Kluwer Arbitration Blog

Risky business: political risk insurance in the OBOR jurisdictions – Report on the 4th CMS-HKIAC Investment Law Lecture

Olga Boltenko (Fangda Partners) and Nanxi Ding (CMS Hong Kong) · Saturday, July 29th, 2017

"And the day came when the risk to remain tight in a bud was more painful than the risk it took to blossom." (Anaïs Nin)

Introduction and background

On 12 July 2017, CMS Hong Kong and the Hong Kong International Arbitration Centre (HKIAC) hosted the fourth joint lecture in their quarterly series focusing on the topics of investment and trade law in the Asia-Pacific region. Marking the first year of the series, the lecture was also the first of its kind to introduce the concept of political risk insurance to the Hong Kong investment community.

Mr Timothy Histed, head of the Multilateral Investment Guarantee Agency of the World Bank Group (MIGA), travelled from Singapore to unveil the World Bank's political risk insurance policies in the context of China's One Belt, One Road (OBOR) initiative.

Political risk insurance: concept and examples

Political risk insurance is by no means a new concept in the world of investment law, and for good reason. Investment in volatile jurisdictions and project financing in developing countries can involve a number of possible setbacks. These include allegations of bribery and corruption; volatility or even the total collapse of a local economy; the cancellation of concessions and contracts; political crises; and government changes. Despite the ever-present security concerns in volatile and conflict-affected States, investors value business opportunities that promise generous returns on their investments, so long as the anticipated returns are high enough to cover the potential increased risk premium.

The MIGA has developed five suites of insurance products that it has utilised successfully in Asia for at least a decade. Its policy statement is to encourage and facilitate foreign direct investment (FDI) in developing countries with a view to eradicating extreme poverty. The MIGA is not a commercial institution; as such, therefore, it does not harbour profit-driven ambitions. This contrasts with private insurers in the region, who have developed similar political risk insurance products but operate in accordance with a profit-driven model.

To benefit from MIGA insurance policies, a foreign investor must be a national of a MIGA member State and must seek insurance for an investment into a developing country. The MIGA also insures investments made by nationals of a host country if the funds originate from outside that country and the host government approves the investment. The MIGA insures investors against losses relating to currency inconvertibility and transfer restrictions, expropriation, war, terrorism and civil disturbance, breach of contract and failure to honour financial obligations.

None of the MIGA's five suites of insurance policy, apart from its breach of contract insurance, requires the insured investor to produce an arbitral award in its favour in order to seek compensation.

The MIGA would pay compensation in the hard currency specified in the contract of guarantee with the investor if the host State blocks currency conversion and repatriation of returns. Compensation is payable for expropriation upon assignment of the investor's interest in the expropriated asset to the MIGA. Under the umbrella of its policy for insuring risks against war, terrorism and civil disturbance, the MIGA protects insured investors against the destruction of tangible assets or total business interruption caused by politically motivated acts of war or civil disturbance in the host country. In cases of States or State-owned enterprises not honouring their financial obligations, it would compensate the insured investor on the basis of the insured outstanding principal and any accrued and unpaid interest.

MIGA insurance against breach of contract is the only insurance policy that requires the insured investor to engage a contractual dispute resolution mechanism as a precondition for compensation. If, after a specified period of time, the investor is unable to obtain an arbitral award as a result of interference by the respondent government with the dispute resolution mechanism, or it has obtained an award but has not received payment under it, the MIGA would pay compensation.

MIGA's leverage

As Timothy Histed explained during the lecture, many investors choose the MIGA not only for the variety of its insurance policies but also for its ability to leverage the network of the World Bank Group. The network has direct access to the governments of host States, who often depend on that organisation for funding and subsidies.

The MIGA would see it as a failure if the insured investor were to be required to engage dispute resolution mechanisms in order to receive compensation for its losses. In the 29 years of the MIGA's insurance operations, only nine investors have had to resort to dispute resolution mechanisms.

Political risk insurance and investment arbitration: the interplay

Many attendees of the lecture questioned the precise interplay between investment arbitration and political risk insurance. Traditionally, the investment community views recourse to investment arbitration itself as a form of insurance against political risks and argues that such recourse facilitates FDI and brings down the costs of investing in fragile jurisdictions. The ongoing public policy debate begs the question whether the availability of political risk insurance makes investment treaty arbitration unnecessary. The answer is 'no', albeit with caveats.

The interplay between the two concepts is inevitable, but it does not mean that political risk insurance removes the need for investment arbitration. Sophisticated investors often have access to

both political risk insurance policies and investment treaty arbitration, and indeed engage both mechanisms to recover their lost investments.

By way of example, CalEnergy Company Inc (a foreign investor listed at the time on the New York Stock Exchange (NYSE), the Philippine Stock Exchange (PSE) and the London Stock Exchange (LSE)) acquired political risk insurance to cover two geothermal power projects in Indonesia. When the projects were suspended by the government, CalEnergy's subsidiaries launched two investment treaty claims against Indonesia, alleging expropriation. CalEnergy's insurance policies not only provided standard expropriation cover but also, expressly and separately, covered arbitral awards.

