The Relationship between Political Risk Insurance Policies and International Investment Agreements

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ABSTRACT

This thesis analyses the relationship between political risk insurance ("PRI") policies issued by public providers such as the Overseas Private Investment Corporation ("OPIC") and international investment agreements ("IIAs"). The analysis proceeds in three parts.

Part I explains the basic features of the PRI industry and compares IIAs with PRI policies. Generally speaking, IIAs provide broad protections that are available to investors for free, whereas PRI policies provide specific and narrower protections, which are more effective and easier to enforce. Ultimately, both PRI policies and IIAs are risk-mitigation tools that should be evaluated together by investors at the time of making foreign investments.

Part II explores the impact of PRI policies on the development of international law. Of particular importance are subrogation provisions found in most IIAs, which allow PRI providers to 'step into the shoes' of the investors and seek recovery from the host State. PRI providers should therefore take account of rights available to them under IIAs when assessing their recovery options. Further, as public insurers are government owned agencies, their actions give rise to State practice that may be relevant for interpretation of treaties in accordance with Articles 31(3)(a) and 31(3)(b) of the Vienna Convention on the Law of Treaties.

Finally, Part III illustrates the contribution that OPIC jurisprudence can make to international law by studying specific determinations made by OPIC. Two OPIC determinations are particularly revealing: the *Mid-American Holding/Indonesia Determination* and the *BoA/India Determination*. In both cases, OPIC applied

international law to determine whether the host State's actions breached protections contained in the policies and, upon making payment to the investor, OPIC relied on international law to seek recovery fom the host States. Finallly, Part III analyses OPIC jurisprudence in the areas of attribution under international law and quantification of compensation – the analysis shows there is substantial scope for cross-fertilisation between OPIC's jurisprudence and that of investment treaty tribunals.

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LIST OF ABBREVIATIONS

AAA	American Arbitration Association
AAD	Arbitral Awards Default
Bechtel	Bechtel Enterprises Holding Co.
BIT	Bilateral Investment Treaty
BoA	Bank of America
CAFTA-DR	Dominican Republic-Central America Free Trade Agreements
DCF	Discounted Cash Flow
DOJ	Denial of Justice
DPC	Dabhol Power Company
CalEnergy	CalEnergy Company Inc.
ECT	Energy Charter Treaty
ECHR	European Convention of Human Rights
ECtHR	European Court of Human Rights
EDA	Early Dispute Avoidance
Enron	Enron Corp.
FCN	Friendship, Commerce and Navigation
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
GE	General Electric Capital Corporation
GOA	Government of Argentina

GOM	Government of Maharashtra
HCE	Himpurna California Energy Ltd.
GATT	General Agreement on Tariffs and Trade
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Dispute
IFC	International Finance Corporation
IIA	International Investment Agreement
ILC	International Law Commission
Iran- U.S.C.T.R.	Iran-United States Claims Tribunal
ISDS	Investor–State Dispute Settlement
MERC	Maharashtra Electricity Regulatory Commission
MIGA	Multilateral Investment Guarantee Agency
MNE	Multi-National Enterprise
MSEB	Maharashtra State Electricity Board
NAFTA	North America Free Trade Agreement
NBG	National Bank of Georgia
NEXI	Nippon Export Investment Insurance
OECD	The Organisation for Economic Co-operation and Development
OPIC	Overseas Private Investment Corporation
Pertamina	Perusahaan Pertambangan Minyak Dan Gas Bumi Nigara
PPA	Power Purchase Agreement
PPL	Patuha Power Ltd
PRI	Political Risk Insurance

PLN	PT (Persero) Perushaan Listruik Negara
PWC	Price Waterhouse Coopers
QBD	Queen's Bench Division
SOE	State Owned Entities
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	The United Nations Conference on Trade and Development
UNTC	United Nations Treaty Series
USC	United States Code
VCLT	Vienna Convention on Law of Treaties
WTO	World Trade Organization

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PART A:

COMPARISON BETWEEN PRI POLICIES AND IIAs

INTRODUCTION

There has been a remarkable increase in foreign direct investment ("FDI") in the last three decades. From an average of $50 billion per year in 1980-85, global FDI inflows had increased by more than a factor of 20, to $1.23 trillion in 2014.[1] Yet, FDI flows face significant constraints. In particular, when it comes to developing countries, political risk is one of the most significant constraints faced by foreign investors.[2] Put simply, political risk is "the probability of disruption of the operations of companies by political forces and events".[3] The range of political risks faced by investors includes breach of contract, adverse regulatory changes, restrictions on currency transfers, expropriation and political violence.[4]

Given the significant impact that political risk can have on foreign investment, it is not surprising that many investors employ a large variety of risk-mitigation tools before investing abroad.[5] Such tools range from making market-testing smaller investments, joint ventures with local partners, risk analysis and engagement with the local government, to purchasing political risk insurance ("PRI") and structuring investments to gain protections of international investment agreements ("IIAs").[6]

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1 UNCTAD, "*World Investment Reforming International Investment Governance*" (2015), at 2, available at: http://unctad.org/en/PublicationChapters/wir2015ch1_en.pdf.

