a commercial actor from the coverage because the sole purchaser of power to be generated was the Maharashtra State Electricity Board, a government owned entity and its obligations were guaranteed by the government of Maharashtra and the government of India.[93] Furthermore, OPIC's potential liability arising out of governmental interference (Munde Committee's report) experienced just after the construction of the project began in March 1995 was among the issues that were negotiated.[94] Finally, the request by Bechtel for insurance coverage for "loss of business income" resulting from political violence in addition to the coverage of expropriation, political violence and currency inconvertibility risks in the standard policy was met after negotiations.[95]

[86] Lipman, 'Overseas Private Investment Corporation', 347; Zylberglait, 'OPIC's Investment Insurance', 367-9.
[87] *OPIC Contract of Insurance - Form 234 KGT 12-85 SBC NS (Rev. 9/05)*.
[88] Lipman, 'Overseas Private Investment Corporation', 347.
[89] Koven, 'Expropriation and the "Jurisprudence" of OPIC', 274.
[90] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 9.
[91] *Ibid.*
[92] *Ibid.*, 9-10.
[93] *Ibid.*, 10.
[94] *Ibid.*, 10-1.
[95] *Ibid.*

On 12 July 1995, OPIC sent the proposed revisions to sponsors. These revisions included a carve-out for expropriatory acts taken by the government of Maharashtra to fulfill the recommendations of the Munde Committee and an exception to the exclusion of government acts that were politically, rather than commercially motivated. The draft revisions also included several other provisions, such as §10.05 and §10.07 relating to the duties of the policy holders to be entitled to receive compensation.[96] The insurance contracts were finalized in the following days.[97] The revised policies gave rise to disputes between OPIC and the policy holders when the policy holders filed an expropriation claim with OPIC in the following years.

2.1.2. Bank of America

The first phase of the Dabhol Power Project was completed in May 1999. Meanwhile sponsors secured financing for the second phase of the project and its construction commenced subsequently.[98] The Bank of America Trust, an American financial institution, extended a loan as part of the financing in the second phase of the Dabhol Power Project.[99] On 29 April 1999, OPIC concluded an insurance contract to cover Bank of America Trust's losses in connection with the loan as a result of political risks including expropriation as defined in the contract.[100] On 21 March 2002, the bankruptcy of DPC and the Bombay High Court's appointment of a receiver resulted in an automatic acceleration of the outstanding principal amount of Bank of America Trust's loan.[101] Bank of America Trust also filed an expropriation claim with OPIC, asserting that it experienced losses due to the expropriatory acts of the Indian government and governmental authorities.

2.2. U.S. Diplomatic Intervention in Investment Disputes

The obligations that the policy holder has to fulfill in order to be entitled to receive compensation are mostly -but not exclusively- included in Article IX in the OPIC standard form insurance contract. Article IX (9.01) (8), in particular, lays down the warranty to give notice to OPIC of the potential insurance claims:

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[96] *Ibid.*, 11.
[97] *Ibid.*, 12.
[98] Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, 835. See also, Enron Corporation, 'Financing Complete, Construction Commences on Second Phase of Dabhol Power Project', Press Release (6 May 1999).
[99] *Foreign Assistance Act of 1961*, as amended, Section 234 (a) authorizes OPIC to provide foreign investment insurance to eligible investors without distinguishing between equity and debt investment.
[100] The insurance contract was executed by OPIC on 29 April 1999 being effective as of 6 May 1999 and was amended on 26 September 2000. See, OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 835.
[101] *Ibid.*, 836.

"*8. Compulsory Notice. The Investor shall notify OPIC promptly if it has reason to believe that the Investor or the foreign enterprise will not be able to convert or transfer local currency during the waiting period (Article II). The Investor shall notify OPIC promptly of any acts or threats to act in a manner which may come within the scope of the expropriation or political violence coverage (Articles IV and VI) and shall keep OPIC informed as to all relevant developments.*"

When OPIC receives a notification of a dispute between the policy holder and the entities of the host country government, it consults with the policy holder and may communicate with the host country government in an attempt to resolve the dispute and avert the materialization of the insurance claim.[102] OPIC may also turn to the US government for the diplomatic protection of its interests. Among the contributions to a successful advocacy campaign, there are not only the international investment treaties providing investment protection standards and project agreements creating rights and enforceable remedies for investors, but also various diplomatic "pressure points", such as the visit of a head of state to the host country, the periodic meetings of a joint economic commission or the occasion to challenge a country's eligibility for trade or investment benefits or economic assistance.[103]

The Dabhol Power Project exemplifies the advocacy of OPIC and further diplomatic protection provided by the U.S. Government as it was a highly controversial project that culminated in complicated investment disputes both in 1995 following the Munde Committee Report and in 2001 when MSEB rescinded the Power Purchase Agreement.[104] U.S. Government officials intervened several times following the difficulties in 1995 and in 2001. In July 2001, the U.S. National Security Council convened a "Dabhol working group" with various officials including the representative of OPIC for the organization of such intervention in the Dabhol investment disputes.[105] These efforts continued into the fall of 2001.[106] In July of the same year, an assistant secretary of State Christina B. Rocca, met with Indian officials to discuss the

[102] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement', 5.
[103] *Ibid.*
[104] There is ample literature on the disputes surrounding the Dabhol Power Project. See, supra note 1. See also, OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, p. 834; Capital India Power Mauritius I v Maharashtra Power Dev. Corp. Ltd., ICC Award No. 12912/MS (2004); Request for Arbitration Under the Investment Incentive Agreement between the Government of the United States of America and the Government of India 19 November 1997, 4 November 2004.
[105] *Accounting for Enron: U.S. Fought for Company's Project in India* (2002) *Wall Street Journal*; *White House Aided Enron in Dispute: Cheney, Others Intervened over Indian Power Plant* (2002) *Washington Post*.
[106] Minority Staff of House Committee on Government Reform, *Fact Sheet: Background on Enron's Dabhol Power Project* (107th Congress, 2002).

Dabhol controversy. In October 2001, the Undersecretary of State for Economic, Business and Agricultural Affairs, Alan Larson, raised the investors' concerns with the Indian foreign minister and the Indian national security advisor.[107] In November 2001, the President of OPIC, Robert Watson, sent a message to the Indian Prime Minister emphasizing the importance of the Dabhol issue to the U.S. Government[108]:

"*The acute lack of progress in this matter has forced Dabhol to rise to the highest levels of the United States government. … I ask that you give this matter serious and immediate attention*."

2.3. Insurance Claims

Notwithstanding the attempts of OPIC to facilitate the resolution of an investment dispute, policy holders may be exposed to damage or loss due to host country government acts or omissions covered by the insurance contract. In such case, policy holders may file an insurance claim with OPIC to receive due compensation. Article VIII (8.01) sets out the warranties to be fulfilled by the policy holder in order to apply for compensation:

"*8.01 Application for Compensation.*

An application for compensation shall demonstrate the Investor's right to compensation in the amount claimed. The Investor shall provide such additional information as OPIC may reasonably require to evaluate the application. The Investor may amend or withdraw an application for compensation at any time, but the right to recover compensation will be lost for any acts covered by a withdrawn application. …"

Bechtel and CIPM I filed expropriation claims with OPIC and applied for compensation on December 17, 2001 and December 10, 2001, respectively.[109]

When the policy holder files an insurance claim with OPIC, OPIC assesses whether the alleged risk event is covered by the policy.[110] OPIC may decide to pay the complete or a partial amount of the claimed compensation to the investor or it may reject to pay altogether. The amount of compensation is to cover the damage or loss suffered by the investor according to the insurer's analysis.[111] Sometimes, OPIC may make a pre-decision to pay out the investor;

[107] *Chronology of Administration Dealings with Enron's Dabhol Power Plant in India* (2002) *Washington Post*.
[108] Minority Staff of House Committee on Government Reform, *Fact Sheet*.
[109] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 21.
[110] Robert C. O'Sullivan, 'Learning from OPIC's Experience with Claims and Arbitration', in T. Moran and G. T. West (eds.), *International Political Risk Management: Looking to the Future* (Washington, DC: World Bank, 2005), p. 43.
[111] Ocran, 'International Investment Guarantee Agreements'.

however, the payment might be suspended, or the pre-decision may be modified in light of the further evidence.[112]

OPIC reaches an insurance claim determination independently, i.e. without the involvement of the host state. An exception to this procedure was included in the 1974 Investment Guarantee Agreement between the United States and Nigeria which required the United States (OPIC) to notify and consult Nigeria before making any payment to any investor under an insurance policy.[113] This notification and consultation procedure was interpreted by some scholars as giving the Nigerian state the first option to purchase the investor's assets at a mutually negotiated price.[114] However, the consultation process could also have been used by Nigeria to contribute to OPIC's determination of the scope of protection.

The extent of insurance coverage against political risks is directly determined in the insurance contracts between OPIC and the insured investors. However, the clauses that frame the individual political risk coverage in an insurance contract do not stand alone. The other clauses that impose obligations and duties on the insured party are equally important to determine whether an investor is being compensated for losses. Additionally, insurance contracts generally contain exclusions and exceptions which may be used as a defense by investment insurers (i.e. which limit the coverage). Also, the settlement of insurer-insured disputes through (commercial) arbitration influences the extent of political risk coverages.

Disputes between policy holders and OPIC arise more often than not from disagreement on the extent of coverage.[115] Denial of an insurance claim most likely gives rise to a dispute between the parties to the insurance contract. Furthermore, the manner in which OPIC handles a claim or alleged delay in reaching a determination may give rise to disputes between policy holders and OPIC.[116] For instance, with respect to the Dabhol Power Project, investors initiated arbitration proceedings against OPIC before OPIC reached even a preliminary determination[117] on the ground of OPIC's delay in reaching a determination.[118]

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[112] *Ibid.*

[113] *Investment Guarantee Agreement, August 3, 1974, United States-Nigeria*, art. 3, 26 U.S.T. 102, 103, T.I.A.S. No. 8012.

[114] Ocran, 'International Investment Guarantee Agreements', 368.

[115] O'Sullivan, *Learning from OPIC's Experience*, p. 45. Other than an arbitration case filed against OPIC over termination of an insurance contract, which was then settled through negotiation.

[116] *Ibid.*

[117] *Ibid.*

[118] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, pp. 22-3.

Article VIII of the OPIC standard contract provides *inter alia* for the dispute settlement procedures. According to this article, disputes between OPIC and the policy holders that arise out of the insurance contracts are to be settled through arbitration[119]:

"*8.05 Arbitration.*

Except as provided in §7.05, "Appraisal", any controversy or claim arising out of or relating to this contract shall be determined by arbitration in Washington, D.C. according to the then prevailing International Arbitration Rules of the American Arbitration Association. The number of arbitrators shall be three. Unless the Investor initiates arbitration, OPIC's liability shall expire one year after OPIC notifies the Investor of its final determination concerning an application for compensation. A decision by the arbitrators shall be final and binding, and any court having jurisdiction may enter judgment on it."

Bechtel and CIMP I initiated arbitration proceedings according to the rules of the American Arbitration Association ("AAA") on 9 October 2002 and 3 October 2002, respectively. On 3 September 2003, the tribunal announced its decision on the payment of compensation by OPIC to the policy holders up to the maximum amount under their insurance contract as well as due interest. The tribunal decided on two issues; whether the policy holders complied with §10.05 and §10.07 and whether their loss, which they claim they incurred due to the expropriatory acts of the Indian Government, was otherwise covered by the insurance contracts.

OPIC interpreted §10.05 and §10.07 in the insurance contracts that set forth the procedures that Bechtel and CIPM I had to follow in order to be protected by the contracts' expropriation coverage. These sections were identical, the former concerned the policy issued to CIMP I and the latter the policy issued to Bechtel.[120] They provided that the policy holders had to exhaust available remedies including international arbitration. OPIC's internal memoranda indicated that §10.05 and §10.07 were designed to ensure that no compensation would be payable under expropriation coverage unless DPC had exhausted its available remedies under the project agreements and BITs.[121] As a result, OPIC alleged that the language of these sections indicated

[119] *OPIC Contract of Insurance - Form 234 KGT 12-85 SBC NS (Rev. 9/05)*, art. 7.05 as mentioned in Article 8.05 provides the appointment of an impartial appraiser in the event of a disagreement concerning the amount of the compensation the insurance holder is entitled to receive.
[120] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 11.
[121] *Ibid.*, 11-2.

that it only undertook coverage of the risk of non-payment of an arbitral award confirmed by an Indian court of last resort.[122]

In the first arbitration proceeding between OPIC's predecessor USAID and an insured investor, the tribunal stated that it was bound to resolve the dispute pursuant to the terms of the insurance policy, even though a foreign government's acts had given rise to the dispute.[123] Despite the fact that the parties to the dispute, USAID and the insured investor, referred to international law, the law of the host state and the US constitutional law, the tribunal reached a determination on the basis of the insurance contract.[124] Ever since, the insurance policy has been the source of rules of law applicable to the disputes between OPIC and the insured investors. The basic legal order governing the OPIC standard insurance contract is the law the parties agree on -generally either the law of the State of New York or the law of the State of Washington, D.C. Article 8.08 in the standard form contract of OPIC provides that the contract shall be governed by the law of the State of New York:

"8.08 *This contract shall be governed by and construed and enforced in accordance with the law of the State of New York as if all parties were residents of that state. This contract constitutes the entire agreement and understanding between the parties with respect to the subject matter hereof, superseding any prior understandings relating thereto. This contract may be modified or its terms waived only in writing.*"

The tribunal resolved the issue concerning compliance with §10.05 and §10.07 according to Section 206 of the Restatement (Second) of Contracts[125] and Section 83.27 of Couch on Insurance[126] which provide that in the event of uncertainty or ambiguity about a particular term

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[122] OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 869. Similar limitation of coverage was adopted also when OPIC programs began operating in China in 1982. The pervasive involvement of Chines Government and Chinese Government entities in almost all areas of Chinese economy and the lack of a commercial legal framework led OPIC to adopt particular underwriting guidelines designed for China which were somewhat "less stringent" than those applicable to projects elsewhere. As to the expropriation coverage, for example, OPIC reduced the coverage to non-honoring the dispute resolution procedure the parties had agreed for. See, Anthony F. Marra, 'OPIC Programs in China and Problems Faced by Investors' (1985-1986) 3 *China Law Reporter* 170–4 at 170-2.

[123] See, *Valentine Petroleum & Chemical Corporation-U.S. Agency for International Development: Arbitration of Dispute Involving U.S. Investment Guaranty Program* (1970) 9 *ILM*, pp. 889–920, p. 896.

[124] *Ibid.*, p. 895-6.

[125] Restatement (Second) of Contracts as adopted and promulgated by the American Law Institute at Washington, D.C. (17 May 1979), section 206 "Interpretation Against the Draftsman. *In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds*.", available at http://www.nylitigationfirm.com/files/restat.pdf (last visited 11 December 2018).

[126] Steven Plitt, J. D. Rogers, Daniel Maldonado, Lee R. Russ and Thomas F. Segalla, *Couch on Insurance* (Mason, OH: West Thomson, 1995).

in the insurance contract, the term is generally interpreted and construed against the drafting party.[127] In this case, the tribunal stated that the evidence indicated that what the parties to the insurance contract understood the foregoing sections to mean was far from clearand the insertion of these sections in the insurance contracts was not discussed by the parties in any meaningful fashion.[128]

Furthermore, the tribunal decided that the Indian courts made it impracticable for the policy holders to comply with §10.05 and §10.07 through injunctions that prevented the DPC from pursuing arbitration against MSEB under the power purchase agreement. In fact, in May 2001, the Maharashtra Electricity Regulatory Commission ("MERC") issued an order on the demand of the MSEB enjoining the DPC from exercising its right to seek redress through international arbitration and the Bombay High Court and the Indian Supreme Court subsequently upheld the injunction.[129] The evidence suggested to the tribunal that neither party could anticipate that the Indian courts would issue these injunctions as there was no precedent for Indian courts granting such injunctions. The tribunal applied section 261 of the Restatement (Second) of Contract, which provides that where a party's performance is made impracticable by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was based, the duty on that party to render the said performance is discharged.[130] Hence, it concluded that the policy holders were discharged of their obligation to comply with the provisions §10.05 and §10.07.[131]

According to the provisions on expropriation in the insurance contracts at hand, compensation was payable for total expropriation, if (1) the acts are attributable to a foreign governing authority which is in de facto control of the part of the country in which the project is located; (2) the acts are violations of international law without regard to the availability of local remedies or material breach of local law; (3) the acts directly deprive the Investor of fundamental rights in the insured investment (rights are "fundamental" if without them the Investor is substantially deprived of the benefits of the investment); and (4) the violations of law are not remedied and the expropriatory effect continues for six months.[132]

[127] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 27.
[128] *Ibid.*
[129] *Ibid.*, 17.
[130] *Ibid.*, 28.
[131] *Ibid.*, 30.
[132] *Ibid.*, 24-5.

The tribunal concluded that the acts of the foreign governing authorities including the government of India, the government of Maharashtra, the MERC, the MSEB, the Indian courts and the India-based financial institutions who acted as lenders deprived the investors of their fundamental rights in the insured investment.[133] Evidence was clear, according to the tribunal, that MSEB stopped paying DPC for the electricity and purported to "rescind" the power purchase agreement for political reasons.[134] Subsequently, the government of Maharashtra and the central government refused to honor the guarantees they had granted soon after the construction started.[135] MERC and the Indian courts enjoined investors from exercising their right to pursue international arbitration under the power purchase agreement.[136] India-based financial institutions as lenders to the project (as well as OPIC as a lender) did not approve of the termination of the power purchase agreement by the investors, which would have established a "transfer amount" MSEB would have been responsible to pay to the investors in return for the transfer of the project.[137] The tribunal found that these acts of the various governing authorities were motivated by political reasons, that no legal justification was provided and that they violated established principles of international law.[138]

Based upon the foregoing conclusions, the tribunal decided that the investors' losses were covered by the insurance contracts and ordered OPIC to pay US$28,570,000 to Bechtel and CIPM I each.

The determination of OPIC concerning the expropriation claim of the Bank of America differs from the AAA tribunal's decision with respect to Bechtel's and GE's expropriation claims although OPIC decided also that the Bank of America's rights were expropriated through the acts of various Indian Government entities.[139] Bank of America filed a notice of claim with OPIC on 22 March 2002 under the expropriation coverage asserting that the DPC had defaulted on the loan the Bank of America had extended for the second phase of the project by way of various governmental entity acts including the government of Maharashtra's alleged breach of the State Support Agreements, MSEB's alleged repudiation of the Power Purchase Agreement, the alleged interference with DPC's arbitration rights and the alleged obstruction of lenders'

[133] *Ibid.*, 24-5.
[134] *Ibid.*, 25.
[135] *Ibid.*
[136] *Ibid.*
[137] *Ibid.*, 25.
[138] *Ibid.*, 24-5.
[139] Kundra, 'Looking Beyond the Dabhol Debacle', 926.

security arrangements.[140] OPIC determined that MSEB's acts that resulted in the repudiation of the power purchase agreement were commercial in nature. As a result, MSEB's refusal to purchase electricity from the DPC was excluded from the coverage by OPIC while the tribunal had found that it was covered by the Bechtel and General Electric policies.[141] Yet, OPIC concluded that the governmental interference with DPC's arbitration rights and the obstruction of certain arrangements under an escrow agreement were violations of international law and caused DPC to default on a number of scheduled payments. Consequently, on 30 September 2003, OPIC paid to the Bank of America under the expropriation coverage the amount of the loan which had become due with interest.

2.4. Subrogation

An important issue that follows the payment of compensation is the assignment of the insurance holders' investment related interests to OPIC. Generally speaking, OPIC subrogates the rights and claims of the insurance holders once it compensates the insurance holders for their loss. The OPIC standard insurance contract includes distinct terms for different risk types. This section addresses the subrogation provisions pertaining to the expropriation coverage in relation to the expropriation insurance claims that arose from the Dabhol Power Project.

OPIC offers two types of expropriation coverage: total expropriation[142] where the insured investment is expropriated by the host state and expropriation of funds[143] where a return of or earning on the insured investment is subject to taking. The insurance holder shall assign to OPIC, concurrent with the payment of compensation, all interests attributable to the investment in case of total expropriation and funds in case of expropriation of funds, including the claims arising from the expropriation. Article 8.02 in the OPIC standard contract[144] provides for subrogation in the following terms:

"*Within sixty days after OPIC notifies the Investor of the amount of compensation OPIC will pay under expropriation or political violence coverage, and concurrent with payment, the Investor shall transfer to OPIC (a) for expropriation, all interests attributable to the insured*

[140] OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 834.
[141] Section 4.02(b) of the insurance contract between Bank of America and OPIC, as amended by Section 10.05, expressly excluded from coverage any expropriatory action taken by a foreign governing authority in its capacity or through its powers as a purchaser from DPC or as a guarantor of any payment obligation to DPC. See *Ibid.*, 843.
[142] *OPIC Contract of Insurance - Form 234 KGT 12-85 SBC NS (Rev. 9/05)*, art. 4.01.
[143] *Ibid.*, art. 4.02.
[144] *Ibid.*, art. 8.02.

investment (§4.01) or funds (§4.02) as of the date the expropriatory effect commences, including claims arising out of the expropriation…"

Insurance holders assign interests to OPIC only at OPIC's request.[145] While the insurance holders are obligated to transfer all interests in case of total expropriation, and funds in case of expropriation of funds, OPIC may decline all or any portion of these interests.[146] Even when OPIC declines the assignment, insurance holders are still entitled to receive compensation from OPIC for the loss covered by the policy. However, if, in the event of expropriation, there is property remaining under the control of insurance holders, the book value of this property is deducted from the compensation payable by OPIC. OPIC may require the transfer of the remaining portion of property if it agrees to compensate the investor for that portion of the investment as well. In other terms, if the expropriatory acts of the host government have culminated in taking of a portion of the investment and left the investor with some property rights, unless OPIC requires the investor to assign all interests to itself, it compensates the investor only for the expropriated property. This is laid down in article 5.03.4(b) in the OPIC standard insurance contract:

"OPIC may reduce compensation by the amount of

(b) the book value of commercially viable property which remains subject to the Investor's effective disposition and control after the expropriatory effect commences (unless OPIC requires the Investor to assign the property (§8.02))"

Insurance holders have the duty to take measures for the protection of their interests both prior to and after the assignment and they are also responsible to ensure that their interests can be assigned to OPIC freely.[147] OPIC shall pay no compensation if the insurance holders forfeited their interests in the insured investment.[148] Thus, in order to be entitled to receive compensation, the insurance holder must have an interest –right and/or claim- to assign for OPIC to recover the compensation it paid to the insurance holder. Insurance holders shall notify OPIC of the potential disputes and consult with OPIC on measures to preserve the property. In order to protect their interests prior to assignment, insurance holders have the warranty to take all reasonable measures –in consultation with OPIC- including administrative and judicial remedies and negotiation in good faith with the host state; and they have the warranty to assist

[145] *Ibid.*, art. 9.01.9.
[146] *Ibid.*, art. 8.02.
[147] *Ibid.*, art. 9.01.4(b).
[148] *Ibid.*, art. 9.01.4(b)

OPIC in the protection of interests and in prosecuting claims after the assignment occurs.[149] Insurance holders' procedural rights are subrogated by OPIC. However, insurance holders may use these rights only in consultation with OPIC –even before the assignment of interests. In other terms, submission of an insurance claim does not create a fork-in-the-road situation for the insurance holders even when they are compensated by OPIC. If any other source for the compensation of insurance holders' loss appears, they may agree to receive it with OPIC's consent.[150]

It is also important to note that the subrogation principle allows the insurer to substitute the indemnified policy holder's rights *pro tanto*. After the assignment of interests, OPIC has no obligation toward the insurance holders with respect to the interests assigned. OPIC has the full discretion in the manner it deems appropriate to deal with these rights and claims. If, however, OPIC gets reimbursed in excess of the compensation paid to the insurance holder after the related expenses OPIC made for recovery and interests, it has the duty to return the excess value to the investor.[151]

As for the Dabhol Power Project, it is important to turn to the AAA arbitral award in order to understand the subrogation that subsequently took place. The arbitrators decided that a total expropriation took place since the Indian government authorities ceased paying for the electricity generated by the project and then neither Government of Maharashtra nor Government of India honored the guaranties they had granted.[152] As a result, the insurance holders, Bechtel and General Electric, were deprived of their fundamental rights[153] while their shares in DPC were not formally expropriated. OPIC compensated the insurance holders, as ordered by the AAA tribunal, for the losses they were exposed to. As for the Bank of America's expropriation claim, OPIC decided that the insurance holder was entitled to receive compensation for expropriation.[154]

Enron filed an expropriation claim with OPIC as well.[155] However, Enron's bankruptcy in December 2001 complicated the already thorny workout process. This led OPIC to structure a workout process that included the buy-out of Enron interests in the project. In an internal

[149] *Ibid.*, art. 9.01.9
[150] *Ibid.*, art. 9.01.10
[151] *Ibid.*, art. 8.04
[152] *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 17 and 24.
[153] *Ibid.*, 21.
[154] OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 835.
[155] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement', 2.

meeting at OPIC in summer of 2002, OPIC proposed to return the insurance premiums that amounted roughly to US$16 million and were paid over the years by Enron to OPIC as well as to buy out the shares of Enron in DPC for a minimal value ascribed by the Enron's creditors' committee.[156] The proposal was that Enron would turn over its interests to OPIC or its designee.[157] Bechtel and General Electric, although they were reluctant to receive the shares of Enron initially, agreed later to be OPIC's designee.[158] However, the transfer of shares to Bechtel and General Electric was subject to the guaranty granted by the government of India, pursuant to which Enron's shares should not be less than 26 per cent.[159] This led OPIC to structure the buy-out in two phases which is now known as "Enron Lite".[160] In the first phase, Enron's shares would be reduced to the required 26 per cent which would enable Bechtel and General Electric to control DPC and to continue enforcement of DPC's claims against the Indian government, government authorities and other defendants.[161] Enron would be compensated fully in the first phase and would transfer the remaining shares after the government of India gave its consent or when the other parties would decide to go forward without the consent of Indian government.[162]

Bechtel and General Electric maintained their shares in the DPC until they were bought out by the Government of India in summer 2005. These shares constituted commercially viable property under the control and disposition of insurance holders. Pursuant to Article 5.03.4(b) in the OPIC standard insurance contract, unless OPIC requires the insurance holders to assign such property to OPIC, the value of these interests could be deducted from the compensation OPIC would pay to cover total expropriation.[163] The insurance holders were not asked to assign these shares to OPIC in return for compensation. OPIC paid for the loss described in the AAA arbitral award and subrogated the claim the insurance holders had against the government of India and subsequently demanded reimbursement from the government of India. OPIC's recovery process is covered in the following section.

