

Dispute Resolution Hotline

October 08, 2020

VODAFONE INVESTMENT TREATY ARBITRATION AWARD - PART IV

Termination of BITs: Is the Political Risk Insurance Industry ready?

INTRODUCTION

With India and other nations receding from Bilateral Investment Treaties (BITs), the discourse about the interplay of BITs and political risk insurance (PRI) now mandates a nuanced analysis, with focus on the PRI industry.

PRI AND PRI PROVIDERS

Political risks are risks that are associated with government actions which deny or restrict the right of investors to use or benefit from their assets; or reduce the value of their investment. Political risks include war, revolutions, government seizure of property and actions to restrict the movement of profits or other revenues from within a country. They are non-commercial risks, and one of the main concerns for investors when they plan to invest in another country.

PRI is an insurance product that protects investors against such non-commercial risks that interfere in their ability to operate or own investments successfully, and provides coverage for a range of government related risks, arising from adverse actions or inactions of governments. PRIs is mainly sought for investments in developing countries¹ and volatile jurisdictions.

Broadly, insurance providers can be categorised as public, private, regional or multilateral providers. Public PRI providers include national PRI providers that mostly insure national companies in friendly host States. Some examples are OPIC (United States), Euler Hermes-PwC (Germany), NEXI (Japan), OeKB (Austria) and Sinasure (China). Public PRI providers act as gap fillers, and provide insurance where private players are reluctant given the relevant geopolitical volatility.

Private PRI providers are often a specialty line of the general insurance companies. Their products are more flexible, tailored and expedient. However, given that private providers offer coverage without reliance on government, they could offer limited and specific type of coverage such as that excluding currency devaluation. This can be a limitation for investors. Few examples are American International Group (AIG), Chubb Group, Lloyd's of London and Zurich Financial Services.

Regional or multilateral providers include African Trade Insurance Agency, Inter-Arab Investment Guarantee Corporation, the Asian Development Agency, Export Credit and Multilateral Investment Guarantee Agency (MIGA). MIGA, a member of World Bank group,² has been foremost international institution offering PRI to investors. MIGA insures cross border investments, ranging up to 15 years, made by investors from a MIGA member country into a developing member country, in challenging environments and higher risk markets.³

INTERSECTION OF BITS AND PRIS

The intersection of BITs and PRI stems from the fact that both are risk mitigation strategies for investors in cross-border transactions. The objective of BITs and PRI guarantees could overlap, as both facilitate international investments and lower political risks. Some risks covered by BITs are also covered by PRIs, such as direct and indirect expropriation, breaches of contract, political violence and restrictions to transfer profits. In the wake of this overlap, investors need to address the dilemma of buying PRI while making investment in another country. Does existence or lack of BITs play a role in addressing this dilemma?

At the outset, PRI is quintessential for investors investing in countries which have not entered into BITs or multilateral treaties. It is also essential for investors investing in countries that are increasingly disconcerted with the existing investment treaty arbitration regime. International investors might also seek PRI while investing in countries that are devising alternative strategies to BITs, such as Brazil's Cooperation and Facilitation Investment Agreements, as these strategies are nascent and alien to investors.

In a situation where the Host State has entered into BITs with the investor's home country, it may still be important to assess if PRI must be bought. Both BITs and PRI often provide for international arbitration for settlement of disputes arising out of the subject matter of the BIT or PRI. In some situations, PRI could be better than investment treaty arbitration as PRI claims generally compensate investors without mandating them to go through the treaty arbitration, waiting for the outcome, and enforcing the award. We have seen that this choice boils down to investor preference on certainty, speed, cost, or quantum of damages. In some instances, investors have taken recourse to both. PRI could also help sustain the relationship of the investor and the host state.

Therefore, despite considerable intersections, BITs and PRIs could have distinct purposes and utility. Presence of one (BIT or PRI) might not make the other superfluous. It is useful for investors to examine the advantages of one over the other in an investor-State dispute arising out of political risk.