2 See World Bank Group, Multilateral Investment Guarantee Agency (MIGA), "*World Investment and Political Risk 2013*", at 5, figure 1.6, available at: https://www.miga.org/documents/WIPR13.pdf [hereinafter, *MIGA Report 2013*].

3 World Bank Group, Multilateral Investment Guarantee Agency (MIGA), "*World Investment and Political Risk 2011*", at 21, available at: www.miga.org/documents/WIPR11.pdf [hereinafter, *MIGA Report 2011*].

4 *MIGA Report 2013*, *supra* note 2, at p. 14.

5 *MIGA Report 2013*, *supra* note 2, fig. 2.8 (only 4% of the respondents said that they "don't use any tools or products to mitigate political risk").

6 *MIGA Report 2013*, *supra* note 2, at p. 37, fig. 2.8.

IIAs are treaties for the protection and promotion of FDI. The most dominant type of IIAs are bilateral investment treaties ("BITs"), which typically provide reciprocal substantive guarantees, as well as a procedural mechanism pursuant to which the investor is able to initiate binding arbitration against the host State for alleged treaty breaches.[7] Since 1959, States have signed over 3,200 BITs with the bulk of those treaties signed from 1990 onwards.[8] In addition, over the past two decades, there has been a significant rise in the number of investor-State arbitrations brought under BITs. World Bank's International Centre for Settlement of Investment Disputes ("ICSID"), which was created specifically for administering investor-state disputes, has seen its caseload increase from only 35 cases in its first thirty year of operations (1966-96) to nearly 550 registered cases as of December 2015.[9] The large number of BITs and investor-State arbitrations suggests that both States and investors consider BITs an important risk-mitigation tool.

In contrast to guarantees contained in a BIT, which are available to investors for free, PRI policies have to be bought from insurance providers.[10] PRI policies

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[7] *See, e.g.,* Newcombe & Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 2-3 (Kluwer, 2009); Rudolf Dolzer and Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (OUP, 2008); Campbell McLachlan et al, INTERNATIONAL INVESTMENT ARBITRATION—SUBSTANTIVE PRINCIPLES (OUP, 2007).

[8] UNCTAD Issue Note, *Recent Trends in IIAs and ISDS* (2015), available at: http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf.

[9] ICSID, The ICSID Caseload – Statistics (2016), available at: https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/ICSID%20Web%20Stats%202016-1%20(English)%20final.pdf.

[10] Most PRI providers do not publish their rates. However, OPIC makes its indicative rates available online at OPIC, Indicative Rates, available at http://www.opic.gov/what-we-offer/politicalrisk-insurance/indicative-rates. As of February 2016, OPIC's indicative premiums are US$0.18 – 0.42 for inconvertibility, US$0.28 – 0.60 for expropriation and US$0.21 – 0.53 for political violence, per US$100 of investment. These are individual rates and, therefore, in order to cover against all three risks, an investor would have to pay the combined total of these rates. By way of illustration, if an investor is making an investment for US$100 million and the investment has an average risk profile, the insurance premiums would be approximately US$ 0.30 for inconvertibility, US$0.44 for expropriation and US$0.33 (assuming an average risk profile leads to middle of the range premium).

typically insure against three principal non-commercials risks faced by foreign investors: expropriation, currency transferability and political violence.[11] In addition, in limited circumstances, insurance may also be available for arbitral award default ("AAD") and breach of contract.[12] PRI providers include national government agencies (like the U.S. agency, Overseas Private Investment Corporation ("OPIC")), arms of multilateral organisations (like World Bank's Multilateral Investment Guaranty Agency ("MIGA")) and private companies (like Zurich Re and PRI syndicates in Lloyd's of London).[13] PRI is clearly popular amongst investors: one study showed that the PRI industry issued $100 billion in investment insurance over the course of 2012, which meant that nearly 15% of all FDI for that year was covered by PRI.[14]