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[156] *Ibid.*, 2.
[157] *Ibid.*, 2.
[158] *Ibid.*, 2-3.
[159] *Ibid.*, 3
[160] *Ibid.*
[161] *Ibid.*
[162] *Ibid.*
[163] *OPIC Contract of Insurance - Form 234 KGT 12-85 SBC NS (Rev. 9/05)*, Art. 5.03.4(b) "Other Compensation and Retained Property. *OPIC may reduce compensation by the amount of … (b) the book value of commercially viable property which remains subject to the Investor's effective disposition and control after the expropriatory effect commences (unless OPIC requires the Investor to assign the property (§8.02)) …"*

III. Home State-Host State Relationship

3.1. Bilateral Investment Insurance Agreements and Subrogation

The U.S. foreign investment insurance program operates on the basis of bilateral investment insurance agreements with the prospective host states.[164] Section 237 of the Foreign Assistance Act of 1961, as amended,[165] requires the conclusion of agreements with the host states:

"*Sec. 237. General Provisions Relating to Insurance Guaranty, and Financing Program.*
(a) Insurance guaranties, and reinsurance issued under this title shall cover investment made in connection with projects in any less developed friendly country or area with the government to which the President of the United States has agreed to institute a program for insurance, guaranties, or reinsurance."

When the OPIC Board of Directors approved the issuance of investment insurance in June 1994 for the Dabhol Power Project, the investment insurance agreement that was in force was the Agreement between the United States of America and India Relating to the Guaranty of Private Investments, which was dated 19 September 1957.[166] The 1957 Agreement was supplemented by an exchange of notes signed in Washington on 7 December 1959 and in New Delhi on 2 February 1966 after the U.S. Government extended the coverage of foreign investment insurance to include the risk of expropriation.[167] This agreement was replaced by the Investment Incentive Agreement of 19 November 1997,[168] which provides the desire of the parties for the economic development in India through the support of the US agency OPIC in the form of foreign investment insurance, debt and equity investments and investment guaranties:

"*The Government of the United States of America and the Government of India;*

[164] Bilateral investment insurance agreements are covered more extensively in the previous chapter. These agreements may be flexibly drafted, even though most of them contain standardized provisions. For a model agreement, see Robert C. O'Sullivan, 'Model OPIC Investment Incentive Agreement' (1994) 1 *Basic Documents of International Economic Law* 665. See also, Ocran, 'International Investment Guarantee Agreements'; Jon H. Moll, 'Intergovernmental Agreements under the U.S. Investment Guaranty Programs' (1968) 43 *Indiana Law Journal* 429–61.
[165] *Foreign Assistance Act of 1961*, as amended.
[166] Exchange of Notes Constituting an Agreement between the United States of America and India Relating to the Guaranty of Private Investments, Washington, 19 September 1957 (1958) 290 U.N.T.S. at 176.
[167] Exchange of Notes Constituting an Agreement Supplementing the Above-Mentioned Agreement, Washington, 7 December 1959 (1960) 361 U.N.T.S., p. 366 and (1967) 603 U.N.T.S. at 318.
[168] Investment Incentive Agreement between the Government of the United States of America and the Government of India, New Delhi, signed on 19 November 1997, entered into force on 16 April 1998.

Affirming their common desire to encourage economic activities in India that promote the development of economic resources and productive capacities of India; and

Recognizing that this objective can be promoted through investment support provided by the Overseas Private Investment Corporation ("OPIC"), a development institution and an agency of the United States of America, in the form of investment insurance and reinsurance, debt and equity investments and investment guaranties;

Have agreed as follows…"

The bilateral investment insurance agreements between the USA and host states set forth the agreement that OPIC may provide eligible investors with coverage; provide for a provision that the projects to be insured must be approved by the host state; provide for a provision that concern the recognition of the US government's rights as transferee, assignee and subrogee; and provides for a provision concerning the settlement of intergovernmental disputes arising from the agreement or the insurance program through negotiation and, ultimately, arbitration.[169] From the U.S. government's perspective, the most important provisions are those that provide for the recognition of the U.S. government's subrogation right and related procedures that govern subrogation since they are essential for the recovery by OPIC in the event of claim payments.[170] Related provisions satisfy the legislative requirement of "suitable arrangements" to be made for the recovery of losses that arise from the investment insurance claim settlements.[171] Section 237 in the Foreign Assistance Act of 1961, as amended,[172] explicitly lays down this requirement:

"*Sec. 237. General Provisions Relating to Insurance Guaranty, and Financing Program.*
The Corporation shall determine that suitable arrangements exist for protecting the interest of the Corporation in connection with any insurance, guaranty or reinsurance issued under this title, including arrangements concerning ownership, use, and disposition of the currency, credits, assets, or investments on account of which payment under such insurance, guaranty, or reinsurance is to be made, and right, title, claim, or cause of action existing in connection therewith."

Subrogation results in the assignment to the U.S. government, particularly OPIC, of rights and claims of the insurance holder. A critical issue with respect to the intergovernmental

[169] O'Sullivan, 'Model OPIC Investment Incentive Agreement'.
[170] *Ibid.*
[171] *Ibid.*
[172] *Foreign Assistance Act of 1961*, as amended.

relationship is that OPIC as the U.S. government agency shall assert no greater rights than those of the insurance holder transferred or succeeded to under coverage. This, however, shall not limit the right of the U.S. government to assert a claim under international law in its sovereign capacity. Article 3 in the India-U.S. Investment Incentive Agreement lays down the recognition of the U.S. government's subrogation right:

"Article 3

(b) If the Issuer makes a payment to any person or entity, as Issuer of Investment Insurance or an investment guaranty in connection with any Investment Support, the Government of India shall recognize in connection with any dispute contemplated under the provisions of Article 6(c) hereof the transfer to the Issuer in connection with such payment of the right to exercise the rights and assert the claims of such person or entity.

(c) With respect to any interests transferred to the Issuer or any interests to which the Issuer succeeds under this Article, the Issuer shall assert no greater rights than those of the person or entity from whom such interests were received, without prejudice to any other rights that the two parties may have in their sovereign capacities."

This provision specifically promulgates that, in addition to subrogation, the U.S. government preserves its right to intervene in the investment disputes diplomatically and assert a claim against the host country under public international law.[173] Diplomatic protection may be performed not only to protect the interests of investors. OPIC may also invoke the political and diplomatic arm of the U.S. government.[174] This, however, has not been very often brought into play. Nevertheless, this legal construction that involves the diplomatic arm of the U.S. government plays a crucial role for the maintenance of this effectiveness as a "fleet in being", an instrument of intimidation.[175]

As for the Dabhol Power Project, the U.S. government (both the Clinton administration and the Bush administration that followed) backed vigorously the interests of the investors. Several interventions by U.S. Government officials ensued both following the difficulties in 1995 and in 2001. When the Indian government filed suit, following the Munde Committee's report in September 1995, to void the power purchase agreement for alleged fraud and misrepresentation,

[173] David G. Gill, Bruce Wilson, James V. Hackney, Gerald T. West, Heribert Golsong, Aksen and Gerald R., 'Legal Principles and Practices Relating to Private Foreign Investment' (1983) 77 *Proceedings of the Annual Meeting (American Society of International Law)* 292–312 at 306.
[174] *Ibid.*
[175] *Ibid.*

U.S. officials including Energy Secretary Hazel O'Leary warned India not to act in a manner to discourage foreign investment.[176] When the situation soured after the completion of Phase I of the project, diplomatic intervention resumed. In April 2001, the U.S. Secretary of State Colin Powell discussed Enron's problems regarding the Dabhol project in a meeting with his Indian counterpart.[177] In July 2001, the U.S. National Security Council convened a "Dabhol working group" of various officials including the representative of OPIC for the organization of such intervention in the Dabhol investment disputes.[178] Such efforts continued into the fall of 2001.[179] In July of the same year, an assistant secretary of State Christina B. Rocca, met with the Indian officials to discuss the Dabhol issue. In October 2001, the Undersecretary of State for Economic, Business and Agricultural Affairs, Alan Larson, raised investors' problems with the Indian foreign minister and the Indian national security advisor.[180] In November 2001, the President of OPIC, Robert Watson, sent a message to the Indian Prime Minister emphasizing the importance of the Dabhol issue to the US Government[181]:

"*The acute lack of progress in this matter has forced Dabhol to rise to the highest levels of the United States government… I ask that you give this matter serious and immediate attention*."

These efforts did not lead to an immediate settlement of the ongoing disputes though. Following the claim payments as ordered by an arbitral tribunal, OPIC sought to recover from the Indian government the compensation it had paid to the insurance holders.

3.2. Recovery by OPIC of its Losses with respect to Investment Insurance

Pursuant to Article 3(b) of the Investment Incentive Agreement as well as the "established principles of subrogation", the U.S. Government requested India on several occasions to reimburse OPIC for the insurance claim payments, plus interest and costs, and otherwise to compensate OPIC to the fullest extent of the rights, interests and claims transferred to OPIC from the investors and the Bank of America.[182] On 10 October 2003, the U.S. Embassy delivered a request to the Indian Ministry of Finance to commence negotiation for the reimbursement of OPIC for its losses with respect to the investment insurance.[183] In the following months, the U.S. Government reiterated its desire to commence negotiation on this

[176] Minority Staff of House Committee on Government Reform, *Fact Sheet*.
[177] *Ibid.*
[178] *Accounting for Enron*; *White House Aided Enron in Dispute*.
[179] Minority Staff of House Committee on Government Reform, *Fact Sheet*.
[180] *Chronology of Administration Dealings with Enron's Dabhol Power Plant in India*.
[181] Minority Staff of House Committee on Government Reform, *Fact Sheet*.
[182] *Request for Arbitration Under the Investment Incentive Agreement between the Government of the United States of America and the Government of India 19 November 1997* (2004), p. 18.
[183] *Ibid.*, 5.

dispute.[184] Around 1 June 2004, OPIC President Peter Watson invited the new Indian Minister of Finance to seek an amicable resolution of the dispute.[185] OPIC also notified the Ministry also of the additional losses arising from its unpaid loans extended to the project.[186] On 16 July 2004, OPIC President Watson notified the Government of India that the U.S. Government was "exploring imminent action" under the bilateral investment insurance agreement.[187] As there was no amicable progress with respect to the dispute, on 4 November 2004, the U.S. Government delivered a "Request for Arbitration" to India pursuant to Article 6 of the Investment Incentive Agreement.[188]

"*Article 6*

(a) Any dispute between the Government of the United States of America and the Government of India regarding the interpretation of this Agreement shall be resolved, insofar as possible, through negotiations between the two Governments. If, six months following a request for negotiations hereunder, the two governments have not resolved the dispute, the dispute, including the question of whether such dispute presents a question of international law shall be submitted, at the initiative of either Government, to an arbitral tribunal for resolution in accordance with paragraph (b) of this Article."

The U.S. Government deemed the Indian Government liable under public international law for the injuries sustained by OPIC as a result of following actions and omissions by or attributable to the Government of India: (1) Expropriating OPIC's rights, interests, use, benefits and control of the Dabhol Project without paying compensation; (2) Frustrating DPC's arbitral remedies, hence, denying DPC justice; and (3) Breaching and repudiating the contractual obligations owed to DPC for discriminatory, governmental, political or other non-commercial reasons.[189] If the government of India were not to take any step to initiate resolution of the dispute before 1 December 2004, the U.S. Government declared its intention to supplement these claims to include its losses arising from OPIC's direct loans to the project.[190]

[184] *Ibid.*
[185] *Ibid.*
[186] *Ibid.*
[187] *Ibid.*
[188] 'U.S. Initiates Arbitration against India over OPIC Claims for the Dabhol Power Project' (2005) 99 *The American Journal of International Law* 271 at 271.
[189] *Request for Arbitration Under the Investment Incentive Agreement between the Government of the United States of America and the Government of India 19 November 1997*, pp. 16-8.
[190] *Ibid.*, 3 and 5.

This was the first and only arbitration initiated in OPIC's history pursuant to a bilateral investment insurance agreement between the U.S. Government and a host country government.[191] By the summer of 2005, the situation improved dramatically and the parties to the dispute reached a comprehensive settlement.[192] Stakeholders including the Indian banks, offshore lenders and OPIC convened in a meeting in March the same year where the Indian banks tabled terms that commercial lenders considered acceptable.[193] A deal was reached in a short period of time according to which the interests of Bechtel and General Electric in DPC and those of the foreign lenders were transferred to a special purpose entity controlled and owned by the government of India.[194] The deal included also the settlement of OPIC's pending claims against the government of India for the reimbursement of what OPIC paid in claims to policy holders.[195] As a result, OPIC managed to recover its losses with respect to the investment insurance covering the equity and debt interests of the American firms in the Dabhol Power Project.

[191] O'Sullivan, *Learning from OPIC's Experience*, p. 48.
[192] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement', 3; Jeswald W. Salacuse, *The Three Laws of International Investment: National, Contractual, and International Frameworks for Foreign Capital*, 1. ed. (Oxford: Oxford Univ. Press, 2013), p. 293.
[193] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement', 3.
[194] Salacuse, *The Three Laws of International Investment*, p. 293.
[195] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement', 3.

Chapter 3 MIGA Investment Promotion and Protection

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In 1987 Ibrahim Shihata wrote about the relevance of a multilateral investment insurance scheme to the promotion of foreign investment flows into developing countries – which he connected to the development process in such countries.[1] At the time of his writing, the dramatic decline in the overall volume of foreign investment in developing countries had been accompanied by a debt overhang, a factor that amplifies the benefits of private investments for the less-developed regions of the world. Viewing the decline in international capital flows to developing countries "with concern", Shihata pointed out investors' political risk perception as a major barrier to investment flows into these countries, a barrier that may be addressed through political risk insurance.[2] MIGA was established to provide such insurance.[3]

The objective of MIGA is to "*encourage the flow of investments for productive purposes among member countries, and in particular to developing member countries, thus supplementing the activities of the International Bank for Reconstruction and Development, the International Finance Corporation and other international development finance institutions*".[4] MIGA is mandated to increase foreign direct investment flows among its member countries through the provision of technical assistance services to member countries and issuance of investment insurance to private investors.[5]

MIGA is equally vigorous in investment protection. Issuance of investment insurance against the so-called political risk per se contributes to the investment protection regime. MIGA evaluates host states with respect to investment protection (country risk analysis) and defines its own investment protection standards through conceptualization of political risk. MIGA plays an important role as an intermediary in the settlement of investor-state disputes. Moreover, MIGA encourages member states to sign BITs and the Agency enters into bilateral agreements with its members that are connected to BITs.

[1] Shihata, 'Factors Influencing the Flow of Foreign Investment'.
[2] *Ibid.*, 685-9.
[3] Establishment of MIGA goes back to the 1950s though. See the second and the third sections in Chapter 1.
[4] *MIGA Convention*, Article 2.
[5] Akira Iida, *MIGA: The Standard-Setter* (Washington, DC: Multilateral Investment Guarantee Agency, 1997), 68. MIGA has the discretion to decide about the type of complementary services it would offer to achieve its objective. See *MIGA Convention*, Article 2 (b) and (c).

This chapter offers an insightful analysis of the role of MIGA in investment promotion and investment protection. The first section addresses MIGA investment insurance with particular reference to the MIGA's contribution to the investment protection regime. The second section focuses on the technical assistance services provided by MIGA again with reference to the role of MIGA in investment protection. The World Bank and the International Finance Corporation (IFC) also provide certain insurance products associated with foreign direct investments. The last section locates MIGA within the World Bank Group and compares MIGA investment insurance with the insurance products provided by the World Bank and the IFC.

I. MIGA Guarantee Program

Several discussions were held on the operational structure of the proposed multilateral agency prior to the establishment of MIGA. The most disputed issues were subrogation and dispute settlement, i.e. issues concerning interaction between the host country government and the international institution following a claim payment to the investor.[6] It was suggested *inter alia* that when MIGA compensates an investor and the host country defaults in reimbursing MIGA, the Agency should deal with this issue internally, i.e. restore its finances using its own funds. Another suggestion was that MIGA should operate like national investment insurance programs and conclude either bilateral agreements with member states or impose general conditions on each host state before issuing insurance.[7] Eventually, the latter proposal was adopted for the operation of MIGA.[8] Similar to OPIC, MIGA grants insurance in return for premiums. When it pays compensation, it subrogates the rights and claims from the investor. Subsequently, it attempts to recover the compensation from the host state.

Recognition of MIGA's subrogation right is enshrined in Article 18 in the Convention Establishing the MIGA which provides that in the event that MIGA pays a claim, it "*shall be subrogated to such rights or claims related to the guaranteed investment as the holder of a guarantee may have had against the host country*."[9]

The MIGA guarantee program covers investments made only in MIGA developing member countries. As of June 2017, MIGA has 181 members, 156 of which are categorized as developing under the MIGA Convention. Consequently, host states are at the same time MIGA shareholders. The relationship between MIGA and the host state is governed by the public international law and by the bilateral agreement MIGA enters into with the host state. Disputes

[6] Berger, 'The New Multilateral Investment Guarantee Agency', 24.
[7] Gill, Wilson, Hackney, West, Golsong, Aksen and Gerald R., 'Legal Principles and Practices', 306.
[8] *Ibid.*
[9] *MIGA Convention*.

between the Agency and host countries over a subrogated claim are settled by arbitration.[10] The investor must be also from a MIGA member state. The insurance contract governs the relationship between MIGA and the investor. According to MIGA's eligibility rules for investors a national of a member country other than the host country generally can receive a guarantee.[11] As an exception, the Agency may grant eligibility by a special majority vote to a host country national, if this investor transfers funds from another member country.[12] This exception is considered to be consistent with MIGA's central objective of channeling the flow of investment to developing countries, some of which now have nationals living abroad with considerable off-shore funds.[13]

Figure 2 illustrates the tripartite relationship between MIGA, the host state and the investor.

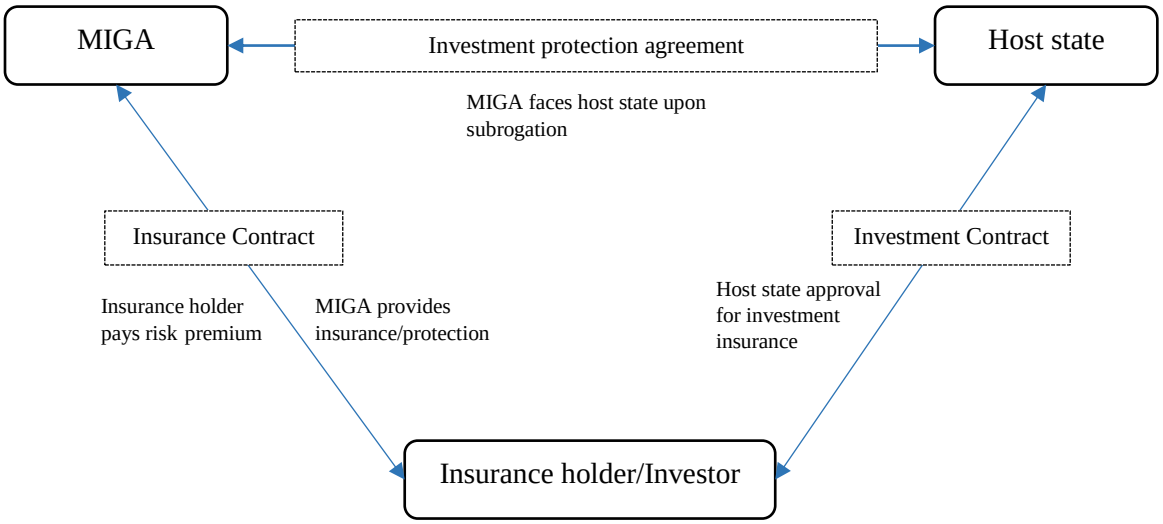

Figure 2: The tripartite relationship between MIGA, the investor and the host state

1.1. Bilateral Agreements between MIGA and Host States

The MIGA Convention categorizes member countries for voting purposes as Category One -developed countries- and Category Two -developing countries. Category One countries include the European countries, North American countries, Australia, and South Africa while Category Two countries include the Caribbean countries, Latin American countries, and African countries. MIGA insures an investment only if it is to be made in a Category Two-developing member country.[14] In the issuance of investment insurance, MIGA may interact

[10] *Ibid.*, art. 57 (b).
[11] *Ibid.*, art. 13(a).
[12] *Ibid.*, art. 13(c). The Convention also requires joint application of the investor and the host country.
[13] *Commentary on the Convention Establishing the Multilateral Investment Guarantee Agency*, para. 23.
[14] MIGA Convention, art. 14.

with the host state for host state's approval for the MIGA investment insurance,[15] amicable settlement of investor-state disputes and recovery of a compensation paid to the investor. The MIGA Convention includes clauses with respect to settlement of disputes with host states.

MIGA's relationship to host state is governed by public international law -primarily bilateral agreements between MIGA and host states. MIGA has thus far entered into over 110 bilateral agreements with developing member states. Typically, these agreements consist of two articles. The first article designates the government authority with which MIGA is to communicate in connection with matters arising under the MIGA Convention. Ministry of finance is generally designated to conduct the communication with MIGA. For instance, the bilateral agreement between MIGA and Azerbaijan[16] lays down that:

"*Pursuant to Article 38 of the Convention, the Government confirms that it has designated the Ministry of Finance to be the authority with which the Agency is to communicate in connection with matters arising under the Convention*."

The second article provides that MIGA shall be accorded treatment no less favorable than the most favorable treatment accorded to any other investment guarantee agency or state. This clause can be interpreted relatively narrowly and broadly. The narrow interpretation refers to the treatment of MIGA as an insurer per se. OPIC is likely to be the most favorable investment insurance agency owing to the bilateral investment insurance agreements between the USA and host states.[17] However, the broad interpretation concerns the treatment of an investment insured by MIGA. In that sense, MIGA requires the host state to treat the MIGA-insured investment not less favorably compared to the treatment of other insured investments in the host state. This allows for a connection between MIGA and BITs, an instrument that MIGA promotes:

"*In view of the Agency's endeavors under Article 23, (b), (ii), of the Convention to conclude agreements relating to the treatment of the Agency with respect to investments guaranteed by it, the Government agrees to accord the Agency treatment no less favorable, with respect to the rights to which it may succeed as subrogee of a compensated guarantee holder, than treatment that the Azerbaijan Republic has accorded or will accord in the future to any State or other public entity in an investment protection treaty or any other agreement related to investment.*"[18]

[15] MIGA Convention, art. 15.
[16] Agreement on Legal Protection for Guaranteed Foreign Investments between the Multilateral Investment Guarantee Agency and the Government of the Azerbaijan Republic (1992).
[17] See, Williams, 'Political and Other Risk Insurance', 85.
[18] Agreement on Legal Protection for Guaranteed Foreign Investments between the Multilateral Investment Guarantee Agency and the Government of the Azerbaijan Republic (1992).

1.2. Issuance of an Investment Guarantee

Principally, MIGA covers different forms of equity investments, and medium- and long-term loans made or guaranteed by owners of equity in the enterprise concerned.[19] However, MIGA's Board of Directors is given discretion to extend coverage to additional forms of investments. The Board's discretion aims to strike a balance between the need to preserve MIGA's scarce capital to promote flows of direct investment and the need to assure future flexibility to extend coverage to other types of investments.[20] Demand for MIGA investment insurance has been generally increasing ever since the establishment of MIGA in 1988. Investors apply for MIGA investment insurance to cover a new project or an extension of their investment against political risks. MIGA's emphasis is on new investments.[21] Modernization of existing investments may be also covered.

Prior to granting insurance, MIGA is required to subject the investment to a substantive review, including testing the economic soundness of the investment and its contribution to the development of the host country; the investment's compliance with the host country's laws and regulations; and its consistency with the declared development objectives and priorities of the host country.[22] Upon investors application, MIGA assures the eligibility of the project by evaluating the possibility of the project to be covered by the private sector.[23]

The process for the issuance of investment insurance (or rejection thereof) can be quite long.[24] The assessment process can take from a few months to a number of years.[25] Assessment of the project may include feasibility studies of the project and evaluation of preliminary project negotiations.[26] Along with the project assessment, MIGA may conduct country risk analysis to evaluate a project's risks and returns. Some investments may rely on MIGA investment

[19] *MIGA Convention*, art. 12(a)
[20] *Commentary on the MIGA Convention*; para. 19 (hereafter Commentary on the MIGA Convention).
[21] Reinsurance issued by MIGA is restricted to investments which are consistent with the purposes of the Convention and meet the eligibility requirements of Articles 11 through 14 of the Convention and Chapter One of MIGA Operational Regulations, except that the investment in respect of which reinsurance is issued need not be implemented subsequent to the application for reinsurance. In other words, while MIGA insures only new investments, the investment which is the subject of reinsurance need not be new. The Board shall approve each issuance of a contract of reinsurance in respect of an investment made prior to the Agency's receipt of the application for such reinsurance.
[22] *MIGA Convention*, art. 12(e).
[23] James C. Baker, 'Global Foreign Investment Insurance: The Case of MIGA with Comparisons to OPIC and Private Insurance' (1995) 21 *Managerial Finance* 23–39 at 29.
[24] Laura Wallace, 'MIGA: Up and Running' (1992) 29 *Finance and Development* 48–9.
[25] Baker, 'Global Foreign Investment Insurance', 29.
[26] *Ibid.*, 29.

insurance.[27] In other words, the investment is made on the condition that MIGA insures the investment.

Sample insurance contracts are made publicly accessible by MIGA. However, it should be borne in mind that individual contracts may differ in terms and conditions.

1.3. Insurance Claims

In the case of insurance claims, the investor as the claimant must establish that there was damage or loss caused by a political risk event that is covered under the insurance contract.[28] Generally, the host state argues against the investor's claim.[29] Unless MIGA decides that the alleged risk event has occurred, the investor does not get paid.[30] MIGA claim payment is audited by the Audit Committee of the MIGA Board of Directors according to risk management principles[31] and MIGA needs enough evidence to justify its decision to pay out the investor.[32]

To this date, MIGA has paid only two claims of expropriation and seven claims of war and civil disturbance. MIGA paid the first expropriation claim in the fiscal year 2000 for a project in Indonesia. The second expropriation claim involved a project in Argentina. While MIGA recovered both compensations for expropriation claims, it did not have any prospects for recovery for the war and civil disturbance claims.

Even though MIGA is not a profit-oriented institution, its rate of return on assets reveals that it makes profits.[33] The MIGA Management is required to allocate all of its net income to reserves until it reaches 5 times the total subscribed capital.[34] In other words, all net income is put to reserves to meet future claims.[35] In case MIGA's reserves are wiped out due to a large extraordinary claim, MIGA may become vulnerable to consecutive insurance claims.[36] However, since MIGA has callable capital, it does not become insolvent as a result of such insurance claims.

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[27] *Ibid.*
[28] Iida, *MIGA*.
[29] *Ibid.*
[30] *Ibid.*
[31] MIGA, *Management's Discussion & Analysis and Financial Statements* (2017), p. 24.
[32] Iida, *MIGA*
[33] *Ibid.*, 15.
[34] *Ibid.*, 15. Required by the MIGA Convention.
[35] *Ibid.*
[36] *Ibid.*, 16.

