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Should Political Risk Insurance Payment Be Deducted From Investment Treaty Award Compensation?

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Introduction

Political Risk Insurance (PRI) was discussed as a concept here. In fact, an earlier post discussed PRI as an alternative to investment treaty arbitration (ITA) for investors. The interaction between PRI and ITA is a germane field of study as both are risk mitigation strategies for investors and in some instances an investor can initiate claims under ITA and under PRI, such as, in cases of expropriation, government changes, political violence etc.

This post seeks to answer the topical conundrum: whether the insurance payment received by an investor (insured) under a PRI policy should be deducted from the compensation to be awarded to the investor (claimant) in an ITA if the grounds of claim under PRI and ITA are the same.

Conundrum

The two recent awards of ICSID tribunals, viz., *Hochtief AG v. Argentine Republic* (ICSID Case No. ARB/07/31, Award dated 19 December 2016) and *Ickale Insaat Ltd Sirketi v. Turkmenistan (*ICSID Case No. ARB/10/24, Award dated 8 March 2016) have answered the conundrum differently. The conundrum is again in front of an ITA Tribunal in *Glencore Finance (Bermuda) Ltd v. The Plurinational State of Bolivia.*[1)]

In the *Hochtief AG* award, the tribunal held the respondent state, Argentina, liable for breach of FET obligation and awarded compensation to the claimant. The claimant had received PRI payment prior to the ITA award. Notably, the grounds for initiating both were the same. An issue of contention between the parties was the deduction of claimant's PRI receipts from the ITA compensation.

The tribunal held the claimant's PRI receipts would not be deducted from the compensation. The tribunal reasoned that the claimant arranged for the insurance payment on its own by paying for it. It is separate from the ICSID claim. The tribunal espoused that the respondent's liability shouldn't be reduced by an arrangement to which the latter was not a party. It agreed that due to such insurance policies the claimant might be obliged to pay some part of the compensation to the insurer.

Some practitioners agree with the principle of non-deduction.

*Remarks on the case***:** Article 6 of the applicable Argentina – Germany BIT [2] mentions that if either contracting party makes a payment to its nationals because of a guarantee it has assumed regarding investments, then the other contracting party shall recognize the assignment, of any right or claim from such national to the paying contracting party. Notably, the article mentions *assignment*, which means complete transfer of ownership.

Further, the tribunal had a problem with reduced liability of the respondent. However, unequivocally the respondent's liability is not reduced, as it will have to pay Germany, the paying contracting party as per the agreement. Rather, the respondent will have to pay twice for the same cause of action.

In the case of *Ickale Insaat*, the tribunal had dismissed the claims of the claimant. The claimant (investor/insured) had a PRI policy for the leased equipment and machinery. However, the tribunal decided to deduct the claimant's PRI receipts in calculating the compensation, if to be awarded, given the evidence and non-rebuttal by the claimant.

The tribunal reasoned that the compensation should be equivalent to the real value of the expropriated investment. It was on the assumption that the claimant might have been paid and would have recovered the value of the insured investment.

Notably, the dissenting arbitrator, and even the claimant, agreed on deduction principally, which is evident from the claimant's request for rectification of the award. The parties only differed with respect to the sufficiency of evidence if the claimants actually got the PRI payment.

Way out and why

The following points indicate that PRI and ITA should be alternative, and not simultaneous means of redress for the investors:

i) The wording of treaties and insurance policies and the principles of insurance law: The language in the treaties for incentivizing agreements, like the article 6 above; and in the contracts of insurance, like the one concluded by the U.S. PRI provider, Overseas Private Investment Corporation (OPIC), mention the *assignment* of the relevant rights of the investor to the paying contracting party or to OPIC, so that the latter then proceeds against the host governments.

The request for arbitration by OPIC also uses *assignment*: that on making the payment to the insured, the insurer (OPIC) received in return*, assignment of certain rights and interests* to pursue recovery against the host government under the applicable agreement.

Assignment has specific legal connotations. Black's Law Dictionary defines assignment as an act by which one-person transfers to another, the whole of the right or interest. It is complete transfer of rights, enabling the insurer to claim on its own without the name of the insured. [3]

When the whole of the right is transferred from the insured to the insurer, then the same right ought not be exercised by the insured at an ITA.

The request for arbitration by OPIC also states: by *subrogation* the host government is liable to reimburse the OPIC for payments it made to the investors and to compensate the OPIC to the fullest extent of rights and interests transferred to OPIC from the investors.