Even though BITs and PRI serve largely the same purpose – mitigation of political risk – and despite their popularity amongst investors, there is a disconnect between the two regimes.[15] Specifically, empirical evidence shows that PRI providers

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Therefore, the combined premium would be US$1.07 per US$100 of investment, which is equal to US$1,070,000 yearly for the US $100 million of insurance cover. So, if the investment is expropriated five years after having been made, the investor will have already paid $5,350,000 in premiums. See Mark Kantor, *Comparing Political Risk Insurance and Investment Treaty Arbitration*, 12 Transnat'l. Disp. Mgmt. 5, 455, at 473-474 (Nov. 2015) [hereinafter *Kantor, BITs and PRI*].

11 Pieter Bekker & Akiko Ogawa, *The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the 'BIT Bang'*, 28 ICSID Review 2, 314, at 333-334 (2013) [hererinafter, *Bekker, BITs and PRI*]; *Kantor, BITs and PRI*, *supra* note 10, at 464; Robert Ginsburg, *Political Risk Insurance and Bilateral Investment Treaties: Making the Connection*, 14 J. World Inv. & Trade 943, at 948 (2013) [hererinafter, *Ginsburg, BITs and PRI*].

12 AAD is effectively a "cover for failure by a State party to honor its obligations under a final international arbitration award". *Kantor, BITs and PRI*, *supra* note 10, at 464.

13 *See, generally, Kantor, BITs and PRI*, *supra* note 10, at 465-466 *MIGA Report 2013*, *supra* note 2; *Bekker, BITs and PRI*, *supra* note 11; *Ginsburg, BITs and PRI*, *supra* note 11.

14 *MIGA Report 2013*, *supra* note 2, at 30.

15 *Ginsburg, BITs and PRI*, *supra* note 11 (making the same argument).

do not review BITs when underwriting insurance policies, and lawyers who specialise in BITs do not consider ways in which PRI policies can strengthen the protections available to investors.[16] This divide has the obvious downside of inhibiting an investor's prospects of using all available tools to mitigate political risk before making an investment.[17] For example, an investor might buy a PRI policy without realizing that the guarantees contained under the policy were also available for free under a BIT. Alternatively, an investor might specifically structure his investment to take advantage of BIT protections, unaware of the host State's record to never comply with arbitration awards (in those circumstances, the investor would be well-advised to purchase a PRI policy against AAD).

However, the fact that an investor is likely to be in a better position to protect itself against future political events is not the only benefit of studying PRI and BITs together. There are many other benefits. First, combined study of the two regimes could contribute to the development of international law. When insurance providers, such as OPIC, decide claims, they issue well-reasoned determinations in support of their decisions.[18] Further, although PRI policies are governed by domestic law (e.g. OPIC policies are governed by New York law), they make reference to international

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[16] *See*, Jason Webb Yackee *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence, 51* Va.J. Int'l L 398, 400 (2010); Lauge Skovgaard Poulsen, *Political Risk Insurance and Bilateral Investment Treaties: A View from Below* Perspectives on topical foreign direct investment issues by the Vale Columbia Center on Sustainable International Investment (Sauvant et al eds. 2010) at 2-3, available at: http://ccsi.columbia.edu/files/2014/01/FDI_27.pdf.

[17] *Ginsburg, BITs and PRI, supra* note 11, at 944.

[18] In total, OPIC and its predecessor AID have issued in excess of 280 determinations so far. These determinations can be divided into three broad categories based on the three main political risks against which OPIC provides coverage: expropriation (over 70 determinations), political violence (over 30 determinations) and currency inconvertibility (over 170 determinations).

law. For example, in order to prove that an investment has been expropriated, an investor insured under an OPIC policy has to show that, *inter alia*, the host State's actions breached international law.[19] As a result, in making its determinations, OPIC applies international law to the specific facts in question, including by making reference to a wide variety of sources, such as decisions of international tribunals, treaties that the U.S. has concluded, scholarly work including American Law Institute's Restatement on Foreign Relations.[20]

Because OPIC is a U.S. government agency, its determinations reflect state practice.[21] Accordingly, the determinations could contribute to the formation or development of customary law. In addition, they could assist tribunals applying U.S. BITs as they arguably form 'agreements on interpretation' under Article 31(3)(b) of the Vienna Convention on the Law of Treaties ("VCLT").[22]

Secondly, investor-State tribunals could rely on determinations issued by OPIC as relevant authorities, in much the same way as they rely on decisions of other bodies, such as the Iran-U.S. Claims Tribunal or the WTO panels and Appellate Body. In fact, it can be argued that OPIC determinations are more relevant than decisions of any other body because of the similarities between BITs and PRI policies (as noted above, both instruments have largely the same purpose and they provide protections against similar risks).