1.4. Settlement of Disputes between MIGA and Investors

Pursuant to the MIGA Convention, Article 58, disputes that arise from a guarantee contract between MIGA and an investor are to be settled by arbitration in accordance with the rules agreed upon in the contract. The MIGA Convention does not provide for specific rules that would apply to the disputes between MIGA and investors; however, it is expected that the individual contracts refer to an internationally recognized body of rules for commercial arbitration. Paragraph 77 of the Commentary on the MIGA Convention states that:

"77. The Convention does not provide specific procedures to govern arbitration between the Agency and holders of a guarantee or a reinsurance policy. It is anticipated that the contracts of guarantee and reinsurance would normally refer to an internationally recognized body of rules for commercial arbitration, such as the ICSID rules, the rules developed by the United Nations Commission on International Trade Law (UNCITRAL) or the rules of the International Chamber of Commerce."

MIGA contributes to the evolution of investment protection standards by constantly determining the scope of insurance coverage. MIGA determines the scope of coverage each time it issues an investment insurance and interferes in an investor-state dispute. So far, MIGA has not been faced with arbitration filed by an insured investor concerning the scope of coverage. This is evidently in correlation with the small number of insurance claims filed with MIGA. However, a discussion on the law that is applicable to MIGA's insurance coverage can demonstrate the intersection of legal systems, e.g. contractual law and public international law, with respect to the operation of MIGA.

In the event of a dispute concerning the liability of MIGA, the principal source of an arbitrator in determining the liability of MIGA for a claim would be the MIGA insurance contract signed with the insurance holder. The insurance contract provides for the extent of coverage by defining the risk events that may trigger insurance claims and also provides for the amount of compensation payable. The insurance contract may include further clauses related to the insurance coverage.

The arbitrators may also consult the *Convention Establishing the MIGA* and *MIGA Operational Regulations* in the settlement of MIGA-investors disputes. The Convention provides for the scope of guarantee MIGA may grant and includes also terms and conditions concerning ancillary liability issues such as the eligibility conditions. The *Commentary on the Convention Establishing the MIGA* is of interpretational use to arbitrators as well. Furthermore,

MIGA Operational Regulations provide for the rules and procedures for the operation of MIGA. They also state that the scope of the MIGA insurance contract must be consistent with the Convention Establishing the MIGA and these Regulations. Nevertheless, if MIGA explicitly grants expropriation coverage that is broader than the coverage provided in the Convention, MIGA is liable to pay out the investor. Moreover, MIGA would be able to recover the amount of compensation even when the scope of coverage is broader than the scope of political risk in the Convention because MIGA receives host state approval prior to issuance of each investment insurance pursuant to Article 15 of the Convention.

1.5. MIGA's Involvement in Investor-State Disputes

In the event of an investor-state dispute, MIGA is required to encourage the investor and the host state to settle the dispute amicably.[37] Host states and investors are both eligible to file a dispute with MIGA alleging that the other party to the investment contract breached their contractual obligations.[38] MIGA examines the responsibility and liability areas of the parties and uses its "good offices" to settle the disputes before they become actual insurance claims.[39] MIGA does not deploy a formal procedure to settle investor-state disputes. There may be a different approach for each case. MIGA generally use the home and host state's World Bank Representatives to communicate with the investor and the host government.[40] MIGA endeavors to understand the nature of the conflict by talking informally with each of the parties separately and in an impartial manner.[41] When talking does not alleviate the dispute, MIGA would use mediation techniques.[42] So far, MIGA has resolved nearly 100 investment disputes in a manner to improve the investment climate and the sustainability of the project in question and also in an attempt to avoid insurance claims.

Recently, Chalamish and Howse published a comprehensive analysis of MIGA's role in the settlement of investor-state disputes.[43] They assess the effectiveness of MIGA in investor-state dispute settlement in comparison with investment protection by BITs and stabilization clauses in investment contracts. They associate MIGA's success mainly with lower information costs

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[37] MIGA Convention, art. 23 (b) (i)

[38] www.miga.org/investment-guarantees/dispute-resolution (last visited 11 December 2018) *"A dispute may arise when an investor alleges that the government has breached its contractual obligations or expropriated its investment. Conversely, a dispute may be brought by a host government alleging that the investor has breached its contractual obligations. Both sides may disagree about who is at fault and about how the aggrieved party should be compensated."*

[39] www.miga.org/investment-guarantees/dispute-resolution

[40] *Ibid.*, p. 732.

[41] *Ibid*.

[42] *Ibid*.

[43] *Ibid*.

in assessment of risk on a regular basis. In comparison to investors, and other public and private investment insurers, MIGA possesses advantages with respect to assessing and pricing the risk. MIGA has a comprehensive risk assessment process that continues after the installment of the investment. Moreover, MIGA draws upon internal information, experience and judgments about the country risk in the World Bank. Thanks to its close connection to high-ranking government officials, MIGA is also more likely to receive comprehensive and more current information about the "risky" government actions or political violence risk in a host state. Access to relevant information in the early stage of a (potential) dispute in such occasions allows MIGA to alleviate the conflict before it escalates.

Similarly, MIGA regularly evaluates the likely benefit of the investment both to the investor and the host state because disappointing results may trigger political risk events. Financial difficulties may decrease investor's incentive to manage political risk while increasing the likelihood of a governmental intervention for the protection of public interests. In addition, MIGA may be notified through complaints by third parties, such as NGOs, about investor's compliance with environmental and social requirements in the host state. Moreover, MIGA's influence on insured investors may be also a potential explanation for the dispute settlement success of MIGA. Their reputation and their ability to access investment insurance in the future are at the stake if they refuse to cooperate with MIGA.[44]

Chalamish and Howse's explanation stands in contrast to what they call "the standard story", i.e. MIGA's deterrence effect on host states as part of the World Bank,[45] which is also upheld in this thesis.[46] In its interference in investment disputes, MIGA is not authorized to impose any sanction on host countries.[47] For example, a host country refusal to collaborate with MIGA does not result in a country's suspension from the MIGA guarantee program. Yet, Chalamish and Howse admit that MIGA as a repeat player may directly affect the level of investment flows to certain markets.[48]

MIGA's involvement in investor-state disputes entails two aspects that are generally overlooked in the investment insurance literature. First of all, without regard to the explanation of MIGA's success through the deterrence effect hypothesis or the lower information cost

[44] *Ibid*.
[45] They do not identify the standard story as the deterrence effect though. As a result, they do not engage with the literature that addresses the deterrence effect not only with respect to MIGA but also national investment insurers.
[46] See Chapter 4.
[47] *Ibid.* at 728.
[48] *Ibid.*, 729-30.

hypothesis, it is evident that MIGA constantly contributes to the determination of scope of investment protection in developing countries by effecting the host state regulation of investments. This is addressed in Chapter 4 comprehensively.

Secondly, even though MIGA works on a legal construction similar to OPIC's, MIGA puts more weight to the settlement of investor-state disputes before they become insurance claims because a high number of insurance claim is likely to jeopardize MIGA's role in economic development of poor countries. A high number of insurance claims represents disruptions or failures in the insured investments. That is, these investments contribute no longer to the economic development of the host state as envisaged prior to issuance of insurance, or their contribution decreased drastically. A high number of insurance claims is also likely to lead to a more frequent claim payment. In that case, MIGA would be required more often to determine insurance claims, i.e. whether the host state action or inaction constituted political risk. Claim determinations and the following recovery endeavors of MIGA would increase the instances where MIGA faces a host state regarding the host state's public policy choices. In each of these scenarios, MIGA is relatively more exposed to public debate. Just as the reputation of investors and host states is important to access investment insurance or insured investments in the future, MIGA's reputation with respect to insured investments is crucial to justify MIGA's insurance activities. Recall that MIGA is required by its Convention to endeavor for an amicable settlement of investor-state disputes. This may be the biggest factor that distinguishes MIGA from other insurers as an international institution for development.[49]

II. MIGA's Other Activities for Investment Promotion and Protection

In addition to investment insurance provision, MIGA is mandated to carry out complementary activities to promote investment flows to developing member countries.[50] These complementary activities may be categorized generally as (1) research and dissemination of information on investment opportunities in developing member countries, and (2) provision of technical advice and assistance upon their request to improve the investment climate in developing member countries.[51] These activities include investment promotion conferences, missions, executive development programs organized to prepare domestic executives for

[49] Shihata, 'Towards a Greater Depoliticization', 24-5.

[50] Art. 2(b) MIGA Convention. Paragraph 41 of the Commentary on the MIGA Convention lays out that MIGA provides technical assistance on a cost-recovery basis: *"… the Agency, at the request of a member, may provide technical assistance and advice with the objective of improving investment conditions. This could include advice on such matters as the drafting of investment codes and reviewing investment incentive programs. Such complementary services may be provided against appropriate fees or may be extended at no cost to the beneficiary countries when warranted."*

[51] Art. 23 (a) MIGA Convention.

encounters with potential foreign investors, policy roundtables in certain regions like Africa and follow-up workshops, and research on global foreign investment trends.[52] More importantly, MIGA carries out activities to strengthen developing countries' institutional capacity to successfully plan, execute, and follow-up investment promotion programs and foreign investment laws.[53]

For this purpose particularly, Shihata was involved in a project that began in the late 1980s for drafting a set of legal guidelines for the treatment of foreign investments.[54] These guidelines were intended to inspire foreign investment legislation in developing member countries. The final draft of the guidelines was adopted anonymously by … in 1992. Moreover, MIGA has been one of the sponsors of FIAS (Facility for Investment Climate Advisory Services) together with IFC. FIAS is a multi-donor funding program for World Bank Group advisory and technical assistance projects and programs.[55] Following the adoption of the legal guidelines in 1992, FIAS projects for drafting, revising, or implementing foreign investment legislation had increasingly been initiated in the developing countries. These guidelines have also paved the way for making of bilateral investment treaties.[56] In fact, MIGA is required to promote and facilitate conclusion of BITs between its member countries.[57] This requirement did not prevent MIGA from issuing investment insurance when there is no BIT in place between the investor's home state and the host state. The absence of a BIT only rarely affected the availability of MIGA investment insurance.[58] However, MIGA played an important role in the promotion of BITs through the legal guidelines. The World Bank Development Committee stated that the guidelines were an instrument to:

"*promote fair and equitable international standards for the general treatment of all foreign direct investment in the absence of applicable treaties, and should be of particular value for developing countries. Ministers expect the Guidelines to serve as an important step of the*

[52] Iida, *MIGA*, p. 72-3.
[53] *Ibid.*, 113.
[54] Ibrahim F. I. Shihata, "Judicial Reform in Developing Countries and the Role of the World Bank", (1993 February) TDM Archive issue, www.transnational-dispute-management.com/article.asp?key=983.
[55] http://www.worldbank.org/en/topic/competitiveness/brief/facility-for-investment-climate-advisory-services-fias (19 October 2016) (last visited 11 December 2018).
[56] Lauge N. Skovgaard Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (Cambridge, United Kingdom: Cambridge University Press, 2015), p. 77.
[57] Art. 23 (b) MIGA Convention
[58] *Ibid.*, 75.

progressive development of international practice in thi area and hope that they will facilitate further developments through bilateral treaties and similar instruments."[59]

However, MIGA withholds investment insurance in the absence of a bilateral agreement that includes an MFN clause between a developing member country and MIGA itself. Developing member countries may obtain from MIGA's lawyers assistance and advice also in the negotiation of such agreements.[60]

MIGA is equipped to consult also on export credit insurance. Focused on the area of political risks, MIGA has occasionally advised the World Bank on establishing facilities to provide credit insurance against political risks for exports.[61] MIGA is also willing to provide advice on export credit insurance to its member countries as it conceives an export credit scheme as one element to attract foreign investment.[62]

III. The World Bank Group Political Risk Mitigation Products

Even though IBRD, IDA (together the World Bank), and IFC were authorized to provide guarantees by the time they were established, they did not use their guarantee function until the 1990s as the importance of insuring equity investments was recognized by them only marginally.[63] As a result of the recognition that "political risk mitigation" is indispensable for the equity investment operations of the World Bank and IFC, they started to provide guarantees along with MIGA in the late 1980s and early 1990s. It is beyond the scope of this chapter to explain how individual World Bank Group guarantee products work. The World Bank and IFC investment guarantees differ from the typical investment insurance referred to in this thesis, however, certain forms of these guarantee products cover political risks as well.[64] In this section, the guarantee products provided by the World Bank and IFC against political risks are briefly addressed in comparison with the MIGA investment insurance.

The World Bank aims at facilitating commercial financing for projects and policies in the member countries by providing loan guarantees at the request of host government.[65] World Bank guarantees have been substantially enhanced and expanded ever since they were

[59] See Shihata, "Judicial Reform in Developing Countries and the Role of the World Bank", (1993 February) TDM Archive issue, www.transnational-dispute-management.com/article.asp?key=983.
[60] Commentary on the MIGA Convention, paragraph 41.
[61] Iida, *MIGA*, 27.
[62] *Ibid.*, 27.
[63] *Ibid.*, 48.
[64] World Bank Group, *World Bank Group Guarantee Products: Guidance Note* (April 2016) available at https://ppp.worldbank.org/public-private-partnership/library/world-bank-group-guarantee-products-guidance-note (last visited 11 December 2018).
[65] *Ibid.*, 5.

established in 1994.[66] IBRD and IDA offer loan guarantees in different forms in order to provide tailor-made risk mitigation instruments that address the needs of member countries and private sector participants.[67] The World Bank guarantees may cover both public sector and private sector projects while MIGA investment insurance only covers the investments of the private businesses.[68] Typically, commercial lender in public sector projects are covered against the risk of debt service defaults by public sector borrowers.[69] However, in private sector projects where the project company borrower is privately owned, commercial lenders are covered against debt service defaults by project company due to an action or inaction of the host government.[70] In private sector projects, the guarantee coverage may include political risks such as expropriation, currency inconvertibility and transfer restriction, war and civil disturbance, the so-called "material adverse government action", non-payment of contractual obligations, adverse regulatory changes, and other specific risks related to the project.[71] This is similar to MIGA's non-honoring of sovereign financial obligations product that protects commercial lenders against losses resulting from host government's failure to fulfill an unconditional financial payment obligation or guarantee.[72]

The World Bank offers guarantees only when it receives a government counter-guarantee. MIGA may also recover from the host state but it is not required to receive a counter-guarantee through an indemnity agreement prior to the issuance of investment insurance.[73] When the World Bank faces a claim and if the Bank decides to pay out the commercial lender, the Bank will then ask the host state to repay the Bank on the basis of an indemnity agreement it signed with the host state.[74] If the host state fails to pay the Bank at once, the Bank will become the creditor of that amount vis-à-vis the host state.[75] In this sense, the World Bank guarantee is an extension of its loan operations whereas the MIGA guarantee is a typical insurance product.[76]

Most national investment insurance schemes offer political risk coverage (in the form of investment insurance) also for commercial bank lending.[77] In this case, a functional overlap

[66] See, Independent Evaluation Group, *The World Bank Group Guarantee Instruments 1990-2007.*
[67] World Bank Group, *World Bank Group Guarantee Products: Guidance Note*, 5.
[68] Iida, *MIGA*, 48.Ibid.
[69] World Bank Group, *World Bank Group Guarantee Products: Guidance Note*, 6.
[70] *Ibid*.
[71] *Ibid.*, 8.
[72] MIGA, *MIGA's Non-Honoring of Sovereign Financial Obligations Product* (March 2012).
[73] Independent Evaluation Group, *The World Bank Group Guarantee Instruments 1990-2007*, p. 66.
[74] Iida, *MIGA*, 50-1.
[75] *Ibid.*, 51.
[76] *Ibid.*
[77] See Chapter 1, Part I.

may occur between the guarantee product of the World Bank and the national schemes, which raised concerns for national providers, as they claimed that the World Bank's pricing policy may disturb the existing guarantee market.[78] However, it is generally expected that the governments would be very selective concerning the projects for which they will provide a counter-guarantee to the World Bank.[79] That is, the World Bank would be involved in an investment only if the commercial lending meets a country's strategic priority needs. i.e. when the project is of high national priority.[80] For the remaining commercial lending in projects in developing countries, national investment insurance schemes may be chosen despite the assumedly cheaper World Bank guarantees.[81]

Similar to the World Bank guarantee instruments, IFC guarantee products are to facilitate commercial financing of development projects in developing member countries. Typically, IFC offers partial credit guarantee that covers debt instruments (bonds and loans) issued by private creditors against debt service defaults irrespective of the cause of defaults, i.e. the default can be caused by a political or commercial risk.[82] That is, IFC's partial credit guarantee offers a comprehensive political and commercial risk coverage. IFC adopted its first guarantee policy in 1988, the same year that MIGA was established.[83] The policy stated explicitly that IFC's and MIGA's guarantee instruments are "*potentially more complementary than competitive*" even though the coverages provided by IFC and MIGA might overlap.[84]

[78] Iida, *MIGA*Ibid., 50.
[79] *Ibid.*, 51.
[80] *Ibid.*
[81] *Ibid.*
[82] World Bank Group, *World Bank Group Guarantee Products: Guidance Note*, 15.
[83] Independent Evaluation Group, *The World Bank Group Guarantee Instruments 1990-2007*, p. 66.
[84] *Ibid*.

Part II Conflicting Goals: Promotion of Development v. Investment Protection

Chapter 4 The Notion of Political Risk and Foreign Investment Insurance

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The notion of insuring international business against political risks dates back at least to the 18th century when the individuals at the Lloyds coffee house, which later became the largest investment insurance provider in the private sector, began to underwrite marine insurance.[1] Banks have been also insuring political risks for centuries.[2] Nevertheless, the notion of political risk had not been carved out and treated separately from other risks until the second half of the 20th century.[3] Studies on political risk increased in number in the post-war period in response to investors' perception of greater risk in foreign business operations that arose out of the political process, especially the process of decolonization.[4] Particularly in the 1960s and 1970s, occurrences that reduced the returns of an investment or enforced ownership change became frequent.[5] This was partly due to the increasing capital flows from North America and Western Europe to developing countries but the main factor was the growing danger posed to these investments in the process of decolonization,[6] with expropriation being necessary to complete the decolonization process.

Studies on political risk should be addressed in the context of the broader social scientific literature on the phenomenon of risk. Literature on risk is extensive and diversified. There are technical and scientific approaches to risk on the one hand and sociocultural approaches on the other.[7] The former often take risk for-granted, as an objective phenomenon.[8] This scholarship is mostly concerned with the identification of risks; it maps the sources of various types of risks and builds predictive models of risk relations; it explores people's responses to risks and

[1] Robert B. Shanks, 'Insuring Investment and Loans against Currency Inconvertibility, Expropriation and Political Violence' (1986) 9 *Hastings International and Comparative Law Review* 417–37 at 417; Kessler, 'Political Risk Insurance', 213.
[2] Shanks, 'Insuring Investment and Loans', 417.
[3] *Ibid.*
[4] David A. Jodice, *Political Risk Assessment: An Annotated Bibliography* (Westport, Conn.: Greenwood Press, 1985), pp. 3-5.
[5] Janie M. Chermak, 'Political Risk Analysis: Past and Present' (1992) *Resources Policy* 167–78 at 170.
[6] Darryl S. L. Jarvis and Martin Griffiths, 'Learning to Fly: The Evolution of Political Risk Analysis' (2007) 21 *Global Society* 5–21 at 8. For a discussion on how the economic and the political were split in the course of decolonization and how this split was adopted within international law see Sundhya Pahuja, *Decolonising International Law: Development, Economic Growth and the Politics of Universality* (Cambridge: Cambridge University Press, 2011).
[7] Deborah Lupton, *Risk* (London: Routledge, 1999), p. 17.
[8] *Ibid.*, 18. Technico-scientific perspectives have emerged from such fields as engineering, statistics, actuarialism, psychology, epidemiology and economics. See *Ibid.*, 17.

proposes methods to limit their effects.[9] The latter treat risk as a sociocultural phenomenon. The scholars take into account the broader social, cultural and historical context from which risk as a concept derives its meaning in order to explore the role risk plays in the contemporary social life and subjectivities.[10]

The studies that center on political risk have been mostly technico-scientific.[11] To address the need for conceptualizing political risk, mostly international business scholars and practitioners have provided definitions of political risk, developed conceptual models exploring the sources of political risk, and improved different risk assessment and management methods for international managers to utilize.[12]

From the technico-scientific perspectives, the question of how to conceptualize political risk is a key one, since the further endeavors to map causal factors, develop predictive models and propose ways of mitigating risk are built on the definition of political risk. However, neither in practice nor in theory is there a universal approach. As regards the grand theoretical approaches and methodological analyses, there is an extensive literature on the phenomenon of political risk, but a definition of political risk that is based on objective-universal criteria cannot be derived from it. Expectations for an overarching universal approach to the concept of political risk are, therefore, bound to be frustrated. This may be explained predominantly by the variety of objectives and purposes for which the concept of political risk has been studied within different fields.[13] Based on the utility of its application and the practical context it will be deployed in, the term political risk is used in various ways across relevant disciplines, such as political science, development studies, international relations, economics and international business.[14] The international business literature on political risk has been the most relevant to

[9] *Ibid.*, 18.
[10] *Ibid.*, 24-35. Sociocultural perspectives have emerged from such fields as cultural anthropology, philosophy, sociology, social history, cultural geography, and science and technology studies.
[11] Studies that treat the concept of political risk as a sociocultural product have been rather rare. For an example of this approach in legal literature, see, Tan, 'Risky Business'.
[12] For reviews of political risk literature, see, Stephen J. Kobrin, 'Political Risk: A Review and Reconsideration' (1979) 10 *Journal of International Business Studies* 67–80; Mark Fitzpatrick, 'The Definition and Assessment of Political Risk in International Business: A Review of the Literature' (1983) 8 *Academy of Management Review* 249–54; Jeffrey D. Simon, 'A Theoretical Perspective on Political Risk' (1984) 15 *Journal of International Business Studies* 123–43; Roberto Friedmann and Jonghoon Kim, 'Political Risk and International Marketing' (1988) 23 *Columbia Journal of World Business* 63–74; Darryl S. L. Jarvis, 'Conceptualizing, Analyzing and Measuring Political Risk: The Evolution of Theory and Method' (2008) *SSRN Electronic Journal*; and Chermak, 'Political Risk Analysis'.
[13] Jarvis, 'Conceptualizing, Analyzing and Measuring Political Risk', 7.
[14] *Ibid.*, 3-18. Jarvis' praxis-driven approach to definitions of political risk is an attempt to encompass the extensive literature across numerous disciplines that have involved with exploration of political risk, including political science, international relations, economics, development studies and international business. He explains how scholars from such fields define political risk according to their purposes and objectives.

the conceptualization of political risk as insured by foreign investment insurers. This chapter addresses the international business literature on the concept of political risk, in an attempt to explain its interaction with the international investment regime.

The dominant approach to the concept of political risk is profoundly business-centered.[15] Much of the work in international business studies has focused on unwanted changes in the investment climate and negative consequences of governmental or societal actions on a country's market a foreign firm operates in or wishes to operate in. Many scholars and practitioners explain the concept of political risk solely from the perspective of investors and are interested mostly in the risk assessment and risk management methods investors may invoke. Such political risk narratives are largely adopted by foreign investment insurers.

While assessment and management of political risk is directly relevant to the managerial strategy of an international firm, the prevailing approach to the concept of political risk also has implications for the broader society. The concept of political risk plays a crucial role for the extent of investment protection. The dominant political risk approach is informed by the prevailing neoliberal economic paradigms that accentuate the desirability of a weak role of the host state in investment regulation.[16] Consequently, the ultimate suggestion of the political risk narratives that are underpinned by neoliberal economic thought is that foreign investors should be provided with indemnities when the government interferes in the market. The events associated with risk are problematized in a way to allow for interventions; because identification of risk is followed by proposals for the management of the identified risk.[17] This process determines what is insurable by insurers and how insurers may intervene in the management of identified risk. Insurers themselves recreate the process of identifying risk by providing coverage against the occurrence of certain events.[18]

It follows that investment insurance contributes to a general framework of expected behaviors, particularly with respect to host states and local communities. This framework involves both ex-ante and general investment climate surveillance mechanisms and ex-post investment-specific supervision. The role of the political risk narratives in organizing and

[15] Jarvis and Griffiths, 'Learning to Fly', 10-1.
[16] Stephen Gill, 'Globalization, Market Civilization and Disciplinary Neoliberalism', in E. Hovden and E. Keene (eds.), *The Globalization of Liberalism* (New York: Palgrave in association with Millennium Journal of International Studies, 2002), pp. 123–51; See also David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge: Cambridge University Press, 2008).
[17] Tan, 'Risky Business', 179.
[18] Tom Baker, 'Risk, Insurance, and the Social Construction of Responsibility', in T. Baker and J. Simon (eds.), *Embracing Risk: The Changing Culture of Insurance and Responsibility* (Chicago: University of Chicago Press, 2002), pp. 33–51, p. 38.

regulating behavior is magnified by the broader framework of surveillance and governance that accompanies an investment insurance arrangement.[19] Country risk analysis conducted by insurance agencies constitutes a mechanism of ex-ante surveillance of investment climate in the host country.[20] This surveillance is maintained with respect to specific investments and public insurance agencies may intervene to resolve disputes that arise out of insured investments. Alongside with the subrogation rights of insurers, insurance arrangements have a disciplining impact upon host states.[21]

This chapter addresses aspects of the notion of political risk that are relevant to the operation of foreign investment insurance and explains the implications of this particular operation upon actors involved in a foreign investment insurance arrangement. Thus, the chapter addresses both technical and sociocultural aspects of the notion of political risk. The first section lays out political risk conceptualizations and discusses how political risk has been approached mainly from a business-centered perspective. In the second section, the relevance of the business-centered political risk approach to the operation of foreign investment insurance is spelled out. Subsequently, the third section provides for a discussion of relevant implications of foreign investment insurance that operates against a business-centered background. It provides an overview of the main supervisory and disciplinary components of investment insurance arrangements. Taking political risk as an objective and universal phenomenon, the last section discusses whether foreign investment insurance would be applicable for investments in developed countries.

I. Conceptualization of Political Risk

Much of the work on the notion of political risk has developed principally from technical perspectives. This part compares these perspectives with sociocultural approaches to risk. Such comparison helps to discern the implications of business-centered political risk approach adopted generally by investment insurers.