In *Hochtief AG v Argentine Republic* (ICSID Case No ARB/07/31, Decision on Jurisdiction, 24 October 2011), Argentina objected to the admissibility of Hochtief's claims on the basis that the German government had agreed to pay Hochtief €11,359 million under a political risk insurance policy that covered the claimant's losses so that, Germany was subrogated to Hochtief's rights by virtue of article 6 of the Germany-Argentina BIT (the BIT) and Hochtief had therefore lost its standing to pursue a treaty claim. The arbitral tribunal dismissed Argentina's objection on the basis of the wording of article 6 of the BIT, thus allowing Hochtief's claims to proceed.

The *Hochtief* tribunal further found that a political insurance payment is a benefit which an investor arranges on its own behalf and for which it pays. Political risk insurance does not reduce the losses caused by a government's actions in breach of the underlying BIT. In essence, political risk insurance is an arrangement made with a third party in order to provide a hedge against potential losses. The *Hochtief* tribunal did not consider that any principle of international law required that such an arrangement, to which the respondent government was not a party, should reduce that government's liability.

Takeaways from the lecture

Political risk insurance is a sophisticated tool to hedge risks of undue government interference with investments in fragile economies and developing States. Whilst it is costly, it guarantees compensation in cases of expropriation, adverse regulation, political instability and the physical destruction of investments. A number of private insurers are currently adjusting their political risk insurance products to offer coverage against claims for denial of justice and breach of investors' legitimate expectations as well.

Most political risk insurance products do not require the insured investor to go to the trouble of obtaining a treaty award in order to claim compensation. Public insurers, such as the MIGA, have the additional leverage of resolving the dispute with the relevant local governments before a full treaty dispute is crystallised.

Investment treaty arbitration remains the most efficient tool to recover the cost of lost investments where political risk insurance is not available and where all other options fail. Treaty tribunals will neither regard political risk insurance as an arrangement that affects the level of compensation, nor will they view political risk insurance as an obstacle to the admissibility of investors' claims.

Conclusion

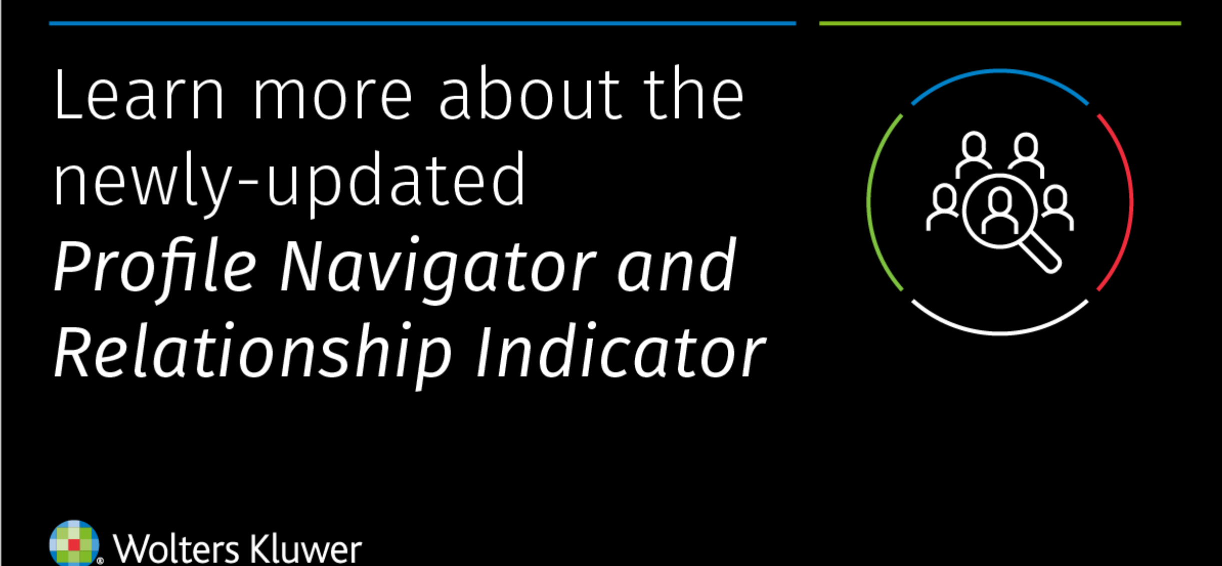
The two concepts – political risk insurance and investment arbitration – should therefore be viewed as complementary concepts that co-exist to reduce the cost of FDI and increase investors'

confidence in exporting capital to developing markets.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.



This entry was posted on Saturday, July 29th, 2017 at 3:14 am and is filed under Argentina, Awards, BIT, foreign direct investment, ICSID, ICSID Arbitration, Insurance, International arbitration, Investor, Investor-State arbitration, Jurisdiction, Political Risk Insurance
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.