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19 *See*, Chapter 4, s. 4.

20 *See*, Chapter 4, s. 2.3.

21 *See*, Chapter 4, s. 3.1.

22 *See*, Chapter 4, s. 3.1.

Finally, BITs contain subrogation clauses, which allow State-controlled insurer to "step into the shoes" of the investor and bring a treaty claim directly against the host State.[23] By doing so, an insurer can recover its losses, suggesting that BITs are relevant to PRI providers at not only the underwriting stage, but also at the recovery stage.

The purpose of this thesis is to answer precisely these questions about the relationship between BITs and PRI. To do so, it proceeds as follows:

Chapter 1 sets out the background for the study by identifying basic facts about the PRI industry, its origins, its size and its key players. It also makes the case for choosing OPIC as a case study. OPIC is the oldest and the most comprehensive political risk insurance program.[24] It has been the inspiration for most other industrialised nations, who have in many respects modelled their insurance programs on the institutional and administrative settings of OPIC. The insurance policies of OPIC are considered important benchmarks in the industry and there is significant convergence between OPIC's policies and policies of other providers. Finally, and very importantly for the purposes of this thesis, OPIC has several decades of experience in deciding claims and has amassed an impressive collection of well-reasoned claim determinations. In fact, OPIC determinations are the only determinations of a PRI provider, anywhere in the world, that have been discussed by international tribunals, signalling both the quality of the analysis in those

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23 *See*, Chapter 3 s.3.

24 On OPIC generally, see M. D. Rowat, *Multilateral Approaches to Improving Investment Climate of Developing Countries: The Cases of ICSID and MIGA*, 33 Harv. Int'l L. J. 103, 140-43 (1992); M. Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation*, 36 Virg. J. Int'l L. 511, 536 (1995); Jennifer M. DeLeonardo, *Are Public and Private Political Risk Insurance Two of A Kind? Suggestions for A New Direction for Government Coverage*, 45 Va. J. Int'l L. 737, 739 (2005).

determinations and the growing cross-fertilisation between OPIC and the broader international law community. [25]

As noted above, this thesis aims to study the relationship between PRI policies and BITs. To be able to do so, it is important to study the key similarities and differences between the two types of instruments. To that end, chapter 2 compares the basic features of OPIC policies and U.S. BITs, such as the eligibility and assessment criteria, length of coverage, the amount of compensation, and the cost and speed of recovery, as well as types of risks that are covered. This comparison demonstrates that the eligibility criteria under both OPIC policies and U.S. BITs are largely similar: only U.S. citizens qualify for protection and almost all types of investments made in the territory of the host State are covered. In terms of substantive guarantees, the contractual provisions in OPIC policies are more detailed and specific, than the wide, and often ambiguous, protections found in BITs. That said, BITs contain several valuable guarantees – such as the host State's promise to treat foreign investment in a 'fair and equitable manner' and to afford it the 'most favoured nation' treatment – which are not found in any PRI policies.

Finally, the process of obtaining compensation is similar in both cases. Under BITs, the investor has to bring a claim before an investor-State tribunal, which applies the legal standards of the treaty to the factual evidence to determine whether there has

[25] See, e.g., *Burlington Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012 and *BG Group Plc. v. Republic of Argentina*, UNCITRAL, Award, 24 December 2007 (citing *Revere Copper & Brass, Inc. v. Overseas Private Investment Corporation*, Award, (14 August 1978) 56 ILR 258 (1978), 17 ILM 1321 (1978)); *National Grid P.L.C. v. Argentina Republic*, UNCITRAL, Award, 3 November 2008 (citing *Expropriation Claim of Ponderosa Assets, L.P Argentina - Contract of Insurance No. D733*, Memorandum of Determinations, 2 August 2005).