1.1. Political Risk, Uncertainty and Insurable Risk

Conceptualization and assessment of political risk appear to be based on rather subjective probabilities, i.e. they are based upon individual cognitive processes, which force us to take issue with Knight's distinction between risk and uncertainty.[22] Following the usual interpretation of Knight's distinction, the term risk refers to situations where one has perfect

[19] Tan, 'Risky Business', 182.
[20] *Ibid.*, 182-4.
[21] *Ibid.*, 184-5.
[22] Frank H. Knight, *Risk, Uncertainty and Profit* (Washington, D.C.: Beard Books, 2002).

knowledge of all possible outcomes associated with an event and the probability of their occurrence, either by calculation of a priori probabilities or by the application of statistical methods to past experience.[23] In other terms, risk refers to situations where information is readily available about all possible outcomes and where all or almost all observers agree upon probabilities.[24] Uncertainty, on the other hand, refers to situations where neither knowledge of all feasible outcomes nor measurable probabilities exist.[25] However, uncertainty is bounded; that is, one can make judgments about most of the outcomes of a future event and the relative likelihood of their occurrence.[26] The modern reading of Knight's distinction also supports the finding that agents can form subjective probability assessments of any situation. Such assessments are subjective as they are based upon "*perceptions that are a function of the available information, previous experience, and individual cognitive processes which synthesize both into an imagined future*".[27] Following this reading, Knight's distinction between risk and uncertainty is based on the presence of objective probabilities, that is, risk denotes objective probabilities, i.e. probabilities that everyone would agree on, while in the case of uncertainty one may only have subjective probabilities.[28]

Applying the distinction between risk and uncertainty to the concept of "political risk", one may argue that political risk is a function of subjective probabilities relating to political uncertainty. Political risk, according to Knight's distinction, would be better termed political uncertainty. In his attempt to conceptualize political risk, for example, Root takes account of Knight's distinction between risk and uncertainty and associates political risk with the subjective probability judgment of a decision maker about the possible occurrence of political events that may have repercussions on the firm:

"*Broadly speaking, political uncertainty for the international manager refers to the possible occurrence of political events of any kind (such as war, revolution, coup d'etat, expropriation, taxation, devaluation, exchange control, and import restrictions) at home or abroad that would cause a loss of profit potential and/or assets in international business operations… When the*

[23] Kobrin, 'Political Risk', 70.
[24] *Ibid.*
[25] Knight, *Risk, Uncertainty and Profit*; Kobrin, 'Political Risk', 70.
[26] G. L. S. Shackle, *Decision, Order, and Time in Human Affairs* (Cambridge: Cambridge University Press, 2010).
[27] Kobrin, 'Political Risk', 70.
[28] Stephen F. LeRoy and Larry D. Singell Jr., 'Knight on Risk and Uncertainty' (1987) 95 *Journal of Political Economy* 394–406 at 398.

international manager makes a probability judgment of an uncertain political event in a host country, he thereby converts a political uncertainty into a political risk."[29]

A better understanding of a country's political environment and its potential impact upon a firm's operations in that country would obviously help decision makers to make a better subjective probability assessment, thereby improving the the firm's ability to mediate "political risks".[30] Hence, most writers suggest that a systematic study and evaluation of political situations by managers will help them to have a more realistic perception of the political risks in a host country. In fact, the consideration of political systems and political risk has led to the development of prescriptive social science models for different states with different system characteristics and different political risk profiles.[31] These models alert investors, states or stakeholders about future risk events and help them mitigate these risks.[32] However, it has been argued that these models so far could not escape the analytical limitations of political risk conceptualization and failed to forecast political risk events.[33] Jarvis and Griffiths give examples of the bottom-line political events that foreign investors faced unexpectedly, such as the fall of Soviet Union in 1991, the fall of President Suharto in Indonesia in 1998 that followed significant economic and political crises in the region, the revolution in the Philippines that overthrew President Marcos in 1986 and similarly the revolution in Iran that disposed the Shah in 1979 and the Asian financial crises in the 1990s. None of these sudden political events had been forecast despite the predictive model building in the previous decades.[34] These efforts could seldom convert uncertainty into risk as in Knight's definition of risk.[35]

In more technical terms, political risk deviates in important ways from "insurable risk".[36] The latter is a basic insurance concept upon which the insurance industry operates.[37] According to the OECD Insurance and Private Pensions Committee, insurable risk is risk that is measurable in terms of probability and severity (assessibility); unexpected and independent of the will of the insured (randomness); and homogenous so that it could be pooled (mutuality).[38]

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[29] Franklin R. Root, 'Analyzing Political Risks in International Business', in A. Kapoor and P. D. Grub (eds.), *The Multinational Enterprise in Transition: Selected Readings and Essays* (Detroit: Darwin Press, 1972), p. 357.
[30] Kobrin, 'Political Risk', 71.
[31] Jarvis and Griffiths, 'Learning to Fly', 13.
[32] *Ibid.*
[33] *Ibid.*, 17.
[34] *Ibid.*
[35] Kobrin, 'Political Risk', 71; Dan Haendel, Gerald T. West and Robert Meadow, *Overseas Investment and Political Risk* (Philadelphia: Lexington Books, 1975).
[36] Gordon, *Investment Guarantees and Political Risk*, p. 93.
[37] *Ibid.*
[38] OECD, Insurance and Private Pensions Committee, *Recommendation of the Council on the Establishment of a Check-List of Criteria to Define Terrorism for the Purpose of Compensation* (2004), Criterion 3.

In terms of assessability, "political risks" deviates from insurable risk since political risk assessment is in a way nothing more than subjective approximation of uncertainty. Furthermore, political risks cannot be pooled as they are rather idiosyncratic as opposed to "homogenous", and they tend to be cross-correlated, which makes insurers face multiple claims at the same time.[39] This was realized when the private investment insurance industry faced heavy losses during the financial crisis of the early 1980s and the international debt crisis that followed the devaluation of the Mexican peso in 1982.[40] As for randomness, political risks are not necessarily independent from the will of the insured.[41] Occurrence of a political risk event may be influenced by the actions of international managers or it may well be under the control of international managers such that international managers could play a role in the prevention of the political risk event or in reducing the negative effects of the event upon the foreign firm.[42]

1.2. Defining Political Risk

On the one hand, political risk assessment is dependent on subjective probabilities. This mainly concerns the measurement of political risks and pricing political risk insurance products. On the other hand, we face the significance of conceptualizing political risk or determining what political risks should be associated with. Conceptualization of political risk must be understood in the context of the role of "risk" in ordering reality.[43] In Ewald's terms:

"*Nothing is a risk in itself; there is no risk in reality. But on the other hand, anything can be a risk; it all depends on how one analyses the danger, considers the event*."[44]

In this sense, what is important about risk is not risk itself but what risk gets attached to.[45] The significance of risk lies rather with the fact that risk is rendered thinkable through forms of knowledge from statistics, sociology, epidemiology to management and accounting; that it is discovered through techniques from calculus of probabilities to interview and governed by social technologies from risk screening, case management to social insurance.[46] Furthermore, risk is embedded within political rationalities and programs such as those that imagine an

[39] Gordon, *Investment Guarantees and Political Risk*, p. 93.
[40] DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 743.
[41] Gordon, *Investment Guarantees and Political Risk*, p. 93.
[42] J. Bannister, 'Does the Risk Manager Have a Role in Handling Political Risk?' (1981) 28 *Risk Management* 98–102.
[43] Mitchell Dean, 'Risk, Calculable and Incalculable', in D. Lupton (ed.), *Risk and Sociocultural Theory: New Directions and Perspectives* (Cambridge: Cambridge Univ. Press, 1999), p. 131.
[44] Ewald, *Insurance and Risk*, p. 199.
[45] Dean, *Risk, Calculable and Incalculable*, p. 131.
[46] *Ibid.*

advanced liberal society of prudential individuals and communities.[47] It may be concluded that risk problematizes events in a way to allow for interventions in societies through a variety of technical means.[48] It follows that the identification of risk in a particular setting prepares the ground for proposals for the management of the identified risk and describing something or somebody as exposed to risk leads to discussions on the management of the entity that is 'at risk' so as not to disrupt the prevailing notions of social and economic order.[49]

In the context of insurance practices, how we determine what constitutes an insurable asset, entity or event depends in important ways on the "shifting cultural conceptions of risk, security, and responsibility."[50] In the same vein, the way we decide who is responsible for what depends in many ways on the risks assumed by insurance.[51] Given the capacity to define what is insurable and what is not, insurers or insurance practices in general, shape ideas about societal relations and normalize or otherwise delegitimize norms of behavior through their representational power.[52]

A better understanding of these characteristics of the phenomenon of risk in general is crucial to carve out the concept of political risk. However, the dominant political risk approach is often perceived as though it is based on objective probabilities and static risk definitions, as this perception has long been consolidated by insurance practices.

1.3. Conceptualization of Political Risk by International Business Scholars

Students of international business have generally associated political risk with exogenous factors, especially those that stem from governmental activities that distort market conditions.[53] They have aimed at explaining the host country non-economic risks international investors should be aware of and should take account of in the investment decision making process. There are diverse approaches to the concept of political risk within the international business scholarship. A significant group of international business scholars explain the concept of political risk on the basis of governmental interference with efficient markets.[54] They conceive political risk as unwanted consequences of political activity for foreign firm or firms operating

[47] *Ibid.*, 132.
[48] Tan, 'Risky Business', 178.
[49] *Ibid.*
[50] Baker and Simon (eds.), *Embracing Risk*, p. 27; Tan, 'Risky Business', 178.
[51] Baker and Simon (eds.), *Embracing Risk*, p. 33.
[52] Tan, 'Risky Business', 178-9; Brian J. Glenn, 'Risk, Insurance and the Changing Nature of Mutual Obligation' (2003) 28 *Law and Social Inquiry* 295–314 at 299.
[53] Jarvis, 'Conceptualizing, Analyzing and Measuring Political Risk', 3.
[54] Jarvis and Griffiths, 'Learning to Fly', 10-1.

in or wishing to operate in a country's market.[55] Weston and Sorge's[56] definition of political risk is representative of this approach:

"*Political risks arise from the actions of national governments which interfere with or prevent business transactions, or change the terms of agreements, or cause the confiscation of wholly or partially foreign owned business property.*"

This approach represents an effort to categorize the multifarious series of non-financial and non-market risks such that they might be described, assessed and mitigated.[57] For instance, Hasmi and Guvenli surveyed the leading U.S. multinational corporations and concluded that there are 14 major governmental activities and political processes in host countries that constitute political risk.[58] From highest risk to lowest risk, according to their results, these are import restriction; unexpected currency devaluation or revaluation of non-floating currencies; delays in profit repatriation; currency inconvertibility; terrorism; unfair tax laws; labor strikes and trade union power; production or export restrictions; contract repudiation; calling off guarantees; restrictions on local market access; expropriation or nationalization; confiscation of property; and restrictions on information flow.[59] Jarvis defines this approach loosely as the catalogue school due to the dominance of lists of possible activities of governments in host countries that detract value and profitability from business operations.[60]

Critics of this approach generally test it for its analytical utility to decision makers at multinational corporations and argue that the approach does not meet the basic performance criteria that would make it possible to develop models informing probable future outcomes.[61] Kobrin concludes in his review of the political risk literature that the emphasis on negative consequences of government interference for the market has an implicit normative dimension that may not be universally valid.[62] This approach entails a simplistic assumption about markets. It assumes that markets are self-regulating and function nearly perfectly as they are prone to equilibrium. "*The notion of imperfect markets, poor transparency, and activities such as monopoly practices, organizational self-preservation and collusion are excluded from the*

[55] *Ibid.*
[56] J. Fred Weston and Bart W. Sorge, *International Managerial Finance*, The Irwin series in finance, 4. pr (Homewood, Ill.: Irwin, 1976), p. 60.
[57] Jarvis and Griffiths, 'Learning to Fly', 11.
[58] M. Anaam Hashmi and Turgut Güvenli, 'Importance of Political Risk Assessment Function in U.S. Multinational Corporations' (1992) 3 *Global Finance Journal* 137–44.
[59] *Ibid.*, 142.
[60] Jarvis, 'Conceptualizing, Analyzing and Measuring Political Risk', 20.
[61] *Ibid.*, 36-7.
[62] Kobrin, 'Political Risk', 69.

theoretical purview" of such an approach.[63] This approach further implies that markets are independent from the functioning of states or from the broader societal polity which potentially hinders efficient market operation.[64] The emphasis on the independence of markets from non-market actors artificially isolates markets from their socio-political contexts and conceives all political activity as detrimental to the otherwise efficient business operations.[65] Representatives of this approach conclude that political risk can be removed only through limiting the power and regulatory range of government.[66]

Critics of the approach, thus, emphasize the role of states as enabling agents of market operation and their regulatory power that insures the transmission of market information and transparency.[67] Economic historians have long recognized that it is rather the absence of regulatory actors that increases the extent of political risk.[68] For example, as the 1997 Asian financial crises has shown, weaker political systems and regulatory bodies create conditions that expose participants to risk.[69] The role of the state and adequacy of institutional capacity is emphasized also by leading international agencies like the International Monetary Fund and the World Bank in supporting "*the operation of financial markets, market transparency and probity*" and in providing "*administrative and legal corridors for the transfer of assets, debt, and debt settlement*".[70]

Nevertheless, the neoliberal approach that points to governments as the source of risk to foreign investment has been the dominant approach to the concept of political risk ever since the emergence of the literature in the 1950s.[71] Haendel explains this with the dominance of business professors in the political risk literature and suggests a more comprehensive approach:

"*Most of the literature on political risk has been produced by business professors, published in academically oriented business journals, and geared primarily to other business professors. Even though some businessmen have benefited from some of this literature, the business community as a whole has had little exposure to the 'political' aspect of political risk. Furthermore, much of this literature has viewed political risk primarily from the perspective of*

[63] Jarvis and Griffiths, 'Learning to Fly', 11-2.
[64] *Ibid.*
[65] *Ibid.*
[66] See Weston and Sorge, *International Managerial Finance*, p. 60; David W. Conklin, 'Analyzing and Managing Country Risks' (2002) 66 *Ivey Business Journal* 37–41.
[67] Jarvis, 'Conceptualizing, Analyzing and Measuring Political Risk', 24.
[68] *Ibid.*
[69] *Ibid.*
[70] *Ibid.*
[71] Jarvis and Griffiths, 'Learning to Fly', 10-1.

the MNEs. Although practitioners hired by MNEs are rightly concerned with the MNEs' point of view, political risk can and should also be viewed from the perspective of other key institutions, such as the host country, the U.S. government, and the insurance industry."[72]

1.4. A Governance-Based Approach to Political Risk

Traditionally, the investor-host state relationship is addressed with particular attention to host country policies toward foreign enterprises. Raymond Vernon's obsolescing bargain model has deeply influenced the research on the interaction between a foreign investor and a host state.[73] According to Vernon, whereas the initial bargain favors a foreign investor, investment arrangements deteriorate for the investor once the investor commits resources to a host country.[74] Assuming that investors have limited influence on the investment climate in the host country after the investment is installed, researchers focused more on the impact of host country politics on the investment decisions of foreign investors.[75]

Nevertheless, researchers have recently turned to the political function of investors in host countries[76] and studies on risk management by multinationals and the overall impact of foreign investors on host country policies have become increasingly prevalent.[77] It has been concluded for quite some time now that the multinationals have to engage in active management of political risks in the host country through methods, such as strategic alliances with local partners and alliances with other investors, staged entry and incentive alignment with local actors, the use of home governments and international organizations to lead discussions and the tactical allocation of proprietary technology and international finance.[78]

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[72] Haendel, *Foreign Investments and the Management of Political Risk*, p. 73. MNE stands for multinational enterprise.

[73] Jensen, Biglaiser, Li, Malesky, Pinto, Pinto and Staats, *Politics and Foreign Direct Investment*, p. 16.

[74] Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of US Enterprises* (New York: Basic Books, 1971) and Raymond Vernon, 'The Obsolescing Bargain: A Key Factor in Political Risk', in M. B. Winchester (ed.), *The International Essays for Business Decision Makers* (New York: AMACOM, 1980), pp. 282–6.

[75] Jensen, Biglaiser, Li, Malesky, Pinto, Pinto and Staats, *Politics and Foreign Direct Investment*, p. 16.

[76] See for instance, Amy J. Hillman and Michael A. Hitt, 'Corporate Political Strategy Formulation: A Model of Approach, Participation, and Strategy Decision' (1999) 24 *Academy of Management Review* 825–42; Lorraine Eden, Stefanie Lenway and Douglas A. Schuler, 'From the Obsolescing Bargain to the Political Bargaining Model', in R. Grosse (ed.), *International Business and Government Relations in the 21st Century* (Cambridge: Cambridge University Press, 2005), pp. 251–73; Alvin G. Wint, 'Has the Obsolescing Bargain Obsolesced? Negotiating with Foreign Investors', in R. Grosse (ed.), *International Business and Government Relations in the 21st Century* (Cambridge: Cambridge University Press, 2005).

[77] Jensen, Biglaiser, Li, Malesky, Pinto, Pinto and Staats, *Politics and Foreign Direct Investment*, p. 119.

[78] *Ibid.*, p. 119; Witold. J. Henisz and Bennet A. Zelner, 'Political Risk Management: A Strategic Perspective', in T. H. Moran (ed.), *International Political Risk Management: The Brave New World* (Washington, DC: World Bank and Multilateral Investment Guarantee Agency, 2013), pp. 154–70. See also, Jean J. Boddewyn and Thomas L. Brewer, 'International-Business Political Behavior: New Theoretical Directions' (1994) 19 *The Academy of Management Review* 119–43; Lorraine Eden and Maureen Appel Molot, 'Insiders, Outsiders, and Host Country

Consequently, the dominant business-oriented political risk approach has been enriched, if not challenged, by a purportedly legitimacy-based approach that focuses on the multinational firms' impression in the eyes of host and home governments and societal groups.[79] In this approach, the reasons that have potentially led to certain acts of a government and the intentions of the government regarding these acts are considered to be crucial for defining political risk. The focus of this approach is to ensure profitability of investment and to increase its endurance by increasing its acceptability by societal groups and/or host government. That is, legitimacy denotes acceptability of the investment and the investor. Basically, this approach is an attempt to highlight the role of firm actions in the occurrence of political risk events. By doing so, it also designates a certain role to firms to mitigate political risks which is reminiscent of "corporate good governance".[80] In that sense, the approach is primarily business-centered.

The governance-based approach draws on studies of the changing nature of host government-multinational firm relations. It is often discussed that the conflictual-adversarial dynamics in the host government-multinational firm relations have increasingly shifted toward cooperative-complementary dynamics.[81] In this context, the traditional bargaining power model is found to be ill-equipped to explain the building blocks of the new form of relationships.[82] Unlike most political risk studies that focus on the *ability* of the host government to intervene in the operation of foreign investment, the focal point of this approach is the *motivation* behind government intervention.[83] The argument goes on to assert that the short-term shifts in bargaining power leading to a government intervention would counter the government's own

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Bargains' (2002) 8 *Journal of International Management* 359–88; John M. Stopford, Susan Strange and John S. Henley, *Rival States, Rival Firms: Competition for World Market Shares*, Cambridge studies in international relations, 1. publ (Cambridge u.a.: Cambridge University Press, 1991), vol. 18; Witold. J. Henisz and Andrew Delios, 'Information or Influence? The Benefits of Experience for Managing Political Uncertainty' (2004) 2 *Strategic Organization* 389–421; Pablo M. Pinto, 'Domestic Coalitions and The Political Economy of Foreign Direct Investment', University of California (2004); Pablo M. Pinto, *Partisan Investment in the Global Economy: Why the Left Loves Foreign Direct Investment and FDI Loves the Left* (Cambridge u.a: Cambridge Univ. Press, 2013); Ravi Ramamurti, 'The Obsolescing 'Bargaining Power'? MNC-Host Developing Country Relations Revisited' (2001) 32 *Journal of International Business Studies* 23–39; Yadong Luo, Oded Shenkar and Mee-Kau Nyaw, 'Mitigating Liabilities of Foreignness: Defensive versus Offensive Approaches' (2002) 8 *Journal of International Management* 283–300.

[79] Charles E. Stevens, En Xie and Mike W. Peng, 'Toward a Legitimacy-Based View of Political Risk: The Case of Google and Yahoo in China' (2015) 37 *Strategic Management Journal* 945–63.

[80] Larry C. Backer, 'Multinational Corporations as Objects and Sources of Transnational Regulation' (2008) 14 *ILSA Journal of International and Comparative Law* 499–523.

[81] J. H. Dunning, 'Governments and Multinational Enterprises: From Confrontation to Co-operation?' (1991) 20 *Millennium - Journal of International Studies* 225–44; Yadong Luo, 'Toward a Cooperative View of MNC-host Government Relations: Building Blocks and Performance Implications' (2001) 32 *Journal of International Business Studies* 401–19 at 401.

[82] *Ibid.*, 402.

[83] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 946.

goals that include attracting foreign capital.[84] Instead of intervening based on short-term shifts in bargaining power, a government takes account of the attributes and activities of the foreign firms over time and evaluates whether they are consistent with the government's long-term economic, political, and social goals.[85] If a government perceives that they are in consistency, the acceptability of these firms in the eyes of government increases.[86]

In fact, assessment by governments or government actors of foreign firms' acceptability is a common practice.[87] How the government perceives a firm's acceptability "*can be a matter of life and death for an organization.*"[88] Since government agents have direct influence on the performance and the very existence of industries and organizations, firm's impression in the eyes of government actors is a "*commonly studied type of legitimacy*."[89] Many studies connect firm's acceptability directly to the political risks the firm faces. Kostova and Zaheer notes that "*the political processes or negotiations between MNEs and host governments … could affect the legitimacy of firms directly -in the regulatory domain-or indirectly- through the social construction engaged in by political interest groups*."[90] Luo asserts that MNEs can reduce their political risk if they can build legitimacy in the eyes of the host government through trustworthy behaviors, social capital, and investments of resources that are valuable and rare in the host economy.[91] Henisz and Zelner also assert that MNEs' tenure allows them to build legitimacy and acceptance in the host environment, thereby reducing political risks over time.[92] These scholars suggest that firms should focus predominantly on building "legitimacy" as opposed to building power to mitigate political risks.[93] Some suggest corporate social responsibility as a

[84] Luo, 'Toward a Cooperative View'.
[85] Witold. J. Henisz and Bennet A. Zelner, 'Legitimacy, Interest Group Pressures, and Change in Emergent Institutions: The Case of Foreign Investors and Host Country Governments' (2005) 30 *Academy of Management Review* 361–82.
[86] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 947; T. Kostova and S. Zaheer, 'Organizational Legitimacy Under Conditions of Complexity: the Case of the Multinational Enterprise' (1999) 24 *Academy of Management Review* 64–81; Marquis C. and Qian C., 'Corporate Social Responsibility Reporting in China: Symbol or Substance?' (2014) 25 *Organization Science* 127–48; M. Suchman, 'Managing Legitimacy: Strategic and Institutional Approaches' (1995) 20 *Academy of Management Review* 571–610.
[87] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 948; J. Baum and C. Oliver, 'Institutional Linkages and Organizational Mortality' (1991) 36 *Administrative Science Quarterly* 187–218; D. Deephouse, 'Does Isomorphism Legitimate?' (1996) 39 *Academy of Management Journal* 1024–39; Marquis C. and Qian C., 'Corporate Social Responsibility Reporting in China'; B. Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge, MA: MIT Press, 2007); H. Rao, 'Institutional Activism in the Early American Automobile Industry' (2004) 19 *Journal of Business Venturing* 359–84.
[88] A. Bitektine, 'Toward a Theory of Social Judgments of Organization: The Case of Legitimacy, Reputation, and Status' (2011) 36 *Academy of Management Review* 151–79 at 152.
[89] *Ibid.*, 156.
[90] Kostova and Zaheer, 'Organizational Legitimacy', 65-6.
[91] Luo, 'Toward a Cooperative View'.
[92] Henisz and Zelner, 'Legitimacy, Interest Group Pressures, and Change'.
[93] *Ibid.*

means of increasing acceptability and mitigating political risks. Marquis and Qian find that "*by taking action in accordance with government policies, positions, and regulations … firms and their executives maintain their legitimacy in the eyes of the government*."[94]

In addition to actions by the firm itself, a firm's country of origin plays a significant role in the perceived legitimacy of the firm in the eyes of the host government. It is argued that host governments' interventions will be affected by the perceived legitimacy of a firm's home country government.[95] In other words, the country from which a firm originates may strengthen or weaken a host government's motivation to intervene.[96] Kostova and Zaheer argue that the host government's perception of an MNE "*may arise from long-established, taken-for-granted assumptions*" about the MNE's home country in general, or that country's government more specifically.[97] They take up the case of Cargill in India that eventually retreated from India due to social and political friction since its investment in India was equated with the British colonialism.[98]

A firm's legitimacy is constantly assessed by various sets of social groups and stakeholders including interest groups, competitors, the media, NGOs, financial institutions, employees, customers, "elite" members of society, and other members of civil society.[99] These actors also have a direct influence in the operation of an organization, i.e. they can provide or withhold their social license for a firm to operate, depending on their perception of the firm's legitimacy.[100] It is, therefore, crucial for firms to build long-lasting relations with such stakeholders.[101] The political risk literature is criticized for overlooking the acceptance of firms by such stakeholders, or in short, for being "undersocialized".[102]

Such social groups and society in general affect indirectly the operation of a firm through their impact on policy. It is argued that a firm's legitimacy in the eyes of a host government

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[94] Marquis C. and Qian C., 'Corporate Social Responsibility Reporting in China', 132.
[95] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 9.
[96] *Ibid.*
[97] Kostova and Zaheer, 'Organizational Legitimacy', 74.
[98] *Ibid.*
[99] M. Bucheli and E. Salvaj, 'Reputation and Political Legitimacy: ITT in Chile, 1927-1972' (2013) 87 *Business History Review* 729–55; Suchman, 'Managing Legitimacy'.
[100] I. Thomson and G. Boutilier, 'Modelling and Measuring the Social License to Operate: Fruits of a Dialogue Between Theory and Practice', in *Proceedings, International Mine Management* (Queensland, Australia, 2011); W. Henisz, S. Dorobantu and L. Nartey, 'Spinning Gold: The Financial Returns to Stakeholder Engagement' (2014) 35 *Strategic Management Journal* 1727–48; J. Prno and D. Slocombe, 'Exploring the Origins of 'Social License to Operate' in the Mining Sector: Perspectives from Governance and Sustainability Theories' (2012) 37 *Resources Policy* 346–57.
[101] Henisz, Dorobantu and Nartey, 'Spinning Gold'.
[102] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 952.

increases when the public perceives the firm's attributes and actions to be desirable, proper, or appropriate.[103] Which members of society are most influential may vary according to the nature of the political system in question.[104] While more authoritarian governments tend to be responsive to a smaller circle of politically connected elites,[105] more democratic governments may be responsive to a larger set of interest groups, including the media, industry lobbyists and the broader civil society.[106] Conversely, a government may signal to the public its support to a firm by providing resources and favorable policies.[107] The degree of a government's influence on the public's perception of a firm's legitimacy depends on the legitimacy of the government in the eyes of the public, other governments and international organizations.[108]