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With increase in BITs in the past decade, the number of private PRI providers have also risen. This is due to the apparently less risky nature of investments - since increase in BITs signify willingness of host states to afford protection to foreign investments. On the other hand, even with increasing termination of BITs, PRI is speculated to receive much traction as a sole risk mitigation strategy for investors.

To what extent do BITs influence PRI premium? Do PRI providers consider existence of BITs as a determinant factor while deciding to underwrite PRI? Contracts between a PRI provider and an insured party, or even model contracts, are not easily accessible. However, certain publicly available information presents useful insights to discern the impact of BITs, if any, on PRIs.

Notably, the German National PRI provider⁴ considers existence of BIT as one of the pre-conditions for providing PRI coverage. In contrast, for the United States PRI provider OPIC and other national PRI providers, existence of a BIT is not consequential in determining the premium or deciding to extend the coverage. Some PRI providers like OPIC cover the risk of non-payment of an arbitral award⁵, along with other risks.

The multilateral PRI provider, MIGA, does not consider existence of a BIT as a precondition for extending the coverage. For pricing of expropriation risk, MIGA considers almost around 57 rating factors to determine the premium rates, and only one of them relates to the existence of “investment protection agreement” which will include BITs and other multilateral trade agreements.

MIGA offers coverage for five types of non-commercial risks, namely currency inconvertibility and transfer restrictions; expropriation; war, terrorism and civil disturbance; breach of contract; and non-honouring of financial obligations. Out of the five, only breach of contract coverage is contingent on any dispute resolution mechanism having been invoked by the investor as a precondition for the investor claim. It does not require an arbitral award in the favour of an insured investor for a successful claim.

In the case of private providers, an empirical study has indicated that most private firms find BITs largely irrelevant for extending the coverage.⁶ Our survey of websites of private PRI providers indicates that the private PRI providers have not yet disclosed their model insurance contracts or the criteria used for calculating PRI premium.

However, the studies have noted that if terminating BITs could be taken as an unequivocal signal that host country wishes to dilute the investor protection, then the PRI provider will naturally take note of it. Though it is speculated and logical that the BIT might have some impact on insurance guarantees or the cost of it, however, it remains to be proven empirically.

In the extant situation of BIT terminations creating a void in mitigating risk, the PRI industry could arise to the opportunity to foster investor confidence in risk mitigation. However, for enhancing the confidence of business community in the PRI industry, the PRI providers need to increase transparency and mobilization in their market.

This can be commenced by providing their model insurance agreements to the public to assess their evaluation methodology, or by enumerating the factors that PRI providers consider for deciding the premium and extension of coverage. This will enable investors and countries to monitor their investments and behaviour accordingly and utilize PRI regime with enhanced confidence.

DO BITS PLAY A ROLE IN PROMOTING FOREIGN DIRECT INVESTMENT? ARE THERE ALTERNATIVE FRAMEWORKS BEING CONSIDERED IN INDIA FOR INVESTMENT PROTECTION?

To understand the role played by BITs in FDI promotion and protection, and assess alternate frameworks being considered in India for investment protection, stay tuned for Part V of our series tomorrow.

– Yashasvi Tripathi & Kshama Loya Modani

You can direct your queries or comments to the authors

¹ Kathryn Gordon, *Investment Guarantees and Political Risk Insurance: Institutions, Incentives, and Development*, OECD Investment Policy Perspectives 2008

² MIGA, *Overview*, <https://www.miga.org/who-we-are/overview/>.

³ Providing Political Risk Insurance and Credit Enhancement Solutions, <https://www.miga.org/sites/default/files/2018-06/MIGA%20products.pdf>

⁴ German Federal Ministry of Economics and Technology and Price WaterhouseCoopers, *Granting of federal guarantees abroad*, July 2006, p 3

⁵ OPIC, *Political Risk Insurance Facilities for Private Equity Investment Funds*, <https://www.dfc.gov/sites/default/files/2019-08/pri-flyer-gec-2013.pdf>.

⁶ Lauge Skovgaard Poulsen, *Political Risk Insurance and Bilateral Investment Treaties*, a view from below. http://ccsi.columbia.edu/files/2014/01/FDI_27.pdf

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