Subrogation is a product of equity, which prevents unjust enrichment. Generally, an insurer has the right of subrogation and not the insured. Further, insurer gets rights of subrogation as soon as the payment is made.[4)]

As a common law principle, an insurer does not have rights of subrogation against its own insured for the claims arising from the same risk for which the insured was covered. Hence, if an investor is being compensated by a host government, after being paid by the insurer, then too the insurer doesn't get the right of subrogation against the insured (the investor), as was claimed by a few practitioners agreeing with the non-deduction principle.

ii) Behavior of PRI providers: Some PRI providers, like Multilateral Investment Guarantee Agency, mandate for the insured to engage in arbitration as a precondition for the grant of PRI compensation. They grant PRI payment if the arbitration process has failed. Meaning thereby, the PRI providers deem compensations from PRI and ITA as an alternative to each other and definitely not something to be awarded simultaneously.

Further, after making the payments, the PRI providers initiate arbitration against host governments for the same cause of action. The authority with which PRI providers proceed against the host governments speaks about their understanding of the transferred rights, which is of ownership and complete.

iii) Phenomenon of moral hazards: Morally hazardous behavior of the investors in presence of PRI coverage (as detailed in a study) signifies that investors at times solely rely on PRI payments for their losses and do not care about the outcomes in ITAs. The investors deem their damages to be sufficiently covered by the PRI itself. Investors view PRI as an easy way out of a country in which they do not want to continue. The CalEnergy case in Indonesia is illustrative of this phenomenon.

This moral hazard is also observed in host governments. In the presence of PRI coverage, they have lesser incentive to reform their markets and economy for foreign investments (noted in an OECD policy paper). This illustrates that host governments don't deem themselves primarily liable to compensate the investor in presence of PRI.

Thus, behavioral understanding of investors and host governments contradicts the non-deduction principle whereby PRI and ITA compensation are paid in addition to each other.

iv) PRI itself as a Dispute Resolution Mechanism: It is possible to equate PRI as one of the dispute resolution mechanisms, like an ITA. The dominance of public PRI providers, eventually changing the dispute to an inter-state dispute, supports this interpretation. For example, the dispute over the Dabhol power plant between an American Company and GOI turned into a state-state dispute between the US and India. It too signifies that PRI is an alternative to ITAs.

v) PRI v. ITA: At times, they have non-intersecting operating spheres. For example, PRI is essential for investors in host countries which haven't entered into BITs or which are pulling out of the ITA regime. For instance, Venezuela and Ecuador denounced the ICSID Convention. PRI and ITA, as remedies, provide comparable but distinct advantages and remedies. Hence, one can be chosen over another depending on the preference of investors for certainty, speed, amount of compensation, cost etc.

vi) Equity: Making the host governments pay to the investor (the insured) for the same cause of action, as has been paid by the PRI provider (the insurer) is not equitable as the insured is getting compensated twice. If not leading to double compensation of the insured, it will lead to unjust enrichment of the insured, or at least liquidity benefits to the insured for a certain period.

Further, it amounts to the host government compensating twice for the same cause of action. This is equivalent to double jeopardy for the host governments, which is inequitable.

vii) Miscellaneous reasons**:** The prevailing conditions give rise to confusion as to who should proceed against the host governments regarding the insured investments, the insured or the PRI provider.

The non-deduction practice increases the transaction cost, as then the insured, who has been compensated by the insurer, will have to pay the insurer, as espoused by few practitioners agreeing with the principle. It leads to the same result of compensating the insurer circuitously.

Further, non-deduction leads to seeing the two fields of law: investment arbitration and insurance as mutually exclusive fields and non-integral. This doesn't bode well for the future of the ITA regime, which already has few disgruntled opinions.

Conclusion

PRI and ITA should co-exist as alternative ways and not as simultaneous sources of compensation for the same cause. Both provide distinct and comparable remedies in their distinct ways. If the PRI provider has paid an investor, then the PRI payment should be deducted from the compensation out of ITA awards. This will lead to a coherent and equitable system.

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References

?1 PCA Case No. 2016-39/AA641, Bolivia's Preliminary Objections, Statement of Defence, and Reply on Bifurcation (18 December 2017).

?2 Treaty between the Federal Republic of Germany and the Argentine Republic on the Encouragement and Reciprocal Protection of investments, 1991.

?3 E.J. Macgillivray, *MacGillivray & Parkington on Insurance Law*, 8th ed

?4 *Id.*

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