The legitimacy-based approach focuses also on a home government's role in the operation of foreign firms. While it is generally considered that the home government's role would be supportive,[109] some assert that the home government may also represent a source of political risk.[110] Similarly, a firm's legitimacy in the eyes of the home society and international public is crucial for its operations abroad. Stevens et al. raise the case of Yahoo in China that cooperated with the Chinese government with respect to the government's censorship program.[111] While cooperation increased Yahoo's legitimacy in the eyes of the Chinese government, it likely decreased its legitimacy in the United States where NGOs, the media, and the general public raised concerns.[112] Even though these stakeholders were not directly affected

[103] *Ibid.*
[104] *Ibid.*
[105] Bucheli and Salvaj, 'Reputation and Political Legitimacy'; D. Langevoort, 'Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and Design of Internal Controls' (2004) 93 *Georgetown Law Journal* 285–317.
[106] R. Putnam, 'Diplomacy and Domestic Politics: The Logic of Two-Level Games' (1988) 42 *International Organization* 427–60.
[107] C. Oliver and I. Holzinger, 'The Effectiveness of Strategic Political Management: A Dynamic Capabilities Framework' (2008) 16 *Academy of Management Review* 145–79; J. Pfeffer and G. Salancik, *The External Control of Organizations: A Resource Dependence Perspective* (New York: Harper and Row, 1978).
[108] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 951; J. Bohman and W. Rehg, *Deliberative Democracy: Essays on Reason and Politics* (Cambridge, MA: MIT, 1997); J. Bonardi, G. Holburn and R. Vanden Bergh, 'Nonmarket Strategy Performance: Evidence from U.S. Electric Utilities' (2006) 49 *Academy of Management Journal* 1209–28; Bucheli and Salvaj, 'Reputation and Political Legitimacy'; Steve Kobrin, 'Multinational Enterprise, Public Authority, and Public Responsibility: The Case of Talisman Energy and Human Rights in Sudan', in R. Grosse (ed.), *International Business and Government Relations in the 21st Century* (New York: Cambridge University Press, 2005), pp. 191–216.
[109] R. Ramamurti, 'The Obsolescing 'Bargaining Model'? MNC-Host Developing Country Relations Revisited' (2001) 32 *Journal of International Business Studies* 23–39.
[110] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 10. See also Spagnoletti and O'Callaghan, 'Going Undercover'.
[111] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 12.
[112] G. Brenkert, 'Google, Human Rights, and Moral Compromise' (2009) 85 *Journal of Business Ethics* 453–78; G. Dann and N. Haddow, 'Just Doing Business or Doing Just Business: Google, Microsoft, Yahoo! and the Business of Censoring China's Internet' (2008) 79 *Journal of Business Ethics* 219–34.

by Yahoo's cooperation with the Chinese government, their perception that Yahoo's cooperative actions are not in accordance with American norms and values arguably contributed to the withdrawal of Yahoo from China.[113]

In fact, closer ties to a more authoritarian government may result in greater risk not only in that country but also at home or in other countries.[114] Similar legitimacy issues arose for Talisman, a Canadian oil company in Sudan. Talisman was sued in U.S. courts under the Alien Tort Claims Act for complicity in human rights violations.[115] Specifically, Talisman was accused of allowing the Sudanese government to use its airstrip to "*stage military action against both rebel and civilian targets*".[116] Even though the firm's cooperation with the host government led to smooth operations in Sudan, the firm was faced with major financial losses due to "*considerable opposition from both the United States and Canadian governments*" as well as "*a coalition of advocacy groups and NGOs*".[117]

II. The Business-Centered Approach and its Relevance for Foreign Investment Insurance

According to the business-centered approach set out above, political risk plays a significant role in governing the behavior of actors in investment insurance arrangements, including not only investors, home and host states but also local communities. Political risk is conceived as if it emanated from the action or inaction of the host state that pose a hazard for the foreign investor while at the same time the interests of local communities are rather marginalized as hazardous to foreign investment.[118] Yet, it does not refer to action or inaction of foreign investors as a source of risk for the host state or local communities.[119] In fact, the contributions of foreign firms to the realization of political risk events are often overlooked by insurers and arbitral tribunals that resolve disputes between insurers and insurance holders. For public investment insurance agencies, the covered investment projects are mostly required to contribute to the economic and social development of the host country.[120] However, even public insurers have long been implementing the business-centered approach to the concept of political

[113] Brenkert, 'Google, Human Rights, and Moral Compromise'.
[114] Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk', 11.
[115] Kobrin, *Multinational Enterprise, Public Authority, and Public Responsibility*.
[116] *Ibid.*, 207.
[117] *Ibid.*, 204.
[118] Tan, 'Risky Business', 180.
[119] *Ibid.*
[120] Michael D. Nolan, Frederic G. Sourgens and Mark L. Rockefeller, 'Political Risk Insurance and Guarantees from Public Providers', in M. Audit and S. W. Schill (eds.), *Transnational Law of Public Contracts*, Droit administratif (Brussels: Bruylant, 2016), pp. 737–71 at 740.

risk that inevitably leads to asymmetrical protection of business interests vis-à-vis public interests.

MIGA defines political risk straightforwardly from the perspective of foreign investors, i.e. its customers. It associates political risks with the probability of disruption of the operations of multinational corporations by political forces or political events.[121] Its business-centered approach reacts to the uncertainty with respect to the actions of governments and political institutions as well as of minority groups:

"*Broadly defined, political risk is the probability of disruption of the operations of MNEs by political forces or events, whether they occur in host countries, home country, or result from changes in the international environment. In host countries, political risk is largely determined by uncertainty over the actions of governments and political institutions, but also of minority groups, such as separatist movements.*"[122]

MIGA has recently reported that governments around the world are increasingly seeking a greater share of returns from the extractive industries.[123] The agency acknowledges that these recent regulatory changes in several emerging economies, especially in Asia, reflect the efforts of host states "*to protect mineral wealth and create benefits for local populations*."[124] At the same time, it argues that resource nationalism, regardless of its justification, constitutes an insurable political risk event.[125] It refers to state initiatives like export restrictions, increase in taxes or royalties, and contract renegotiation as regulatory changes that pose significant risks to foreign investors.[126] In addition to regulatory changes, MIGA considers that the macro environment surrounding the investment is a potential source of hazardous consequences for foreign investments. For instance, it refers to "civil disturbances and conflict", "weak macroeconomic environments" and "inadequate legal and regulatory frameworks" as challenges that pose political risk to foreign investments in the mining sector.[127]

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[121] MIGA, *World Investment and Political Risk 2009*, p. 28.
[122] *Ibid.* Note that this definition provided in this publication is not legally binding but demonstrates tentatively the political risk approach adopted by MIGA.
[123] MIGA, *World Investment and Political Risk 2013*, pp. 19-20.
[124] *Ibid.*, 20.
[125] *Ibid.* "*Recent examples include regulatory changes in the mining sector in several emerging Asian economies in an effort to protect mineral wealth and create benefits for local populations. As the survey by Ernst & Young found (table 1.4.), resource nationalism has become the top business risk in the mining and metals sector, as host governments are keen to retain ownership of their natural resources…*"
[126] *Ibid.*, 19-20.
[127] MIGA Brief, *MIGA: Supporting Mining Investments* (2013). Available at http://www.miga.org/documents/miningbrief.pdf (last visited 11 December 2018).

The business centered political risk approach raises concerns with respect to protection of corporate interests relative to protection of public interests. Such narratives of risk utilized by the investment insurers like MIGA problematize state conduct and delegitimize state acts even when these acts are responsive to the democratic polity, thereby legitimizing specific intervention and mediation from external actors.[128] The potential implications of insurers' political risk approach will be addressed in the next session.

III. The Notion of Political Risk and the Relevant Implications of Foreign Investment Insurance

The tripartite relationship between the investment insurance agencies, investors and host states is part of a broader architecture of investment climate supervision and surveillance.[129] Investment insurance does not only influence the conduct of parties to an insurance contract but also create a general framework of expected behaviors on the side of other actors, i.e. home states, host states and also local communities.[130] In this sense, investment insurance resembles any other form of insurance. The insurance industry, as aforementioned, operates alongside with shifting cultural conceptions of security and responsibility. On the one hand, the answer to what is insurable by insurers depends on these shifting conceptions, on the other, insurers themselves influence the way we decide who is responsible for what.[131] That is, the insurance industry contributes to reshaping ideas about societal relations and normalizes or delegitimizes certain behavior.[132] Foreign investment insurance is no different. It influences the wider societal relations and regulatory and public policy, i.e. it changes the design of the investment project and manages the relationship between the investors and the host states, through a series of ex-ante and ex-post assessments alongside with supervisory and dispute settlement mechanisms.[133]

The association of political risk narratives with the broader framework of investment climate supervision and surveillance plays a significant role in determining "*who benefits from the investment projects and who bears the risk of project failure as well as who undertakes responsibilities for the dislocations that accompany such projects*".[134] As these narratives create a framework of expected behavior from the related actors, they also play a significant role in

[128] Tan, 'Risky Business', 179.
[129] *Ibid.*, 177. See also, Håvard Haarstad, 'The Architecture of Investment Climate Surveillance and the Space for Non-Orthodox Policy' (2012) *Journal of Critical Globalisation Studies* 79–103.
[130] Tan, 'Risky Business', 177.
[131] Baker and Simon (eds.), *Embracing Risk*, p. 27.
[132] Tan, 'Risky Business', 178-9; Baker and Simon (eds.), *Embracing Risk*, p. 27; Glenn, 'Risk, Insurance and the Changing Nature', 299.
[133] Tan, 'Risky Business', 177.
[134] *Ibid.*, 182.

legitimizing interventions when these actors deviate from the norms.[135] In the case of host states, the penalty for deviations includes not only compensation of investors and insurers but also exclusion from access to external resources, foreign capital, foreign aids and international funds.[136] This section outlines the implications of investment insurance arrangements underpinned by the political risk narratives from the ex-ante assessments of the host country to the ex-post interventions by the insurer and home states through a series of supervisory and dispute settlement mechanisms. These implications should be understood in the context of the broader "architecture of investment climate surveillance" and the disciplinary mechanisms this broader framework involves.[137]

3.1. Ex-ante Assessment of the Host Country: Country Risk Analysis

Investment insurers' ex-ante evaluation includes not only the assessment of the economic and financial viability of the investment to be insured but also a general political risk analysis covering the host country and host region.[138] According to MIGA's Operational Policies, MIGA's risk assessment focuses on factors related both to the investment project and the host country.[139] The agency is required to satisfy itself as to the investment climate in the host country and assure itself that the investors are afforded fair and equitable treatment as well as adequate legal protection.[140] The latter requirements are typically considered satisfied if a bilateral investment treaty is in effect between the host and the home state.[141]

MIGA shares the outcome of its country risk analysis only with the host state with a view to enabling the host state to improve the investment climate in its territories.[142] However, for other insurers, country risk analysis principally serves the purpose of pricing the insurance products. Since investment insurers mostly deal with uncertainty, pricing the insurance products becomes an "*endeavor to take the uncertainty for probability and calculate the possible outcomes that are covered by their insurance products*".[143] Insurers use different strategies to

[135] *Ibid.*
[136] *Ibid.*
[137] Haarstad, 'The Architecture of Investment Climate Surveillance'.
[138] Gordon, *Investment Guarantees and Political Risk*, pp. 99-100.
[139] MIGA, *Operational Policies* (2015) (became effective 6 January 2015) pt I, ch three, s III, para 3.17. MIGA Operational Policies replaced MIGA's Operational Regulations. See MIGA, *Operational Regulations* (adopted 22 June 1988) (1988) 27 ILM 1227.
[140] MIGA, *Operational Policies* (2015), pt I, ch three, s III, para. 3.18.
[141] *Ibid.* (2015), pt I, ch three, s III, para. 3.19.
[142] MIGA Operational Policies, 3.19 (b).
[143] Lars H. Thunell, *Political Risks in International Business: Investment Behavior of Multinational Corporations* (New York: Praeger Publishers, 1977) p. 4.

price their products.[144] Since only a few public providers make public the relevant information on their premium fees and country risk analysis, it is difficult to ascertain the differences between public investment insurance agencies regarding this subject.[145] The Belgian insurance agency Credendo employs its own country risk assessment in 246 countries (including developed countries) and publishes the results on its website.[146] Similarly, France's COFACE and the Netherlands' Atradius make their in-house country risk assessments publicly available.[147]

While some insurers have country risk analysis programs of their own, investment insurers also use official or commercial country risk ratings.[148] A number of insurers in OECD member States refer to the OECD Arrangement on Officially Supported Export Credits, which constructs, *inter alia*, an international cooperative framework for country risk analysis that is also relevant for investment insurance.[149] For example, the Australian insurance agency Export Finance and Investment Corporation (EFIC) relies upon the OECD's country risk classification.[150] OECD's country risk classification includes transfer and convertibility risk and cases of force majeure, e.g. expropriation, war, revolution, civil disturbance, floods and earthquakes.[151] With respect to these risks, OECD experts classify countries through the application of quantitative and qualitative models based on three groups of risk indicators which are the payment experience between the country in question and the participants to the OECD Arrangement, the financial situation and the economic situation of the country.[152]

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[144] Gordon, *Investment Guarantees and Political Risk*, p. 99. See also Ocran, 'International Investment Guarantee Agreements' at 365. Regarding OPIC's calculation of risk premiums, in 1988, Ocran wrote that OPIC assesses risk case-by-case on the basis of the investor's undertaking and the projects risk profile. The country where the investment is to be installed plays no role alone. According to Ocran, OPIC calculates base rates for each coverage type and for five different types of investment: manufacturing and services; natural resources; hydrocarbons; institutional lenders and service contractors. Base rates may decrease or increase up to 33% depending on the risk profile of a specific project. More up-to-date information is not available.

[145] Spagnoletti and O'Callaghan, 'Going Undercover', 4-5.

[146] Jensen found that the data made public by Credendo is used even by firms that do not buy investment insurance. See, Nathan Jensen, *Measuring Risk: Political Risk Insurance Premiums and Domestic Political Institutions*, Political Economy of Multinational Corporations and Foreign Direct Investment Conference, Washington University (2005) at 20.

[147] Their country risk assessments are published in their websites. See, http://www.coface.com/Economic-Studies-and-Country-Risks (last visited 17 December 2017) and https://group.atradius.com/publications/ (last visited 17 December 2017).

[148] Gordon, *Investment Guarantees and Political Risk*, p. 100.

[149] *Ibid.*; OECD, *Arrangement on Officially Supported Export Credits, TAD/PG(2017)1* (became effective 1 February 2017) para 25 <http://www.oecd.org/trade/xcred/theexportcreditsarrangementtext.htm> (last visited 20 March 2017).

[150] *https://www.efic.gov.au/education-and-tools/country-profiles/* (last visited 11 December 2018).

[151] OECD, *Arrangement on Officially Supported Export Credits*, para 25. Expropriation is provided as an example of force majeure.

[152] *Ibid.*

Country risk analysis is informed by political risk narratives. Given the investor-centered approaches to the concept of political risk, low political risk is attributed to the Western systems that are developed, liberal democratic and capitalist.[153] By definition, political risk is considered to be a phenomenon of developing countries that differ from the western model.[154] Assessment of these countries on the basis of 'risk indicators' such as pending investment disputes, investment's exposure to host state regulation or host state's record of interventions in foreign investment, creates a subtle framework of criteria that resemble those guiding the traditional conditionality deployed routinely by the Bretton Woods institutions, the World Bank and the International Monetary Fund (IMF).[155] These assessments arguably have an impact on the international and domestic law relating to the regulation of foreign investment in general and they limit a state's adoption of policies that diverge from the interests of foreign investors.[156] They typically promote the orthodox narratives of investment climate and countries' commitment to liberal, investor-centric investment regimes.[157] According to this understanding, political risk assessments display intrinsically *'ethnocentric values'* and '*neo-imperialist attitudes'*.[158]

Furthermore, the disciplinary effect of these analyses is generally reinforced by the intersections between the risk assessment criteria and international investment law, especially the presence of an international investment treaty between the host state and investor's home state which provides for the investor's arbitration right.[159] The existence of an international investment treaty is either a prerequisite for the issuance of insurance or considered to be evidence of the host country's commitment to the international legal protection of foreign investments.[160] For example, public insurers from Belgium, Germany and the Netherlands

[153] Jarvis and Griffiths, 'Learning to Fly', 15; For example, para 25 of the OECD Arrangement articulates that High Income OECD countries and High Income Euro Area countries are not subject to classification. These groups of countries used to be automatically classified as "Country Risk Category Zero" implying that they represent the lowest (or negligible) country risk. Effective from 1 January 2013, automatic classification of these countries within Category Zero was terminated in order to remove any impression that these countries are actually classified on the basis of the methodology applied to other countries *http://www.oecd.org/tad/xcred/cat0.htm*, (last visited 21 March 2017).

[154] Jarvis and Griffiths, 'Learning to Fly', 15.

[155] Haarstad, 'The Architecture of Investment Climate Surveillance', 80.

[156] *Ibid.*

[157] Tan, 'Risky Business', 183.

[158] See Jarvis and Griffiths, 'Learning to Fly', 15.

[159] Tan, 'Risky Business', 183. International investment agreements and particularly investor-state arbitration is again considered to be central actors in the broader architecture of investment climate surveillance. See, Haarstad, 'The Architecture of Investment Climate Surveillance', 86.

[160] Gordon, *Investment Guarantees and Political Risk*, p. 100. If the existence of an international investment agreement is a prerequisite or a matter of consideration for the issuance of insurance, this cannot be explained only with the legal protection of foreign investments but also with the subrogation clause included in these agreements. See, Chapter 1, section 2.2.

consider the existence of an investment treaty with the host country in the analysis of the country risk.[161] MIGA requires adequate legal protection of foreign investment in the host country for the issuance of an investment guarantee and the Agency equates "adequate legal protection" principally with the presence of an international investment treaty between the host state and investor's home state.[162] Beyond the existence of an international investment treaty, insurers take into account a host state's violation of existing BIT obligations, withdrawal of the host state consent to submit investment disputes to international arbitration and its track record in honoring arbitral awards.[163] It has been argued that the proliferation of BITs and other forms of international investment agreements have stimulated the private political risk insurance industry through both signaling the credibility of the host state commitments to legal protection of foreign investors and transferring a portion, if not all, of the risk assumed by the insurer to the host state.[164] That is, international investment agreements alongside with investor-state arbitration and foreign investment insurance practices operate in a way to reinforce each other and strengthen investment climate surveillance and disciplinary mechanisms.

3.2. Deterrence Effect and Interference in Investment Disputes: OPIC Advocacy and MIGA's Good Offices

Public investment insurers play a significant role in protecting investors from potential losses arising from host state action or inaction.[165] Some insurers have considerable influence on host state governments and their involvement in investment projects may act as an effective deterrent against host government interference with the insured investment.[166] The influence of political risk insurers on the conduct of host country governments is generally explained with reference to their success "*in preventing adverse events from occurring or in securing preferential treatment for investors when adverse events do occur*".[167] In the case of an investment that is backed by a public insurer including international public insurers, host countries have more at stake than just the individual project. Above all the potentially more important relationship with the home State or related international organization could be at

[161] *Ibid.*
[162] MIGA, *Operational Policies* (2015), pt I, ch three, s III, para. 3.19.
[163] Poulsen, *The Importance of BITs*.
[164] Bekker and Ogawa, 'The Impact of Bilateral Investment Treaty Proliferation' at 338-9; DeLeonardo, 'Are Public and Private Political Risk Insurance Two of a Kind?', 758–9.
[165] Gerald T. West and Keith Martin, 'Political Risk Investment Insurance: The Renaissance Revisited', in T. H. Moran (ed.), *International Political Risk Management: Exploring New Frontiers* (Washington, D.C., 2001), pp. 207–30.
[166] *Ibid.*
[167] Kausar Hamdani, Elise Liebers and George Zanjani, *An Overview of Political Risk Insurance* (2005), p. 3 <www.bis.org/publ/cgfs22fedny3.pdf> (last visited 21 March 2017).

risk.[168] For example, during the financial crisis in Argentina in 2002, certain investors were granted by the Argentine Central Bank special exemptions from currency controls, just because they were covered by political risk insurance by the members of the Berne Union at that time.[169]

MIGA appears to use its geopolitical and economic power as an international institution and as a member of the World Bank Group routinely to access "officials at the highest levels of government" in host states in order to resolve potential investment disputes and to deter government actions that could disrupt insured investments.[170] It has been actively involved in the settlement of nearly a hundred investment related disputes since its inception, and thereby avoided facing potential insurance claims that could have arisen out of these disputes.[171]

Public investment insurers sometimes exert extensive political and financial leverage over host states in order to obtain a settlement of disputes related to insured investments.[172] When OPIC, for example, receives a notification of a dispute between the investor and the entities of the host state, it intervenes with the host state in an attempt to resolve the dispute and avert the insurance claim.[173] Among the reasons that explain the success of advocacy, are not only the international investment treaties and project agreements creating rights and enforceable remedies for investors, but also various diplomatic "pressure points".[174] As for the advocacy of OPIC, these pressure points may include the visit of the head of state to the host country, the visit of trade missions and other occasions when a country's eligibility for trade or investment benefits or economic assistance could be challenged.[175] This is demonstrated by the settlement of the Dabhol dispute following the interference of the U.S. government.[176]

Private political risk insurers also tout their political and government connections to mitigate clients' losses.[177] For example, *Zurich* encourages its clients to give notification of potential disputes in order to develop a strategy to reduce investor's losses. It claims to rely on "*long standing relationships with a variety of export credit agencies and multilateral development banks*" and as a member of the Berne Union, Zurich capitalizes on the "*ongoing*

[168] Independent Evaluation Group, *The World Bank Group Guarantee Instruments 1990-2007*, p. 27.
[169] Hamdani, Liebers and Zanjani, *An Overview of Political Risk Insurance*.
[170] MIGA, *Dispute Resolution and Claims* (2015).
<https://www.miga.org/Documents/Dispute_Resolution_and_Claims.pdf> (last visited 21 March 2017).
[171] *Ibid.*
[172] Salacuse, *The Three Laws of International Investment*, p. 293.
[173] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement' at 5.
[174] *Ibid.*
[175] *Ibid.*
[176] See Chapter 2.
[177] Tan, 'Risky Business', 185.

dialogue with host country officials", thereby helping clients mitigating their losses.[178] When, during the Argentine crisis, the Argentine Central Bank permitted borrowers who owed money to lenders insured by Berne Union members to convert transfer funds, clients of Zurich were granted the same privilege.[179] Furthermore, the deterrence effect of private political risk insurers to host states is further strengthened by certain public investment insurance practices. In the MIGA Operational Policies, adequate legal protection of an investment is associated with the protection under the law and practice of the host country where such laws and practice are deemed to be consistent with international law by MIGA.[180] The substance of host state practice, which is consistent with international law, is not specified in the Operational Policies. However, MIGA Operational Regulations that was replaced by Operational Policies in 2015 laid down that MIGA considers prior to the issuance of a guarantee whether the host state had any pending dispute with any other official or private political risk insurer, thereby extending its disciplinary mechanisms to cover private political risk insurance firms and their clients as well.[181]

IV. Political Risk as a Developed Country Phenomenon

As to the perception of political risk, a distinction should be made between developed and developing countries as recipients of foreign direct investment. The relevance of distinguishing between developing and developed countries rests particularly with the conventional association of political risks and political risk management with developing countries. For decades after the Second World War, developed countries have been the main source and recipients of FDI. As of today, developing countries still receive a limited share of global FDI flows. .[182] One reason for this was considered to be the strong opposition of developing countries against foreign capital and particularly against the multinational corporations.[183] A multinational corporation is generally defined as an entity that engages in foreign direct investment and owns or controls business activities in more than one country.[184] Broadly

[178] Zurich, *Credit and Political Risk Claim Overview*
[179] *Ibid.*
[180] MIGA Operational Policies, 3.19 (iii).
[181] MIGA Operational Regulations, 3.18 (ii).
[182] UNCTAD, *World Investment Report 2014*, p. xiii.
[183] Edith Penrose, 'The State and Multinational Enterprises in Less-Developed Countries', in J. H. Dunning (ed.), *The Multinational Enterprise* (London: George Allen&Unwin, 1971), pp. 221–39.
[184] John H. Dunning and Sarianna M. Lundan, *Multinational Enterprises and the Global Economy* (Cheltenham: Edward Elgar Publishing, 2008), p. 3 "This is the threshold definition of a multinational enterprise and one that is widely accepted in academic and business circles…" For broad discussions on multinational corporations see also, Giorgio Barba Navaretti and Anthony J. Venables, *Multinational Firms in the World Economy* (New Jersey: Princeton University Press, 2004) and Richard E. Caves, *Multinational Enterprise and Economic Analysis* (Cambridge: Cambridge University Press, 1996).

speaking, developing countries, many newly independent from former colonial rule in the post-World War II era, were skeptical about the disproportionate financial power of multinational corporations.[185] The fact that most multinational corporations were from the former metropolitan countries augmented the fear of neocolonialism. Furthermore, developing countries fretted about the excessive profits earned by multinational corporations, particularly in extractive resource industries. Consequently, many developing countries adopted restrictive legal and financial policies toward foreign capital inflows which was perceived by foreign investors as a factor that poses political risk. Especially the outright expropriations in the process of decolonization led to conceptualization of political risk as a developing country phenomenon. Even though most developing countries reversed their policies toward foreign capital in the 1980s in an attempt to support economic development,[186] political risk is still, almost exclusively associated with developing countries.

Most public insurers, notably MIGA and OPIC do not provide insurance to countries that are classified as "developed" under their mandates, particularly Western countries and Japan. Yet, recent developments in the international investment regime have brought a latent reality out into the open: while it is argued that investors' perception of political risk in developed countries is negligible, the political risk concept as such is equally applicable to these group of countries. Section 4.1. discusses the relevance of political risk to developed countries.

From a global order perspective, a relevant question is how the design of foreign investment insurance, as an investment protection instrument that includes particular dispute settlement mechanisms, would be affected if it were extended to investments in developed countries. The survival of the system and the public investment insurers may be challenged if foreign investment insurance was applicable in developed and developing countries alike. Critiques of the international investment protection regime concern generally the scope of investment protection and treaty-based investment arbitration. Similar critiques are applicable to the form and extent of investment protection provided by foreign investment insurance. The problems generated by the business-centered political risk conceptualization are discussed in the previous section in this chapter. Moreover, as discussed in Chapter 1, the operation of foreign investment insurance includes diplomatic protection in a rather subtle or indirect way which is likely to appear as hegemonic behavior of the developed country that has issued investment insurance vis-à-vis the developing country that has agreed to host the insured investment. Were

[185] Jensen, Biglaiser, Li, Malesky, Pinto, Pinto and Staats, *Politics and Foreign Direct Investment*, pp. 1-2.
[186] Sornarajah, *The International Law on Foreign Investment*.

investment insurance applicable in developed countries, these legitimacy problems would become even more evident, mainly thanks to the higher public awareness in these countries. Thus, section 4.2. provides a discussion on the rather hypothetical operation of foreign investment insurance in developed countries with particular regard to the extent of insurance coverage and settlement of subrogated claims.

4.1. Prospects for Foreign Investment Insurance for Investment in Developed Countries

Recent developments have demonstrated that political risk -as it is generally understood- may as well be relevant with respect to developed countries that adhere to the rule of law and strong protection of property rights.[187] For example, despite its reciprocity, the investor-state arbitration clause in NAFTA, the North American Free Trade Agreement, was initially intended to protect the foreign investors investing in Mexico.[188] However, the developed country parties to the agreement, namely Canada and the USA have been eventually subjected to investor claims before arbitral tribunals with regard to, *inter alia*, public interest policies as well. More recently, Philip Morris Asia, a cigarette manufacturer, has challenged Australia's legislation on "plain packaging" that mandates a complete prohibition of displaying any brand name on cigarette cartons while the federal government of Germany has been brought by Vattenfall, a Swedish energy company, before an ICSID tribunal basically for measures taken in relation to the construction of a coal fired power plant and its decision to phase out nuclear power completely.[189]

The relevance of the concept of political risk to developed countries may be also exemplified by recent developments within the European Union. In October 2015, the European Commission decided that the selective tax advantages granted by the governments of Luxembourg and the Netherlands to Fiat and Starbucks, respectively, were illegal for constituting unlawful state aid in breach of Articles 107(1) and 108(3) of the Treaty on the Functioning of the European Union (TFEU).[190] The Commission stated that the tax advantages

[187] See Julian M. Campisi, 'Reconsidering Political Risk in Developed Economies' (2016) 4 *Journal of Political Risk*.

[188] Jan Kleinheisterkamp and Lauge Poulsen, *Investment Protection in TTIP: Three Feasible Proposals*, GEG & BSG Policy Brief (2014), p. 7.

[189] See Philip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12, available at https://www.italaw.com/cases/851 (last visited 17 December 2017) and Vattenfall AB and Others v. Federal Republic of Germany, ICSID Case No. ARB/12/12, available at https://www.italaw.com/cases/1654 (last visited 17 December 2017).

[190] See, Commission Decision of 21.10.2015 on State Aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat, Official Journal of the European Union, L 351, 22 December 2016, p. 78; and Commission Decision of 21.10.2015 on State Aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, Official Journal of the European Union, L 83, 29 March 2017, p. 102.

do not reflect economic reality; instead, they endorse artificial and complex calculation methods to establish taxable profits. The governments of Luxembourg and the Netherlands were ordered by the European Commission to recover the unpaid tax from these two firms. From the perspective of the foreign investors, the decision of the European Commission constitutes possibly a political risk event, which could arguably be categorized as indirect expropriation.

Whereas developed countries may be faced with investment arbitration for alleged occurrence of political risks, foreign investment insurance as investment protection in developed countries remains rather unlikely. In fact, the possibility of treaty-based arbitration is now controversial. The scope of investment protection vis-à-vis the protection of public interests have recently come under close scrutiny in the course of negotiations between the USA, Canada and the European Union of regional trade and investment agreements, TTIP (Transatlantic Trade and Investment Partnership) and CETA (Comprehensive Economic and Trade Agreement). It is questioned whether foreign investors in the USA and EU countries should be allowed to bypass domestic courts that are generally held to be independent and competent to deal with investor-state disputes. Investment insurance has recently been invoked by some scholars as a possible alternative to ISDS for investors that are concerned with investment protection in a few EU countries.[191] There is clearly a distinction between developed and developing country members of the EU and for developed country members, neither treaty-based arbitration nor investment insurance is advisable.

Yet it is useful to ask how public investment insurance would work with respect to FDI in developed countries. Would the government of Canada invoke the subrogation clause in the free trade agreement between the EU and Canada?[192]

4.2. A Hypothetical Approach: Would it Work?

Settlement of subrogated claims is mostly dependent on the home state's deployment of political and economic leverage over the host state. In the case of developed countries, their interest in maintaining a broader political and economic relationship is generally mutual, which prevents them from displaying hegemonic behavior over each other. The standard dispute

[191] Kleinheisterkamp and Poulsen, *Investment Protection in TTIP: Three Feasible Proposals*, p. 5.

[192] EU and Canada have concluded the negotiations on Comprehensive Economic and Trade Agreement in 2014. The consolidated text of CETA includes a subrogation clause. Article X.13: Subrogation "If a Party, or an agency thereof, makes a payment under an indemnity, guarantee or contract of insurance it has entered into in respect of an investment made by one of its investors in the territory of the other Party, the other Party shall recognize that the Party or its agency shall be entitled in all circumstances to the same rights as those of the investor in respect of the investment. Such rights may be exercised by the Party or an agency thereof, or by the investor if the Party or an agency thereof so authorizes."

settlement mechanism between developed countries is interstate consultations and arbitration. In a scenario where the parties to a subrogated claim consist of developed countries, they would prefer to submit the dispute to an interstate arbitration tribunal if state-to-state consultation yields no settlement. Judicial review of insurers' claim determinations would constitute a positive development in terms of the legitimacy of foreign investment insurance. In this context, legitimacy denotes depoliticization in the sense that claim determinations come to be reviewed in terms of their compliance with [international investment law (in the presence of an international investment protection agreement between the host and the home state) and/or] public international law. Currently, insurers' claim determinations are subject to little scrutiny and when the interstate power dynamics are in favor of the home state, they enhance insurers' latitude with respect to claim determinations.[193]

From a public debate perspective, such developments that centers on insurance claim determinations are likely to give rise to discussions over the legitimacy of investment insurance arrangements including the investment protection standards implemented through insurers. In fact, applying investment insurance arrangements where both the investor's home state and the host state are developed countries would generate very similar outcomes as, for example, the investor-state arbitration clause in NAFTA. Although arbitral awards were in favor of the US and Canadian governments, being sued before international arbitration tribunals where they were required to justify their interference in foreign investments accelerated discussions over the asymmetries between investor's rights and public interests and the legitimacy of investor-state arbitration itself. Investment insurance between developed countries would undeniably extend the exposure of the operation of public investment insurance and the political risk narratives to this now widespread legitimacy discussion under international investment law.

Bypassing local courts in developed countries has proven highly controversial. In the scenario where the state actors involved in an investment insurance arrangement consist of developed countries, public investment insurers are likely to require the policyholders to exhaust all remedies available, including domestic courts and international investment arbitration, with a view to avoiding interstate confrontation. In fact, this can be arguably observed even in cases where the host state is classified as developing but relatively big and powerful. In other words, the capabilities of prospective host states on the international plane vis-à-vis the investor's home state that issues the investment guarantee potentially influence the terms and conditions of insurance coverage. When the US investment insurance programs

[193] See Chapter 5, section 2.1. that discusses the flexibility of OPIC with respect to claim determination.

began operating in China in 1982, OPIC, for example, adopted particular underwriting guidelines designed for China which were somewhat "less stringent" than those applicable to projects elsewhere.[194] As to the expropriation coverage, for example, OPIC reduced the coverage to not-honoring the dispute resolution procedure the investor and the Chinese government had agreed for.[195] A similar limitation of coverage was adopted also with respect to the Dabhol power project. OPIC inserted two additional clauses into the insurance contract it signed with investors for the Dabhol power project, limiting the insurance coverage to non-payment of arbitral awards confirmed by an Indian court of last resort.[196] Nevertheless, OPIC was obliged to compensate investors by an arbitral tribunal that was set up to settle OPIC-investor dispute even though this contractual obligation had not been fulfilled by the investors.[197] Consequently OPIC sought recovery from the Indian government. Perhaps, the fact that the US government had to initiate an interstate arbitration for OPIC's recovery under its investment insurance program for the first time in the history of OPIC demonstrates in some way the power dynamics between the USA and India that had influenced the extent of coverage, answering why OPIC required the investors to invoke other remedies available to investors under domestic as well as international law in the first place.[198]

It is rather unlikely for investment insurance to remain attractive to investors, if insurers require exhaustion of local and international remedies including investment treaty arbitration. Unless the investment insurance coverage is more extensive than the relevant investment protection standards in the relevant BIT (that contains investment arbitration), the exhaustion of available remedies rule restricts the insurance coverage to non-payment of arbitral awards. Investors' perception of risk that is associated with the non-payment of arbitral awards by developed countries can be expected to be negligible. Therefore, if arbitration is an option for the investor under the investment agreement or an investment treaty, the use of investment insurance for investments in developed countries would be marginally small. On the other hand, if an insurer does not require exhaustion of available remedies, it may not be able to justify its decision to pay out the investor and its request for the settlement of the subrogated claim by the

[194] Marra, 'OPIC Programs in China' at 170-2.
[195] *Ibid.*, 171-2.
[196] OPIC Memorandum of Determinations-Bank of America in Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol. II, p. 869.
[197] See Chapter 2.
[198] See Chapter 2. In the settlement of OPIC-investor dispute with respect to Dabhol power project, arbitrators stated that limitation of coverage to non-payment of arbitral awards was imposed by OPIC in order to assist OPIC when it was faced with an insurance claim that it has to pay and commence the recovery procedure against the Government of India pursuant to the Investment Incentive Agreement. See, *Bechtel v. OPIC, AAA Case No. 50 T195 00509 02, 3 September 2003*, p. 27.

“developed” host state because a claim payment despite a local court decision about the legality of the government action or inaction would imply a mistrust to domestic legal system. Unless insurers operate financially self-sufficient through risk premiums or reinsurance from private insurers, public investment insurance without “recovery” might become a sort of subsidy.

Chapter 5 Moral Hazards, Hazards, and Community Safeguards

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Promotion of foreign investment flows to developing countries for development purposes raises questions concerning the governance of investments. On the one hand, insurers may impede developmental endeavors if they cause undue restrictions of the sovereign right of the host state to regulate the foreign investment in question. If insurers provide support to investments that are unsustainable, detrimental to the environment, cause human rights violations and impoverish local communities, such investment protection would be contrary to their development mandate. On the other hand, developing countries may not be capable of enforcing or may not be willing to enforce laws and regulations on a foreign investment to increase the contribution of the investment to the economic development of the country. Moreover, the need for foreign investment in developing countries may lead to a deal that is excessively favorable to a foreign investor compared to local communities or the society in general. Such situations create a legitimacy problem not only for foreign investors but also for third parties such as investment insurers that facilitate the investment through their insurance products. Public investment insurers generally adopt guidelines, policies or standards on social and environmental sustainability in an attempt to legitimize their conduct of business in supporting foreign investments.

An equally crucial concern related to the developmental outcomes of publicly insured investments consists in the moral hazard that the investment insurance products give rise to. Investment insurance as a regular insurance product prompts moral hazard that affect the behavior of involved actors in a manner that may limit or eliminate the benefits of insured investments. Even though insurers take measures to tackle moral hazard in their underwriting business, these “side effects” generate a conflict between their primary function which is to protect foreign investments and their ultimate goal which is to promote economic development of poor countries.

This chapter explains the operation of investment insurance with reference to these inherently competitive goals. Focusing on moral hazard, the first and second sections illustrate the circumstances under which a conflict of goals emerges in investment insurance. The third section offers an analysis of further hazards that may jeopardize the developmental impacts of insured investments. The fourth section provides a descriptive analysis of the community

safeguards and the accountability mechanisms adopted by OPIC and MIGA and argues on the basis of case studies that such accountability mechanisms may not resolve the conflict entirely. The section argues that the community safeguards and the accountability mechanisms may not prevent project failure unless they are implemented as core elements of investment insurance underwriting.

I. Moral Hazards on the Part of the Insured Investors

Political risk events may be beyond the control of investors. At the same time, investor activities may contribute to the occurrence of political risk events.[1] In that sense, political risks differ from insurable risks which are always beyond the control of insurance holders.[2] Investors may trigger political risk events in various ways. Poor management of the project, causing suppression of opposing groups, disregarding the economic situation of the region or country, direct or indirect human rights violations, or environmental degradation as a result of the project may contribute to occurrence of political risk events. For instance, if a mining company fails to address community resistance, tension might escalate to a point of widespread local opposition to the mining project which, in turn, might lead to suspension of government approval for the project.[3] It is argued that there are instances where the perception of developing country governments that communities are not benefitting from the project is the primary reason for expropriation or other interference with particular projects.[4]

Despite investors' role in the occurrence of political risk events, defining political risks exclusively with respect to government acts contradicts insurers' objective to contribute to the economic development of host states. By transferring the risk of poor management from the investor to the insurer and eventually to the host state, investment insurance generates moral hazard on the part of the insured investor.

As a remedy to this sort of moral hazard, many scholars point to the importance of corporate social responsibility mechanisms.[5] Webb suggests that corporate social responsibility is a risk mitigation tool and insurance contracts may play a regulatory role in the good management of

[1] Kernaghan Webb, 'Political Risk Insurance, CSR and the Mining Sector: An Illustration of the Regulatory Effects of Contracts' (2012) 54 *International Journal of Law and Management* 394–415.
[2] Gordon, *Investment Guarantees and Political Risk*.
[3] Webb, 'Political Risk Insurance, CSR and the Mining Sector'.
[4] Surya P. Subedi, 'The Challenge of Reconciling the Competing Principles within the Law of Foreign Investment with Special Reference to the Recent Trend in the Interpretation of the Term "Expropriation"' (2006) 40 *The International Lawyer* 121–41.
[5] A. Inniss, 'Rethinking Political Risk Insurance: Incentives for Investor Risk Mitigation' (2010) 16 *Southwestern Journal of International Law*; Webb, 'Political Risk Insurance, CSR and the Mining Sector'; Subedi, 'The Challenge of Reconciling the Competing Principles'.

investments, if compliance with corporate social responsibility is made part of them. Corporate social responsibility is generally connected to a firm's responsibility to address its social, environmental and economic impacts in its decisions and actions; to take into account the expectations of stakeholders; to operate in an ethical and transparent manner; to meet laws and international norms, in all of its relationships, including with its contractual partners; and thereby to contribute to sustainable development and the health and welfare of societies.[6] For instance, if a mining company can demonstrate the benefits of the mining project to local communities by establishing agreements committing to employment and business opportunities or through investment in local infrastructure, or through the payment of royalties and taxes; and if it can put in place programs that decrease the risk of negative environmental impacts or improve labor conditions, this in turn may minimize the likelihood of local resistance or opposition to the mining project.[7] Amicable relationships between corporations and local communities in general decreases the risk of political interference in investment projects.[8] Therefore, corporate social responsibility mechanisms can be characterized as proactive forms of political risk mitigation.[9] This also suggests that a corporation's failure to adopt such mechanisms may contribute in the occurrence of political risk events and this failure arguably merits rejection or reduction of investment protection by insurers.

In the same vein, Webb suggests that lower premium rates decrease moral hazard by incentivizing the insured investor to comply with corporate social responsibility.[10] Similar to conventional insurance, investment insurance affects the incentives of the insured investors to mitigate risk. With purchase of investment insurance, investors might be incentivized to omit to put in place their own risk management programs.[11] However, when insurers operate on lower premium rates and request investors to implement corporate social responsibility, this would signal that the insurer prioritizes mitigation of the covered risks and lead the insured investor to implement additional risk management tools.

[6] ISO, 2010.
[7] Webb, 'Political Risk Insurance, CSR and the Mining Sector'.
[8] Subedi, 'The Challenge of Reconciling the Competing Principles'.
[9] Webb, 'Political Risk Insurance, CSR and the Mining Sector', 396-7.
[10] Inniss, 'Rethinking Political Risk Insurance'.
[11] Louis T. Wells and Rafiq Ahmed, *Making Foreign Investment Safe: Property Rights and National Sovereignty* (Oxford: Oxford Univ. Press, 2007), p. 201.

Moral hazard can also be addressed through deductibles and exclusion clauses to some extent. For instance, public insurers generally do not cover the complete investment. That is, coverage is provided by most insurers up to 95% of the investment.[12]

However, some scholars assert that foreign investment insurance as any insurance product, regardless of the premiums, inherently raises moral hazard that lower investors' incentives to reduce their exposure to political risks. Moral hazard remains despite the fact that terms in insurance contracts may require the investors to use reasonable care and due diligence as if the investment was not insured.[13] However, this arguably does not suffice to correct investors' behaviors. Moody asserts that given protection through public investment insurance, investors may be more reckless in making investments, or less precautionary in risk assessment, than a competitive investment market would require.[14] Indeed, foreign investment insurance makes it more likely for an investor to invest in a riskier environment and this encouragement to invest in risky regions is the primary aim of insurers like OPIC and MIGA. However, the existence of insurance does not eliminate insured investor's responsibility to implement risk mitigation. Yet, it is often argued that when investment insurance contracts are in place, investors might manage their host country relationships differently.[15]

Techniques to tackle moral hazards would fail, especially when the investor incurs financial difficulties and intends to exit the market. In other words, in the event of a conflict, a foreign investor that is backed by an insurance policy may tend to avoid engaging in activities to reduce tensions.[16] If it is a viable option for the foreign investor to retreat from the host country, then investment insurance may prevent the investor from renegotiating to settle the dispute. This sort of moral hazard can be illustrated with respect to MidAmerican's geothermal power projects in Indonesia.[17]

In 1994, Nebraska-based MidAmerican Energy Holdings Company invested in two geothermal power projects in Indonesia.[18] MidAmerican had different local partners for each

[12] Ratio depends on the insurance contract. Every insurer might adopt a different ratio.
[13] Webb, 'Political Risk Insurance, CSR and the Mining Sector'.
[14] Roger Moody, *The Risks We Run: Mining, Communities and Political Risk Insurance* (Utrecht: International Books, 2005).
[15] Theodore H. Moran, *Harnessing Foreign Direct Investment for Development* (Washington, D.C., 2006).
[16] Corene Crossin and Jessie Banfield, *Conflict and Project Finance: Exploring Options for Better Management of Conflict Risk* (2006), p. i.
[17] MidAmerican Energy Holdings Company, formerly CalEnergy Company, Inc. See, Spagnoletti and O'Callaghan, 'Going Undercover', 15.
[18] J. Martin, 'OPIC Modified Expropriation Coverage Case Study: MidAmerican's Projects in Indonesia', in T. H. Moran (ed.), *International Political Risk Management: Exploring New Frontiers* (Washington, D.C., 2001), pp. 58–68 at 60.

of the projects. In 1997, disputes arose when then President Suharto suspended the contractual obligations of Perusahaan Listrik Negara, an Indonesian government-owned natural gas supplier, toward MidAmerican.[19] Failing to resolve the disputes, MidAmerican sought arbitration pursuant to the Energy Sales Contract against Perusahaan Listrik Negara and later against the Government of Indonesia under the Support Letter issued by the Ministry of Finance.[20] MidAmerican often has been criticized for not renegotiating the investment agreements in an attempt to alleviate tensions, as other firms did. It is asserted that two facts influenced the trajectory of the investment project.[21] Firstly, the parent company, MidAmerican, has changed hands in the course of investment.[22] This brought along a change of policy concerning the overseas operations of the company. The new leadership basically decided to withdraw their business from overseas including their investments in Indonesia. Secondly, the investment was substantially protected by investment insurance from OPIC.[23]

When MidAmerican filed a claim with OPIC, the latter decided that abrogating the contractual agreements as well as the subsequent failure by the Republic of Indonesia to honor the arbitral award violated the investor's fundamental rights in the projects in contravention of the customary international law principles concerning expropriation.[24] Consequently, OPIC paid to MidAmerican US$217 million in compensation.[25] It is likely that payment by OPIC contributed to the decision of the investor to retreat from its Indonesian businesses instead of renegotiating the investment contracts.[26] Following payment of the insurance claim and further negotiations between the US and Indonesian governments, a final settlement for OPIC's recovery was concluded in late 2001, whereby Indonesia agreed to reimburse OPIC pursuant to the US-Indonesia investment insurance agreement of 1967.[27] In this case, moral hazard raises

[19] *Ibid.*, 60-1. This was a consequence of the severe depression of the Indonesian economy and the massive depreciation of the rupiah.
[20] *Ibid.*, 61. Both arbitral tribunals entered final awards in favor of MidAmerican in the amount of US$572.3 million and US$575.6 million, respectively.
[21] Wells and Ahmed, *Making Foreign Investment Safe*, p. 223.
[22] *Ibid.*
[23] *Ibid.*
[24] Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol 2, p. 731.
[25] *Ibid.*
[26] Wells and Ahmed, *Making Foreign Investment Safe*, p. 227.
[27] Chadwick, 'The Overseas Private Investment Corporation', p. 107. Exchange of Notes Constituting an Agreement between the United States of America and Indonesia Relating to Investment Guaranties (signed 7 January 1967, entered into force 22 August 1967) 692 UNTS 109. In 2010, a new investment insurance agreement was signed between the USA and Indonesia. See Investment Support Agreement Between the Government of the United States of America and the Government of the Republic of Indonesia (signed 13 April 2010) <https://www.state.gov/documents/organization/149390.pdf> (last visited 23 March 2017).

legitimacy questions as it leads a private company to passing risks on to the taxpayers of the host country.[28]

A similar impact on the behavior of investors may be observed with respect to investment arbitration. Moran argues that lucrative arbitral awards exacerbate the problem of moral hazard:

"*The tendency of arbitral panels to provide overly generous awards… reinforces moral hazard in a perverse manner. Besides tilting the investor toward demanding compensation rather than engaging in a work-out, the promise of lucrative compensation tempts an investor to bail out of an investment once it becomes apparent that the original surrounding assumptions were too rosy. This protective legal structure not only skews the choices facing the investors themselves, but also affects the behaviour of their financial backers - as when the banks lending to infrastructure projects in Asia refused to authorize the investors to restructure the original package.*"[29]

II. Moral Hazards on the Part of Insurers and Host States

Foreign investment insurance may also influence the behavior of third parties that are in a position to affect the risk, such as insurers and host states.[30] Moral hazard, as concerns foreign investment insurance is far-reaching and complex since foreign investment insurance deals with relationships between investors and various political actors in host countries and home countries.[31] While common insurance practices affect only the behavior of the insured, foreign investment insurance has the potential to influence host state political behavior as well.[32] Tan conceptualizes this as operation of foreign investment insurance in a broader architecture of investment climate surveillance through a reference to a complex web of relations.[33] Indeed, the political risk narratives may influence the behavior of host states. It is argued that foreign investment insurance can affect host country behavior in two ways; firstly, by reducing market-based incentives for host country policy reform.[34] Investment insurance may weaken the incentives for host government to commit public policy reforms that would enhance protection

[28] M. van Voorst, 'Case Study: Debt Creating Aspects of Export Credits', in *A Race to the Bottom: Creating Risk, Generating Debt and Guaranteeing Environmental Destruction* (1998), pp. 33–7, p. 33.
[29] Moran, *Harnessing Foreign Direct Investment for Development*, p. 98.
[30] Rasmiya Kazimova, 'Insurance as a Risk Management Tool: A Mitigating or Aggravating Factor?', in S. Leader and D. Ong (eds.), *Global Project Finance, Human Rights and Sustainable Development* (Cambridge: Cambridge University Press, 2013), p. 243.
[31] Gordon, *Investment Guarantees and Political Risk*.
[32] *Ibid.*
[33] Tan, 'Risky Business'.
[34] Gordon, *Investment Guarantees and Political Risk*, p. 94.

of investments such as improving public sector transparency and accountability.[35] Secondly by influencing the host government's decision to take regulatory action covered by an investment insurance policy.[36] If the insured investor notifies the insurer or the home country of a regulatory action that might lead to an insurance claim, the insurer or the home country may resort to "good offices" or diplomatic channels to settle the dispute. The shift in the host government's interlocutor from the investor to the insurer or the home state may affect host government's evaluation of taking such a regulatory action.[37] As an example of direct influence, Moody reports that a MIGA official communicated to a developing country government that new environmental regulations would be "tantamount to expropriation", thereby in effect compelling the government to provide compensation to the mining companies involved.[38] This sort of deterrence effect is studied by Wodehouse who suggests that the presence of bilateral or multilateral lenders or insurers in a project has significant risk mitigating effects for investors, because host countries may alter their behavior if they feel that agents of the home country government may intervene on behalf of the investor.[39]

The deterrence effect is enhanced by the principle of subrogation. If the insurer pays out the investor, the host government faces the insurer or the home state with the subrogated claim. By means of subrogation, the ultimate bearer of the risk is the host state, i.e. the taxpayers in the host country, and particularly local communities. Thus, it is important to understand the role of subrogation in political risk insurance arrangements for the issue of moral hazard. Under conventional insurance law, one of the aims of subrogation is to remedy moral hazard on the part of the wrongdoer, which is the host state in the context of investment insurance. Penalizing host states for regulatory changes or administrative intervention in an investment project may lead to disincentives for host states to use governmental authority even when they aim at broader developmental impacts.[40] Moreover, the recovery option on the basis of subrogated claim makes the insurer act in a more careless way with respect to issuance of insurance.

2.1. Subrogation and Salvage Prospects

Subrogation may enhance the moral hazard associated with political risk insurance that affects investors' and insurers' behavior.[41] Prior to the issuance of insurance, insurers conduct

[35] *Ibid.*, 94.
[36] *Ibid.*
[37] *Ibid.*
[38] Moody, *The Risks We Run*.
[39] Erik J. Wodehouse, 'The Obsolescing Bargain Redux? Foreign Investment in the Electric Power Sector in Developing Countries' (2006) 38 *New York University Journal of International Law and Politics* 121–219.
[40] Tan, 'Risky Business', 184-5.
[41] *Ibid.*

due diligence to assess the risks associated with the project and the probability of these and other risks materializing.[42] Based on this due diligence, insurers then may require the insured investors to take all reasonable and available measures to reduce the probability of these risks materializing and they may monitor the project after the issuance of insurance. The terms and conditions of the insurance contract and the amount of premiums may be used by insurers to impose better risk management on insured investors.[43]

However, if an insurer believes that it will recover the payment triggered by the risk event, it will have less incentive to carry out the necessary due diligence. Recovery rewards insurers even in the event of an initial lack of due diligence and subsequent monitoring of investment projects.[44] Thus, it is argued that investment insurers are increasingly being shielded by means of subrogation.[45] Moreover, subrogation may enhance moral hazard by influencing insurance claim settlements. As for OPIC, the prospect for recovery of the insurance claim payment is very good and this may incentivize OPIC to extend the scope of coverage through broad interpretations of insurance contracts or to pay compensation even in cases where there is no conclusive finding of a risk event. As a consequence, subrogation makes it easier for investors to exit financially unviable projects, and thereby transfer economic risks to the host States.[46] For example, in the Dabhol power project in India, disputes and ultimate failure of the project were virtually inevitable and they had appeared fairly foreseeable. The Dabhol project was born fragile, giving rise to controversies on a range of grounds such as the allegedly corrupt process that led to the project, the substance of the deal and the alleged adverse impacts on society and the environment.[47] Disputes and project failure could have been prevented beforehand if the parties, particularly the foreign investor firms, had assumed corporate social responsibility to mitigate the risks the project itself created.[48] Nevertheless, the role of foreign investors in the creation of political risks were never fully investigated by OPIC neither prior to nor after the issuance of insurance.

[42] Kazimova, *Insurance as a Risk Management Tool*, p. 247.
[43] *Ibid.*
[44] Tan, 'Risky Business', 184-5; Louis T. Wells Jr., 'The New International Property Rights: Can the Foreign Investor Rely on Them?', in T. Moran and G. T. West (eds.), *International Political Risk Management: Looking to the Future* (Washington, DC: World Bank, 2005), pp. 87–102 at 96.
[45] Kazimova, *Insurance as a Risk Management Tool*, pp. 260-1.
[46] Tan, 'Risky Business', p. 184-5. See also Wells and Ahmed, *Making Foreign Investment Safe*, p. 223.
[47] See, van Harten, 'TWAIL and the Dabhol Arbitration'.
[48] For a discussion on the role of corporate social responsibility as a risk mitigation tool, see Webb, 'Political Risk Insurance, CSR and the Mining Sector'.

A decade after OPIC had started operation, it was argued that, when faced with an expropriation claim, OPIC normally pays particular attention to whether investor's losses would have occurred independently of the governmental action, even when that action has been expropriatory in intent.[49] In fact, OPIC denied several claims for the reason that the failure of the insured enterprise was due to commercial factors other than the covered political risks. Yet, in the meantime OPIC has become more lenient in its assessment of insurance claims. For example, it has decided to pay some expropriation insurance claims only to avoid future arbitration but without conclusive expropriation finding, as in the settlements of *AES Corporation* and *Bank of America* claims.

The expropriation claims of Bank of America and AES Corporation concerned two separate gas-fired power plants in Colombia.[50] Bank of America contracted with OPIC in 1999 to insure a project loan and an interest rate swap agreement related to the TermoCandelaria gas-fired power plant in Cartegana, Colombia.[51] The other power plant was the Mamanol gas-fired power plant in the same region of Colombia. Inter American Leasing Company, represented by AES Corporation, contracted with OPIC in 1993 to insure an equity investment in the project. In February 2001, an unspecified guerilla group destroyed the power transmission lines connecting key hydroelectric plants to some major cities in Colombia, thereby creating isolated service areas that could be supplied with power only by more expensive power producers, such as TermoCandelaria and Mamanol. To maintain price stability, the Colombian regulatory authority enacted a measure, Resolution 34, imposing a cap on the rates that a generator could charge. Bank of America whose loan was insured by OPIC and equity investors represented by AES Corporation and insured similarly by OPIC claimed that Resolution 34 operated to prevent recovery of actual costs and caused losses that undermined the projects' ability to service their debts. In both cases, OPIC analyzed the projects with assistance of outside engineering and financial experts and concluded for both cases that the projects' inability to meet their financial obligations may have been due to commercial factors and not any covered political risk. As a result, OPIC reached preliminary decisions that the claims should be denied. Nevertheless, OPIC eventually decided to compensate both of the policy holders on the ground that parties, including OPIC and policy holders, should avoid the 'risks and uncertainties' they would face if the policy holders submitted their claims to arbitration.[52]

[49] Koven, 'Expropriation and the "Jurisprudence" of OPIC', 287.
[50] See Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*, vol 2, pp. 896 and 953.
[51] See *Ibid.*, 896.
[52] *Ibid.*, 899.

Similarly, in another case, OPIC decided to pay compensation despite the lack of an expropriation finding.[53] The Bernard J Salvador case concerns investments of three U.S. investors in a commercial fishing corporation, CSI Ltd., organized under the laws of St. Kitts for the purpose of conducting a fishing venture based on St. Kitts. A license was issued to CSI including a provision that CSI was licensed "*to carry on deep sea fishing ONLY; NO inshore fishing is to be done*", implying that the investor was requested to restrict his operations to areas more than three miles offshore.[54] However, the three-mile restriction was not clear and generated a series of disputes. Investors stated their dissatisfaction with the three-mile restriction; however, they did not appeal it. They found new fishing grounds within the restrictions and enjoyed good catch rates for a while. It was noted that there was a growing tension between the investors and the local fishermen though. Eventually, the boat of the investors was destroyed in a fire while at anchor in St. Kitts. The investor applied for and obtained from the Customs Department a 3-month license permitting them to import 20,000 lbs. of frozen fish in order to keep their retail store operating. The Ministry of Trade was informed about the 3-month import license through the investors' advertising campaign. While discussions took place, the investors requested a permanent import license; however, their request was refused by the Ministry of Trade as that would make the project simply a fish importing venture. Government officials offered to renew the temporary import license until the CSI could begin fishing again. The investors' request for resident status which would enable them to fish at the grounds used by the local fishermen was also declined as they did not meet the relevant criteria. Consequently, the investors decided to cease operations and notified OPIC that in their view, the three-mile restriction was of an expropriatory nature.

In OPIC's finding, the three-mile restriction was not a violation of the license; however, it "*may have been hasty and arbitrary*" as "*there was no attempt to verify the charges made against Mr. Salvador, no explanation to him of what the charges-were, and apparently no real opportunity to contest the decision once taken*".[55] Subsequently, OPIC determined to settle the claim despite the fact that there was no finding of expropriation:

"Notwithstanding OPIC's conclusion that the claim does not support a clear finding on the merits that Expropriatory Action occurred, however, OPIC has determined that a settlement of $180,000 is appropriate in this case to avoid a further contest of the factual and legal issues involved, which are uniquely complex and ambiguous. While in OPIC's view the evidence does

[53] See *Ibid.*, 479.
[54] *Ibid.*
[55] *Ibid.*, 482-3. Mr. Salvador was one of the investors and was acting also on behalf of other two U.S. investors.

not clearly support a finding that Expropriatory Action occurred, the Investor does not accept this conclusion."[56]

Generally speaking, OPIC subrogates the property, rights and/or claims of the insurance holders once it compensates the insured investors for their loss.[57] In effect, in cases of alleged (total) expropriation, compensation payment by OPIC terminates the investment project. The insured investor shall assign to OPIC, concurrent with the payment of compensation, all interests attributable to the investment in case of total expropriation. Investors have the duty to take measures for the protection of their interests in the insured investment both prior to and after the assignment and they are also responsible to ensure that their interests can be assigned to OPIC freely.[58] OPIC shall pay no compensation if the insured investors forfeited their interests in the insured investment.[59] This means that, in order to be entitled to receive compensation, the insured investors must have an interest –property, right and/or claim-, such as commercially viable property or procedural rights under international or host State law to assign for OPIC to recover the compensation it paid out to the investors.[60] OPIC may recover the compensation paid out to the insured investor through, *inter alia*, disposition of assets left in the host country or settlement directly with the host state, both of which may distort compliance of the investment with host state law, e.g. bankruptcy law, and its economic benefits if a project, in reality, is being terminated not because of a 'non-commercial' event but due to commercial unviability for investors. A host government is not liable for the consequences of its actions that are legal, as opposed to wrongful -even if these actions may be associated with the termination of an investment project as in the example of the enactment of Resolution 34 by the Columbian government.[61] However, considering the political and economic leverage industrialized countries like the USA exert on developing host states for the settlement of subrogated claims and the difficulty of finding an appropriate legal standard in political risk insurance industry that distinguishes between legitimate and wrongful government regulatory

[56] *Ibid.*, 483. (GOSK stands for the government of St. Kitts).
[57] The OPIC standard insurance contract provides distinct terms for different risk types. For subrogation right of OPIC pertaining different risk types, see *OPIC Contract of Insurance - Form 234 KGT 12-85 SBC NS (Rev. 9/05)*.
[58] *Ibid.* art 9.01.4 (b).
[59] *Ibid.*
[60] This does not mean that submission of an insurance claim creates a fork-in-the-road situation for the insured investors even when they are compensated by OPIC. Insured investors may use their procedural rights with consultation with OPIC. See *Ibid.* art 9.01.9.
[61] Frederick E. Jenney, 'A Sword in a Stone: Problems (and a Few Solutions) Regarding Political Risk Insurance Coverage of Regulatory Takings', in T. H. Moran, G. T. West and K. Martin (eds.), *International Political Risk Management: Needs of the Present, Challenges for the Future* (Washington, D.C., 2008), pp. 171–88, p. 171.

actions,[62] a legitimacy problem inevitably arises out of the operation of OPIC's political risk insurance.

2.2. Market Forces and OPIC's Institutional Survival Concerns

The public investment insurance *industry* as such is primarily informed and guided by investor-centered political risk approaches. Conversely, the industry constantly regenerates such approaches to political risk in order to remain in operation. That is, insurers are responsive to investors' needs and requests as their existence is often justified by investors' demand for their insurance products. Even the large and important investment insurers, like MIGA and OPIC, whose mandate is limited to supporting projects with positive developmental impacts on the host country economy, are very much dependent on the prioritization of investors as their clients. In general terms, investment insurers' viability depends on the provision of surveillance and investment protection that is in the interest of investors. A closer look at OPIC's history helps illustrating the influence of corporate preferences on the investment insurance industry.[63]

The US Congress about whether to reauthorize OPIC programs, the term of the reauthorization and the conditions thereof.[64] OPIC's operative authority was first extended through the end of 1974 by the Foreign Assistance Act of 1973.[65] As from this date, OPIC was being reauthorized on a three to five-year basis. The last long-term reauthorization was made in 2003, which lasted through the year 2007.[66] Between April and September 2008, OPIC's authorization lapsed and, in this period, OPIC refused to accept new business.[67] Ever since, OPIC has been reauthorized on an annual basis.[68]

Since Congress may or may not extend OPIC's authorization, it is essential for OPIC to address the concerns of Congress. A disagreement between the House of Representatives and the Senate Committee on Foreign Relations on the purpose and functionality of OPIC resulted in hard-fought debates in the 1973 Congress hearings.[69] The Senate subcommittee on Multinational Corporations was particularly concerned whether OPIC was able to contribute to the development aid goals of the USA and did not merely compromise the national budget for

[62] See *Ibid.*, 173.
[63] While there might be other factors that affect the viability of OPIC, the emphasis in this section will be on the influence of corporations -the clientele- and their preferences on the operation of OPIC investment insurance.
[64] Akhtar, *The Overseas Private Investment Corporation: Background and Legislative Issues*, p. 15.
[65] *Foreign Assistance Act of 1973*, Pub L 93-189 (enacted 17 December 1973), s. 240A (b).
[66] Akhtar, *The Overseas Private Investment Corporation: Background and Legislative Issues*, p. 15.
[67] *Ibid.*
[68] *Ibid.*
[69] Haendel, West and Meadow, *Overseas Investment and Political Risk*, p. 20-5.

the protection of investors.[70] In an attempt to address such concerns, legislative changes were made particularly through the OPIC Amendments Acts of 1974, 1978 and 1981. Certain measures were adopted to ensure that OPIC insured projects are environmentally sound and have economic and social development impacts. As to the financial resources, OPIC Amendments Act of 1974 inserted into OPIC's Charter a provision that OPIC shall conduct its programs on a self-sustaining basis, thereby ending its financial dependence on the US Treasury. That is, OPIC was required to insulate the US Treasury against its operative risks and to conduct financing, insurance, and reinsurance operations on a self-sustaining basis.[71] Furthermore, through the OPIC Amendments Act of 1981, OPIC was required to return to the general fund of the US Treasury, amounts equal to the total amounts which were assigned to it before January 1, 1975. For that purpose, OPIC was required to pay to the Treasury at least 10% of its net income for the preceding fiscal year until the aggregate amount of such payments equaled the amounts to be returned to the Treasury.[72] In 1982, OPIC repaid to the Treasury the total amounts of its original paid-in capital.[73]

Officially, the primary rationale behind the establishment of the US investment insurance scheme is the desire to contribute to the economic development of *risky* areas of the world through promotion of private investment flows to these regions. The developmental role of investment insurance rests mainly upon its impact on the corporate foreign investment decision-making process.[74] Therefore, it is crucial for OPIC to demonstrate to Congress that its services and products are needed and consistently sought by US firms that have an interest in venturing abroad. In other words, OPIC's existence inherently depends on the demand for the investment insurance it offers.

This, in turn, creates a competitive situation where OPIC needs to be responsive to the needs and requests of investors -its clientele. From the perspective of investors, there are certain advantages of taking up investment insurance. Investment insurance is generally insulated from the *inherent vagaries of international law* such as the expense, delay and inconvenience of prosecuting claims against foreign states for investment related losses and potential obstacles represented by such doctrines as sovereign immunity and act of state since the insurance

[70] *Ibid.*, 21-2.
[71] See *Foreign Assistance Act of 1961*, s. 231.
[72] See *Overseas Private Investment Corporation Amendments Act of 1981*, Pub L 97-65 (enacted 16 October 1981).
[73] OPIC, *Congressional Budget Justification-Fiscal Year 2013* (2013), p. 3.
[74] Steven Franklin and Gerald T. West, 'The Overseas Private Investment Corporation Amendments Act of 1978: A Reaffirmation of the Developmental Role of Investment Insurance' (1979) 14 *Texas International Law Journal* 1–35 at 8-9.

coverage is determined by an insurance contract that is subject to US law.[75] In practice, the effectiveness of OPIC investment insurance is mainly evaluated with respect to the usefulness of the investment insurance after an unfavorable event actually occurred.[76] Therefore, OPIC could gain the confidence of investors mainly through prompt claim payments: "*it is doubtful that OPIC will ever be fully accepted by its users until it promptly pays a major claim*".[77] From 1966 to 1970, USAID paid US$3.5 million in settlement of eight insurance claims.[78] It denied eight other claims in the same period, one of which was submitted to arbitration by the insured investor.[79] From 1971 to September 2015, OPIC settled 298 insurance claims by paying out US$977.2 million in total while denying 30 insurance claims, of which 15 have been submitted to arbitration by the insured investors.[80]

The fact that OPIC is responsive not only to investors but also to Congress raised concerns on the part of investors in the first years of OPIC.[81] As aforementioned, the main concern of investors was the scope of insurance coverage. Indeed, OPIC cannot pay out insurance claims on the same basis as a private insurance company.[82] Being a government agency, it is subject to audits by the US Government Accountability Office and bound not to make a payment that is not mandated by US law.[83]

It may be argued that self-sustainability of OPIC facilitates determination of insurance claims favorable to insured investors even when there are legal suggestions that the claim should be denied. OPIC's self-sustainability enhances its corporate identity and likens it to a private insurance company that pays out insurance claims on a different basis than a public insurer.[84] OPIC has actually become a profit-making agency that contributes to the US Treasury.[85] OPIC's contribution to the Federal budget totaled US$434 million in fiscal year

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[75] Koven, 'Expropriation and the "Jurisprudence" of OPIC', 270; For a recent study that compares political risk insurance with investment treaty arbitration, see Kantor, *Comparing Political Risk Insurance and Investment Treaty Arbitration*.

[76] J. Heller, 'Political Risk Insurance' (1978) 12 *Journal of International Law and Economics* 231–4 at 231.

[77] *Ibid.*, 232.

[78] OPIC, *Insurance Claims Experience to Date* <https://www.opic.gov/sites/default/files/files/2015-Annual-Claims-Report.pdf> (last visited 20 March 2017).

[79] *Ibid.*

[80] *Ibid.* As will be discussed in Section 2.4, disputes between OPIC and insured investors are settled through arbitration.

[81] Heller, 'Political Risk Insurance', 232; see also Bruce E. Clubb and Verne W. Vance, 'Incentives to Private U. S. Investment Abroad under the Foreign Assistance Program' (1963) 72 *The Yale Law Journal* 475 at 476.

[82] Heller, 'Political Risk Insurance', 232.

[83] *Ibid.*

[84] A private insurance firm may not violate the law, but it may go beyond what is required by law to satisfy its customers.

[85] OPIC, *Congressional Budget Justification - Fiscal Year 2017* (2017), p. 1 <https://www.opic.gov/content/congressional-budget-justification> (last visited 23 March 2017).

2015 – the 38th consecutive year that OPIC has had a positive effect on the budget.[86] OPIC covers its administrative and program expenses up to the maximum spending level set by Congress each year[87] and the surplus is transferred to the US Treasury. By the fiscal year 2015, OPIC's reserves have totaled US$5.4 billion invested in Treasury securities, thereby insulating the US Treasury from the risk of losses in excess of those already budgeted.[88]

It is likely that it is the self-sustainability of OPIC and its contributions to the US Treasury that allow it to make claim payments based on expansive interpretations of the scope of coverage, thus going beyond international investment law guarantees. The expropriation risk insurance provided by OPIC has been quite often compared to investment protection standards concerning expropriation under international investment law. In his study of OPIC's first standard contract, Koven concludes that the contract's definition of expropriation is substantially broader than the definition likely to be employed by an arbitral tribunal applying current principles of international investment law.[89] The first standard contract contained restrictive clauses that signaled that the scope of OPIC expropriation coverage might not go beyond the expropriation protection in international law. One of the clauses suggested denial of coverage for governmental regulation where international law did not require compensation, and another one made clear that breach of contract was not a basis for recovery unless it also constituted an expropriation. Nevertheless, OPIC itself and arbitral tribunals deciding on insurance claims (those set up to settle disputes between insured investors and OPIC) have often resolved tensions between the definition of expropriation and these restrictive clauses in a manner favorable to investors.[90] Over time then the standard contract's definition of expropriation has been redrafted in an expansionary manner. Zylberglait notes that OPIC is eager to pay claims so much that it is ready to go to great lengths to reinterpret or even waive contractual terms in order to help an investor's claim.[91]

There appears, therefore, to be a causal link between on the one hand the incentives to gain the confidence of investors and the financial sector so as to justify further reauthorizations and on the other hand the flexible interpretation of insurance contracts as to the extent of compensation payment even in case of inconclusive expropriation decisions. Some argue that

[86] *Ibid.*
[87] Akhtar, *The Overseas Private Investment Corporation: Background and Legislative Issues*, p. 5.
[88] OPIC, *Congressional Budget Justification-Fiscal Year 2015* (2015), p. 7 <https://www.opic.gov/content/congressional-budget-justification> (last visited 23 March 2017).
[89] Koven, 'Expropriation and the "Jurisprudence" of OPIC', 280.
[90] Steven R. Ratner, 'Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law' (2008) 102 *American Journal of International Law* 475–528 at 490.
[91] Zylberglait, 'OPIC's Investment Insurance', 367.

OPIC is free to interpret the insurance contracts flexibly to protect policy holders beyond policy coverage.[92] This is, however, only convincing when OPIC is not dependent on tax-money and finances its activities through risk premiums similar to a private insurance company.

III. Further Hazards of Foreign Investment Insurance

Related to the geopolitical, economic and financial leverage provided by subrogation rights, there are other characteristics of foreign investment insurance that influence investment trajectories in host countries, such as the lack of clarity and transparency over what constitutes a covered risk event for the purposes of compensation.[93]

Similar to investor-state arbitration, insurers' determination whether the state action (or inaction) is compensable under the insurance contract is not dependent on the intention of the government or reasons behind such action, and this makes it difficult for host states to challenge the decisions of insurers to compensate investors.[94]

Moreover, insurers are often reluctant to reveal the terms and conditions of their insurance contracts and to disclose the outcome of their claim determinations or arbitral decisions over disputes with policyholders.[95] Crucially, the terms of the insurance contracts are not revealed even to the host states.[96] For example, in the publicized subrogation dispute between OPIC and Indonesia concerning the suspended geothermal power project, it is noted that OPIC refused to provide the Indonesian government with copies of its insurance contract with the investor.[97]

In fact, the existence of an insurance policy itself is often concealed.[98] Other than OPIC and MIGA, public investment insurers provide little information about their underwriting business, their insurance policies to be precise. OPIC provides some useful annual statistics which include a list of its new clients, their particular industry sector and the amounts underwritten.[99] Most of its claim determinations are published as well.[100] MIGA also provides information on the projects it has supported through investment insurance. With the exception of OPIC and MIGA, lack of transparency across the foreign investment insurance industry is widespread.

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[92] Ratner, 'Regulatory Takings in Institutional Context'.
[93] Tan, 'Risky Business', 185-6.
[94] Kazimova, *Insurance as a Risk Management Tool*, pp. 262-3; Wells Jr., *The New International Property Rights*, p. 97.
[95] Kazimova, *Insurance as a Risk Management Tool*, p. 262-3; Wells Jr., *The New International Property Rights*, p. 97.
[96] See *Ibid.*, 97 and 102.
[97] *Ibid.*
[98] Spagnoletti and O'Callaghan, 'Going Undercover', 2.
[99] *Ibid.*
[100] See Kantor (ed.), *Reports of Overseas Private Investment Corporation Determinations*.

Furthermore, especially in project finance arrangements, lenders have been increasingly requiring sponsors to take up insurance against all risks that are not borne by participants in the project and which could prejudice the capacity of the project to meet its debt obligations in time.[101] In the context of commercial risk insurance, Short argues that insurance provided by state-backed agents in project financing may lift from lenders the onus of rigorously analyzing the commercial risks of a project, thereby leading to the possibility that commercially unviable projects will be undertaken.[102] Analyses of the moral hazards associated with political risk insurance indicate that political risk insurance (notably breach of contract coverage) may similarly lead to reduced diligence in the evaluation of underlying market fundamentals by project lenders.[103] Lenders might spend their time and effort elsewhere instead of conducting due diligence to understand the project's commercial realities, if insurance coverage guarantees repayment of the loan.[104] This does not mean that insurance completely replaces due diligence by lenders but it distorts analysis of the project's commercial viability. As a consequence, the benefits that foreign investment and project finance offer to the host country's economic development may be mitigated.[105]

IV. Community Safeguards and Accountability Mechanisms

Public providers of foreign investment insurance pursue public interests which makes them subject to stricter transparency and accountability requirements with regard to their underwriting business than private insurance firms.[106] For example, in the "Guiding Principles on Business and Human Rights", the UN Special Representative on human rights and transnational corporations recognized the responsibility of the home state to take measures to prevent corporations that received support in the form of investment insurance from engaging in human rights violations in the host country.[107] Principle I (B) (4) lays down that "*States should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, or that receive substantial support and services from State*

[101] See Chapter 1. Kazimova, *Insurance as a Risk Management Tool*, p. 240.
[102] Rodney Short, 'Export Credit Agencies, Project Finance, and Commercial Risks: Whose Risk Is It, Anyway?' (2000) 24 *Fordham International Law Journal* 1371–81 at 1371.
[103] Henrik M. Inadomi, *Independent Power Projects in Developing Countries*, Energy and environmental law & policy series (Alphen aan den Rijn: Wolters Kluwer, 2010), vol. 7, p. 295.
[104] *Ibid.*, 294.
[105] See Short, 'Export Credit Agencies, Project Finance, and Commercial Risks', 1377-8.
[106] Gordon, *Investment Guarantees and Political Risk*. With respect to the accountability of MIGA, an international organization, for the way it exercises its power, see e.g. *2004 Final Report of the Committee on the Accountability of International Organizations to the Berlin Conference 5* (2004).
[107] Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework (2011).

agencies such as export credit agencies and official investment insurance or guarantee agencies, including, where appropriate, by requiring human rights due diligence."[108]

In recent years, public insurers including state and multilateral providers of investment insurance have increasingly adopted policies to address the environmental and social impacts of projects they insure on the local communities.[109] For example, most OECD-based insurance providers incorporated in their assessment criteria '*various combinations of environmental, local community impacts, labor rights and anti-bribery considerations*', under the guidance of '*major international instruments*', such as the OECD's Guidelines for Multinational Enterprises and the Recommendation on Common Approaches on Environment and Officially Supported Export Credits.[110]

The following outlines the environmental and social standards and procedures adopted by OPIC and MIGA.

4.1. Performance Standards and Policies

The environmental and social safeguards adopted by OPIC and MIGA are largely based on the International Finance Corporation's (IFC's) Performance Standards on Environmental and Social Sustainability (Performance Standards).[111] In 2007, MIGA adopted the *Performance Standards on Social and Environmental Sustainability* to manage social and environmental risks and impacts and to enhance development opportunities in the projects that it insures. The Performance Standards were revised in 2013.[112] MIGA requires investors as part of the investment insurance contract to take the actions necessary to meet performance standards

[108] For discussions on state responsibility of investment insurance activities, see Rekha Oleschak, 'Export Credit and Investment Insurance Agencies - Extraterritorial Obligations of Home-States of Investors', in A. Reinisch and C. Knahr (eds.), *International Investment Law in Context* (Utrecht: Eleven International Publishing, 2008), pp. 115–39; Robert McCorquodale and Penelope C. Simons, 'Responsibility Beyond Borders: State Responsibility for Extraterritorial Violations by Corporations of International Human Rights Law' (2007) 70 *Modern Law Review* 598–625; Özgür Can and Sara L. Seck, *The Legal Obligations with Respect to Human Rights and Export Credit Agencies*, Final Discussion Paper (2006); Adam McBeth, 'Privatising Human Rights: What Happens to the State`s Human Rights Duties When Services are Privatised?' (2004) 5 *Melbourne journal of international law* 133–54.

[109] Webb, 'Political Risk Insurance, CSR and the Mining Sector', 401-2. Research suggests that there is considerable variability in terms of transparency and accountability among public insurers. See Gordon, Investment Guarantees and Political Risk.

[110] Gordon, *Investment Guarantees and Political Risk*, p. 100.

[111] OPIC, *Environmental and Social Policy Statement* (2010), p. 2, available at www.opic.gov/sites/default/files/consolidated_esps.pdf (last visited 11 December 2018).

[112] https://www.miga.org/news/miga-revises-sustainability-policy-and-performance-standards (last visited 11 December 2018)..

pursuant to its *Policy on Environmental and Social Sustainability*.[113] Investors are required by MIGA also to follow environmental guidelines that have been developed on sectoral basis.[114]

In 2009, OPIC was required through an amendment in the Foreign Assistance Act to adopt a "*comprehensive set of environmental, transparency and internationally recognized worker rights and human rights guidelines with requirements binding on the Corporation and its investors*".[115] Similar to MIGA, in 2010, OPIC adopted IFC's Performance Standards on Environmental and Social Sustainability and the World Bank Group's Environmental, Health, and Safety Guidelines.

According to its Policy on Environmental and Social Sustainability, MIGA is required to integrate environmental and social due diligence into its overall project assessment and to set certain conditions pursuant to the outcome of this due diligence.[116] Similarly, OPIC screens and categorizes prospective projects according to their actual or estimated environmental and social risks over the project's life-cycle and determines if the project can be implemented in accordance with the Performance Standards.[117] If the assessment reveals '*moderate to high levels of environmental or social risk'*, the environmental and social performance of the project throughout its life-cycle must be monitored in accordance with the Performance Standards.[118] In the projects assessed "*likely to generate potential significant adverse impacts on communities*", investors are required to engage in a consultative process and obtain "*free, prior and informed consent*" where indigenous peoples are impacted as well as to establish a grievance mechanism to receive and facilitate resolution of affected communities' concerns and grievances about the client's environmental and social performance.[119]

MIGA's standard contract stipulates that in no case will it be liable for any loss which is due to corrupt practices attributable to the investor in connection with the investment project, or non-compliance by the investor with the Performance Standards and environmental guidelines in effect.[120] The investor is required to comply with and abide by all laws and regulations of the host country in implementing the investment project, including

[113] In 2007, MIGA adopted the Policy on Social and Environmental Sustainability. This was revised in 2013 and renamed as the Policy on Environmental and Social Sustainability.
[114] Webb, 'Political Risk Insurance, CSR and the Mining Sector', 403.
[115] 22 US Code §2191b.
[116] MIGA, *Policy on Environmental and Social Sustainability* (2013), p. ii, available at www.miga.org/documents/Policy_Environmental_Social_Sustainability.pdf (last visited 11 December 2018).
[117] OPIC, *OPIC Environmental and Social Policy Statement*, 3–5 and 7–10.
[118] MIGA, *Policy on Environmental and Social Sustainability*, i-ii.
[119] *Ibid.*, v-vii; MIGA, *Performance Standards on Environmental and Social Sustainability* (2013), p. 9.
[120] *MIGA Contract of Guarantee for Equity Investments* (2012), art. 9.

environmental laws and regulations and those that protect core labor standards.[121] Furthermore, the investor is required to take all reasonable actions and take all measures to avert, or if a covered risk giving rise to a loss occurs, to minimize a potential loss.[122] MIGA has the authority to terminate the contract if at any time it reasonably determines that the insured investor is in non-compliance with any responsibility or obligation specified under the contract, including a material violation of the laws and regulations of the host country, material violation of the performance standards and environmental guidelines, or if the guarantee holder is engaging in corrupt practices.[123] However, MIGA may grant, at its sole discretion, a reasonable period of time to cure situations of non-compliance with host country laws or the Performance Standards and environmental guidelines.[124] Pursuant to MIGA's standard insurance contract, investors are typically under an obligation to constantly monitor and report on compliance with insurance contract terms to MIGA. This self-monitoring and reporting requirement is in effect a client-centered disclosure mechanism designed to ensure ongoing implementation of the corporate social responsibility-oriented terms of insurance contracts. In addition, MIGA has the authority to engage in site visits to verify compliance with insurance contract terms.[125]

4.2. Accountability Mechanisms

Compliance of MIGA with its own operating rules and procedures is scrutinized through an independent inspection mechanism. In 1999, MIGA and the International Finance Corporation established the Office of the Compliance and Advisor/Ombudsman (CAO) that reports directly to the President of the World Bank Group.[126]

CAO's functions are threefold.[127] Firstly, CAO's ombudsman function provides a grievance mechanism through which individuals or communities can lodge a complaint about the environmental and/or social aspects of an IFC/MIGA supported project.[128] In other words, an individual or a group of local people have the right to submit complaints to the CAO claiming that they are being harmed or will be harmed and that the harm is a result of the failure of

[121] *Ibid.*, art. 12.
[122] *Ibid.*
[123] *Ibid.*, art. 13.
[124] *Ibid.*
[125] *Ibid.*, para. 22.
[126] *Office of the Compliance Advisor/Ombudsman (CAO) Terms of Reference*. CAO's mandate is articulated in its Terms of Reference (TOR), which was instituted by the President of the World Bank Group in 1999.
[127] *Office of the Compliance Advisor Ombudsman of IFC/MIGA Operational Guidelines 2013*. See also, Daniel D. Bradlow, 'Private Complainants and International Organizations: A Comparative Study of the Independent Inspection Mechanisms in International Financial Institutions' (2004-2005) 36 *Georgetown Journal of International Law* 403–94 at 433.
[128] *CAO Operational Guidelines 2013*.

IFC/MIGA to comply with their own operating rules and procedures. Secondly, CAO may initiate a compliance audit on its own; on the request of the IFC/MIGA management; or on the basis of the Ombudsman's investigation. Compliance audits oversee compliance appraisals and investigations of the environmental and social performance of IFC/MIGA at the project level.[129] Thirdly, CAO may advise the President of the World Bank Group or IFC/MIGA on broader environmental and social issues related to policies, standards, guidelines, procedures, resources and systems established to improve the performance of IFC/MIGA projects.[130]

In 2005, OPIC similarly established an Office of Accountability to "*provide a forum for affected stakeholders and clients to address concerns and conflicts around the environmental or social effects of Projects*" and to "*evaluate and report on OPIC's compliance with its environmental, social, human rights, and labor rights policies*".[131]

It is argued that the efficacy of independent accountability mechanisms like MIGA's Compliance Advisor Ombudsman[132] and OPIC's Office of Accountability, is often weakened by their limited remit.[133] The lack of any formal administrative or judicial review function render these facilities merely problem-solving platforms with terms of reference limited to reviewing the operations of the insurer itself under the internal policies such as performance standards without any power to examine the activities of investors and their compliance with international law, human rights or environmental law.[134] The limitations of MIGA's Compliance Advisor Ombudsman, for example, were evident in its 2006 report concerning the MIGA-supported paper pulp mills projects in Uruguay.[135] While the complainant, the Centre for Human Rights and Environment complained about the violations of international law, including environmental law, the report had to focus exclusively on MIGA's compliance with internal policies rather than on alleged violations of international law.[136]

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[129] *Ibid.*
[130] *Ibid.*
[131] OPIC, *Office of Accountability: Operational Guidelines Handbook for Problem-Solving and Compliance Review Services* (Washington, DC, 2014), p. 3.
[132] The Office of the Compliance Advisor/Ombudsman is the independent recourse mechanism for the International Finance Corporation (IFC) and MIGA and reports directly to the President of the World Bank Group.
[133] Tan, 'Risky Business', 190.
[134] *Ibid.*, 190. See also, *CAO Operational Guidelines 2013*, pp. 4-5; OPIC, *Office of Accountability*, p. 9. This is relevant to Chapter 4, section 4.2.
[135] CAO Audit of IFC's and MIGA's Due Diligence for two Pulp Mills in Uruguay, Final Report, February 22, 2006.
[136] *Ibid.*, 190.

4.3. Performance Standards and Foreign Investment Insurance

Performance Standards are alienated from the operation of foreign investment insurance as, in essence, they contradict the business-centered political risk conceptualization by investment insurers. However, they fit in the operation of foreign investment insurance as both Performance Standards and political risk conceptualization are in alignment with respect to corporate power as opposed to the regulatory power of host state.

4.3.1. Performance Standards Contradicting Political Risk Conceptualization

The way investment insurance operates creates asymmetries not only between the rights of foreign investors and authorities of the host states, but it also impacts the interests of community stakeholders by marginalizing and even problematizing them.[137] In fact, in an investment project covered by investment insurance it is the local communities that ultimately bear the greatest risk, be it political or economic, although they play a negligible role if at all in the design and implementation of the project and have limited recourse to compensation if the project fails.[138]

Public investment insurers' performance standards and monitoring practices purportedly work to the advantage of affected communities by making corporate and host state processes subject to greater transparency in decision-making and by providing grievance mechanisms.[139] However, studies so far report that the current processes are largely plagued with serious shortcomings particularly in due diligence and monitoring by insurers.

One reason for the shortcomings in the current processes is the conflict between the core underwriting business of public insurers and their expected leaning toward compliance with environmental and social standards of behavior.[140] Current MIGA Operational Policies, for example, require that the agency's underwriters must confirm that the project is consistent with MIGA's Performance Standards, but these due diligence requirements are separate from the agency's core risk assessment of the project pursuant to which the agency decides whether to issue a guarantee, and if it will do so, the premiums to be paid.

Some intrinsic problems associated with the preliminary assessments are illustrated by the Dikulushi copper and silver mining project in the Democratic Republic of the Congo (DRC). The Office of the Compliance Advisor/Ombudsman confirmed in a report concerning the

[137] *Ibid*., 187.
[138] *Ibid.*
[139] Webb, 'Political Risk Insurance, CSR and the Mining Sector', 398-401.
[140] Tan, 'Risky Business', 190.

Dikulushi copper and silver mining project, that MIGA's due diligence framework was limited to the consideration of conflict and security issues as insurable risks to the investment project with a particular focus on the likelihood of future claims to be filed by the investors.[141] On the other hand, whether the project might influence the conflict dynamics or adversely impact society are not part of the core due diligence process of MIGA.[142] The factual background might help to illustrate the shortcomings in the due diligence process. The Dikulushi project involved open pit mining of copper and silver ores in the Haut-Katanga district of the Katanga province in the DRC.[143] The ores were to be concentrated and trucked to smelters in South Africa and Namibia for further processing.[144] On September 21, 2004, MIGA Board of Directors approved two proposed guarantees and after six months of contract negotiations, in April 2005, MIGA issued US$13.6 million in guarantees, covering an investment and loans by Anvil Mining Ltd., a Canadian company with its head office in Perth, Australia, whose common shares were listed on the Australian and Toronto Stock Exchange, and RMB International (Dublin) Ltd. of Ireland to the project company Anvil Mining Congo, SARL, incorporated in the DRC.[145] MIGA's guarantee covered risks of transfer restriction, expropriation, breach of contract, war and civil disturbance.[146]

On October 16, 2004, the Congolese Army, the FARDC (Forces Armées de la République Démocratique du Congo) committed a massacre of civilians at Kilwa.[147] Between 70 and 100 civilians were reportedly killed by the army. On June 6, 2005, it was alleged during a television program aired by the Australian Broadcasting Corporation (ABC) that Anvil was involved in the massacre, providing logistical support to the FARDC to deal with an uprising by a small number of rebels. Referring to ABC's report, on July 8, 2005, Rights and Accountability in Development (RAID), a United Kingdom based non-governmental organization wrote to the World Bank President Wolfowitz alleging a number of MIGA's due diligence failures and invited MIGA to withdraw from the project. Consequently, the President of the World Bank Group, Paul Wolfowitz requested the Office of the Compliance Advisor/Ombudsman to audit

[141] CAO, *CAO Audit of MIGA's Due Diligence of the Dikulushi Copper-Silver Mining Project in the Democratic Republic of the Congo, Final Report* (2005), pp. 7-8. Available at http://www.cao-ombudsman.org/cases/document-links/documents/DikulushiDRCfinalversion02-01-06.pdf (last visited 11 December 2018).
[142] *Ibid.*
[143] *Ibid.*, 1.
[144] MIGA, *Project Brief: Anvil Mining Congo, SARL* available at https://www.miga.org/pages/projects/project.aspx?pid=634 (last visited 11 December 2018).
[145] *Ibid.*
[146] *Ibid.*
[147] The paragraph draws on the factual information provided in the audit report. See, CAO, *CAO Audit of MIGA's Due Diligence, Final Report*, pp. 4-5.

MIGA's due diligence of the Dikulushi project. In their final report dated November 2005, the Office acknowledged that MIGA had failed to address whether the project itself might influence the dynamics of the conflict in the region and whether the security provision for the project may have negative impacts on the local communities, and stated that these issues had, at best, been addressed elsewhere, such as under the agency's environmental and social review procedures:

"*In summary, as an integral part of its core business practices, MIGA explicitly considers conflict and security issues risks under its underwriting and risk management procedures. It is important to emphasize that these issues are treated as insurable risks to the project, based on their assessed likelihood and consequences and therefore focus only on the risk of war and civil disturbance to the assets or activities of the project. Neither the underwriting nor the risk management processes explicitly consider the risks that the presence of, or security provision for, a project could indirectly lead to adverse impacts on the local community. These aspects could potentially be captured under MIGA's Environmental and Social Review Procedures.*"[148]

Another expression of the contradiction between the Performance Standards and political risk conceptualization is the insurers' *"arms-length relationship with the project company*" that arguably creates difficulties with monitoring and enforcing project compliance.[149] A review of December 2002 by the CAO concerning MIGA's application of its environmental and social review procedures suggested that while MIGA systematically and diligently tracks progress on specific contract conditions, it needed to do a better job of requiring investors to provide adequate information concerning ongoing compliance of insurance contract conditions.[150] The CAO report also found that MIGA's arrangements for compliance monitoring were inadequate, since the burden of responsibility for ensuring compliance was largely transferred to the investor.[151] In addition, while MIGA's environmental review capacity was found to be adequate, the absence of in-house expertise on social issues was considered to be a weakness that needed to be addressed.[152] More recently, a report of an Independent Evaluation Group in 2013 revealed that only "*38 percent of evaluated MIGA projects were rated satisfactory or higher for the quality of their underwriting, assessment, and monitoring*", including of

[148] *Ibid.*, pp. 7-8.
[149] IEG, Assessing the Monitoring and Evaluation Systems of IFC and MIGA: Biennial Report on Operations Evaluation (2013), p. xiii.
[150] Office of the Compliance Advisor Ombudsman of IFC/MIGA, *Insuring Responsible Investments? A Review of the Application of MIGA's Environmental and Social Review Procedures* (Washington, DC, 2002).
[151] *Ibid.*
[152] *Ibid.*

environmental and social aspects.[153] It has been argued that, compared to a financier or equity investor, MIGA and similar insurers "*cannot be expected to have the capacity to influence project design*"[154] as policyholders "*have limited obligations to provide information directly to MIGA [or other insurer] unless specified in the contract of guarantee*".[155] Furthermore, it has been reported that in relation to MIGA itself, even "*where the guarantee contract specifies submission of project updates on [environmental and social impacts], follow-up by MIGA has been weak*", that MIGA fails to "*comprehensively track the environmental and social effects of all its projects*".[156]

4.3.2. Performance Standards Complementing Political Risk Conceptualization

Despite the externality of Performance Standards, they are compatible with the political risk conceptualization among investment insurers in many ways. Both political risk conceptualization and Performance Standards underpin an autonomous and self-contained regulatory system within which the foreign investors do business.[157] They are compatible in the sense that both augment corporate power relative to the host state in the regulatory sphere. Foreign investment insurance addresses non-commercial risks, so that foreign investors make investment decisions on the economic risk-return basis. This approach is an expression of a largely apolitical relationship between developing countries and foreign investors. Similarly, Performance Standards enhances the approach that designates corporations as technical and economic experts that efficiently solve problems that are not solved through political processes. Whereas the political risk conceptualization requires the host state not to interfere in the foreign investment, the Performance Standards require and/or allow the foreign investor to regulate its own social and economic relationships in the host state.

This is not to say that the investor is not required to comply with domestic law. However, domestic laws of developing countries that are also associated with high political risks are presumed inadequate to impose standards as high as Performance Standards or developing countries are assumed too weak or too corrupt to apply their own laws even if the standards are adequate. Together, political risk conceptualization and Performance Standards increase the

[153] Independent Evaluation Group, *Results and Performance of the World Bank Group 2012* (Washington, DC, 2013), 35.
[154] *Ibid.*, 28.
[155] *Ibid.*, 48.
[156] *Ibid.*, 48-9.
[157] See, Backer, 'Multinational Corporations as Objects and Sources of Transnational Regulation'.

autonomy of an insured investor as a non-state regulatory actor, thereby contributing to the emergence of a transnational regulatory framework.[158]

From a global order perspective, this regulatory framework is largely dominated by the values of industrialized West. Firstly, Performance Standards as part of the global order of sustainable finance (and insurance) are produced in processes dominated by developed countries.[159] Secondly, the stakeholders to which foreign investors render themselves accountable to are often consumers and investors in the developed world, or as in this case, also national insurers from developed countries.[160] Through the Performance Standards, western values are universalized and imposed on the local communities in developing countries.[161] This is largely in conformity with the political risk conceptualization in which political risks are associated with developing countries and developed countries are presumed to pose no risk to foreign investors. In fact, developed countries even refuse to be subject to classification with respect to political risk assessments[162] and multinational corporations doing business in developed countries are only required to comply with domestic law. This is critical because the development orthodoxy imposed through investment insurance (that deploys a business-centered political risk conceptualization and Performance Standards) may pose impediments to development of social and political conditions that are suitable in the local context.[163] In other words, development that is measured on the basis of industrialization and GDP growth may not be in line with local interests.

For these reasons, Performance Standards do not constitute a response to legitimacy deficit of foreign investment insurance. The demands and interests of local communities are alienated from the operation of foreign investment not only by political risk conceptualization but also Performance Standards. Thus, foreign investment insurance with these instruments constitute an impediment to bottom-up emancipation.

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[158] *Ibid.*

[159] See, Michael Riegner, 'The Equator Principles on Sustainable Finance Assessed from a Critical Development and Third World Perspective' (2014) 5 *Transnational Legal Theory* 3, 489-510 at 498.

[160] Debashish Munshi and Priya Kurian, 'Imperializing Spin Cycles: A Postcolonial Look at Public Relations, Greenwashing, and the Separation of Publics' (2005) 31 *Public Relations Review* 513–20

[161] Pahuja, *Decolonising International Law*.

[162] See footnote 153 in Chapter 4.

[163] B. S. Chimni, 'International Institutions Today: An Imperial Global State in the Making' (2004) 15 *European Journal of International Law* 1–37.

Conclusion

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Traditionally, foreign investment protection is an instance of diplomatic protection of aliens, as such, the home state may take action on its national's behalf against the host state under international law.[1] However, the investor-state dispute settlement that emerged in the twentieth century has largely replaced diplomatic protection of investors.[2] An important result of this replacement is the so-called depoliticization of settlement of investment disputes.[3] Investor-state arbitration is considered to depoliticize investment disputes by; (1) replacing diplomatic protection that is based on the power relations between states with a neutral arbitral forum; and (2) enabling the investor to directly sue the host state before an international tribunal instead of domestic courts that are possibly under the political influence of the host state.

Against the background of these developments in the field of international investment law, this thesis addresses two main questions that arise in the public policy debate in different forms: what is the law of foreign investment insurance and where do we locate foreign investment insurance within the contemporary investment protection regime?

Foreign investment insurance is seemingly of a depoliticized nature. The investor contributes to investment protection with insurance premiums and receives financial protection only when the insurer decides for a compensation payment. The insurer is generally required to adopt risk management principles and finance itself with its own income, so that the investment insurance scheme would not constitute a subsidy for investors that venture abroad. By means of an insurance policy, the investor is generally required by the insurer to give notification of potential investment related disputes with the host state so that the insurer may get involved in order to resolve the dispute. Even the term "political risk" is often regarded depoliticized as if it is conceptualized on the basis of a universally valid ideology, or an ideology-free socio-economic fact that is proved to underpin economic development of host countries.

[1] Kate Miles, *The Origins of International Investment Law: Empire, Environment, and the Safeguarding of Capital* (Cambridge: Cambridge University Press, 2013), p. 47; See, Barcelona Traction Case.
[2] Juratowitch, 'The Relationship between Diplomatic Protection and Investment Treaties'.
[3] For a critique of diplomatic protection of investors, see, Stephan Schill, 'Private Enforcement of International Investment Law: Why We Need Investor Standing in BIT Dispute Settlement', in Michael Waibel et al. (eds.), *The Backlash Against Investment Arbitration: Perceptions and Reality* (Alphen aan den Rijn: Kluwer Law International, 2010), p. 36.

By focusing on the individual relationships between home state, host state and investors, this thesis demonstrates the political nature of public investment insurance schemes and addresses it as a subject matter of controversy. The principle of subrogation is key to the operation of foreign investment insurance. In case the insurer pays out the investor, it subrogates the insured investor's rights and claims, and recovers the compensation from the host state pursuant to an international agreement, such as a BIT or bilateral investment insurance agreement. These agreements often provide for arbitration for the settlement of interstate disputes so that diplomatic protection may be replaced by neutral arbitral forums. However, none of the subrogated claims has yet led to an interstate arbitration. Only in the case of Dabhol Power Project, the US government initiated arbitration against India for the settlement of the dispute that arose from the subrogated claim. However, the dispute was eventually settled amicably by the parties.

If diplomatic protection is taking diplomatic action or using force to make another state comply with international obligations, what is then an international obligation and what is the role of power relations in establishing international obligations? As concerns the foreign investment insurance, international obligations are embodied in the concept of political risk. The dominant approach in the literature and in practice associates political risk with host state action or inaction that has an adverse impact on the foreign investment. Political risk narratives utilized by public investment insurers problematize state conduct and delegitimize state acts even when they are responsive to the democratic polity.[4]

The concept of political risk plays a significant role in the governance of the relationships among actors in the investment insurance arrangements, including not only the investors, home and host states but also local communities. While governmental interference is denounced, interests of local communities are marginalized by means of political risk conceptualization. The business-centered political risk approach also legitimizes specific intervention from insurers. Some public investment insurers have considerable influence over the conduct of host country governments with respect to insured investments -which is generally referred as deterrence effect.[5] Public investment insurers may sometimes exert extensive political and financial leverage over the host states in order to obtain a settlement of disputes related to insured investments.[6] They may invoke not only the international investment treaties providing and project agreements creating rights and enforceable remedies for investors, but also various

[4] Tan, 'Risky Business', 179.
[5] West and Martin, *Political Risk Investment Insurance: The Renaissance Revisited*, p. 213.
[6] Salacuse, *The Three Laws of International Investment*, p. 293.

diplomatic "pressure points", such as the visit of the head of state to the host country, the visit of trade missions and other occasions when a country's eligibility for trade or investment benefits or economic assistance could be challenged.[7]

Foreign investment insurance influences the design of the investment project and affects the host states, through a series of ex-ante and ex-post assessments alongside with supervisory and dispute settlement mechanisms.[8] Insurers generally conduct a country risk analysis that is informed by business-oriented political risk narratives. Political risk is considered to be a phenomenon of developing countries as opposed to the Western countries that are developed, liberal democratic, and capitalist.[9] It is argued that country risk analysis on the basis of risk indicators, such as pending investment disputes, investment's exposure to host state regulation or host state's record of interventions in foreign investment, creates a subtle framework that resembles the traditional conditionality deployed routinely by the Bretton Woods institutions, the World Bank and the IMF.[10] In this context, assessment of developing countries based on such criteria may limit a state's adoption of policies that diverge from the interests of foreign investors.[11]

The contribution of foreign investors to the realization of the political risk events are often overlooked by insurers in the conceptualization of political risk.[12] Yet moral hazard in foreign investment insurance arrangements may affect an insured investor's behavior regarding the potential risk events. Being covered by investment insurance, investors may be less inclined to implement risk mitigation and their action or inaction may even trigger political risk events. Moreover, investment insurance may affect the behavior of insured investors with respect to settlement of disputes with the host state. If a foreign investor has a strategy to retreat from the host country and believes that it would be compensated by the insurer in that case, it would have less incentive to renegotiate in order to settle ongoing disputes.[13] It is argued that moral hazard in the operation of foreign investment insurance may be eliminated, if firms are required to undertake corporate social responsibility.[14] However, developmental codes of conduct of

[7] Hansen, O'Sullivan and Anderson, 'The Dabhol Power Project Settlement', 5.
[8] Tan, 'Risky Business', 177.
[9] Jarvis and Griffiths, 'Learning to Fly', 15.
[10] Haarstad, 'The Architecture of Investment Climate Surveillance', 80.
[11] *Ibid.*
[12] Tan, 'Risky Business'.
[13] Wells and Ahmed, *Making Foreign Investment Safe*, p. 224.
[14] Inniss, 'Rethinking Political Risk Insurance'; Webb, 'Political Risk Insurance, CSR and the Mining Sector'; Subedi, 'The Challenge of Reconciling the Competing Principles'.

foreign investors are integrated into the operation of foreign investment insurance only by external mechanisms.

Foreign investment insurance may also influence the behavior of insurers.[15] As for the insurer, the moral hazard in foreign investment insurance lie in the principle of subrogation. Subrogation may increase moral hazard by influencing insurer's behavior, especially insurer's conduct of due diligence to assess the risks already inherited in the project and the probability of these and other potential risks materializing.[16] An insurer would have less incentive to carry out the necessary due diligence, if it believes that it will manage to recover the compensation paid to the investor. It is argued that subrogation rewards insurers even when they fail to carry out due diligence and monitor investment projects.[17] Moreover, the principle of subrogation may influence insurers regarding their determinations of insurance claims. In fact, the prospects to be recovered may incentivize insurers to extend the scope of coverage through broad interpretations of insurance contracts.

However, recovery from the host state is crucial for the operation of foreign investment insurance for two main reasons. First, risk premiums collected from the insured investors generally do not constitute adequate resources for the self-sufficiency of public insurers. In the lack of recovery, the home state may have to appropriate funds for the insurer. Consequently, the investment insurance scheme would become a subsidy for firms that seek foreign investment insurance. Second, investment insurance without recovery mechanism would increase moral hazards that affect behavior of host states. Host states would be more inclined to expropriate a foreign investment, if they knew the investor will be compensated by the insurer and the insurer would not turn to the host state for the recovery of this compensation.

Yet foreign investment insurance affects also behavior of host states. Foreign investment insurance reduces market-based incentives for host country policy reform and influences the host government's risk evaluation of taking action specifically for the insured investment.[18] Moreover, the lack of clarity and transparency over what constitutes a covered risk event for the purposes of compensation claim prevents host states from challenging the claim determinations for which they are required to reimburse the insurer.[19] In conclusion, moral

[15] Kazimova, *Insurance as a Risk Management Tool*, p. 243.
[16] *Ibid.*, p. 247; Tan, 'Risky Business', 184-5.
[17] *Ibid.*, 184-5; Wells Jr., *The New International Property Rights*, p. 96.
[18] Spagnoletti and O'Callaghan, 'Going Undercover', 15.
[19] See Tan, 'Risky Business', 185-6.

hazard in foreign investment insurance arrangements affect behavior of involved actors in a manner that may limit the benefits of insured investments for the host country economy.

For these reasons, this thesis subjects foreign investment insurance to scrutiny while it sheds light to the laws that govern the relationships between actors involved in a foreign investment insurance arrangement. In this regard, the thesis contributes to the more recent debate about the investment protection mechanisms that may substitute ISDS.[20] Even though the debate on alternative dispute settlement mechanisms originates from the legitimacy concerns, the legitimacy deficit in the operation of foreign investment insurance is generally overlooked by scholars who argue that foreign investment insurance may replace ISDS. This is mainly due to a lack of a comprehensive understanding of the law of foreign investment insurance.

Whether investment insurance can function as a more legitimate equivalent to investor-state dispute settlement mechanisms depends on whether the legitimacy problems discussed in this thesis can be remedied.[21] Perhaps, a legitimacy-based political risk approach that focuses on the multinational firms' legitimacy in the eyes of host and home governments and societal groups may constitute a response to the essence of these legitimacy problems which is the business-oriented conceptualization of political risk.[22] However, such a change in the approach of public investment insurers to political risk is feasible only along with a paradigm change in the development orthodoxy and investment protection regime.[23]

[20] Stiglitz, 'Principles of Cross-Border Legal Frameworks in a Globalized World'; Chalamish and Howse, *Conceptualizing Political Risk Insurance*; Poulsen, *The Importance of BITs*.
[21] Karagöz, 'The Influence of Investor-Centered Values in the Operation of Political Risk Insurance', 35.
[22] See, Stevens, Xie and Peng, 'Toward a Legitimacy-Based View of Political Risk'.
[23] Karagöz, 'The Influence of Investor-Centered Values in the Operation of Political Risk Insurance', 36.

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