been a violation and, if so, the amount of compensation owed to the investor. In case of OPIC, the claim is brought before an OPIC panel, which applies the provisions of the policy to the factual evidence to determine whether the conditions of the policy have been met and, if so, the amount of compensation owed to the investor. There are, however, two important differences. First, an investor-State arbitration typically takes longer, and costs substantially more, than a claim before OPIC. Secondly, at the end of an investor-State arbitration, the investor receives an award, which has to be enforced. The tribunal cannot compel the State to pay. It is therefore possible that, despite receiving a favourable award, the investor may never receive any compensation. By contrast, a PRI policy is effectively "a promise to pay money to the insured investor if certain conditions are met".[26] Therefore, as long as OPIC has the funds, which is likely to be always the case given that it has the "full faith and credit" of the U.S. government, the insured investor will get paid.[27]

The connection between BITs and PRI schemes is provided by the doctrine of subrogation. Subrogation is "the principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to any loss covered by the policy".[28] Most BITs contain subrogation clauses,[29] and therefore BITs are not only a risk-mitigation tool for investors, they are also a means of recovery for insurers.

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[26] *Kantor, BITs and PRI*, *supra* note 10, at 456.

[27] The Foreign Assistance Act, Pub. L. 87-195, 75 Stat., 22 U.S.C. § 2151 *et seq.*, § 2197(c) (1969).

[28] Black's Law Dictionary (10th ed. 2014).

[29] U.S. BITs are an exception in this regard as they do not contain subrogation provisions. That is the case because, as explained in Chapter 2, the U.S. government has concluded agreements with a large number of countries around the world, under which those countries agree to recognise OPIC's

In light of the above, Chapter 3 analyses the doctrine of subrogation under domestic law (in an attempt to identify any general principles) and international law. In the latter case, as there are no formal sources of international law on this subject, relevant rules are collected from decisions of international courts.[30] In addition, Chapter 3 studies variations amongst subrogation clauses found in different BITs. That study reveals that, generally, only those insurers that are part of the State or have been specifically designated by the State are entitled to the benefits of a BIT's subrogation clause. Put differently, a BIT's subrogation clause is of no direct benefit to a private insurer. That said, there are no publicly known cases where a subrogated State-owned insurer has brought a claim against the host State under a BIT. The absence of such cases may be explained by yet another aspect of the doctrine of subrogation. A subrogated insurer is not required to bring a claim under its own name: after a payment under the insurance policy, the insurer becomes the beneficial owner of the claim (up to the value of the insurance payment made); however, the investor continues to be the legal owner and, therefore, the proper claimant, for all of the claims.[31] Moreover, most insurance policies require that, after an investor has received compensation from the insurer, it must cooperate with the insurer in the pursuit of the

subrogation rights and also agree to submit any disputes relating to OPIC's claim to international arbitration. *See*, Chapter 2 s. 2.8.

30 *See*, e.g., *Aerial Incident of 27 July 1955 (Israel v. Bulgaria) Preliminary Objections, Judgment*, [1959] ICJ Rep 127; *Phelps Dodge International Corp. v The Islamic Republic of Iran*, Award No. 217-99-2 (1986) [hereinafter, *Phelps Dodge*]; *Foremost Tehran, Inc. v. Islamic Republic of Iran*, 10 Iran U.S. Cl. Trib. Rep. 228, 1986 WL 424309 (1986) [hereinafter, *Foremost*]; *Hochtief v Argentina*, ICSID Case No. ARB/07/31 (2015) [hereinafter, *Hochtief*].

31 *See*, e.g., *Phelps Dodge*, *supra* note 30; *Foremost Tehran, Inc. v. Islamic Republic of Iran*, 10 Iran U.S. Cl. Trib. Rep. 228, 1986 WL 424309 (1986) *Foremost*, *supra* note 30; *Hochtief*, *supra* note 30, at p.44.

claim.[32] The insurer funds all expenses incurred by the investor in pursuing claims on behalf of the insurer.[33] Therefore, it is possible that there are cases where the investor is bringing a claim effectively on behalf of the insurer, but because the named claimant in the arbitration continues to be the investor, the identity of the insurer is not known.

However, subrogation rights, by themselves, may not be sufficient for an insurer. Given the differences in the language of a PRI policy and a BIT, it is possible that a political event, which satisfies the conditions of an insurance policy, would not constitute a breach of a BIT. In those circumstances, the insurer would not be able to recover under the BIT. This is not just a theoretical concern, as evidenced by the experience of Enron.

In February 2001, Enron brought a claim against Argentina under the U.S.-Argenitna BIT seeking compensation for losses it had suffered as a result of certain adverse regulatory changes.[34] Nearly 18 months later, in August 2012, Enron filed an application at OPIC seeking compensation pursuant to a political risk policy it had purchased in 1993.[35] The two claims therefore involved the same facts. The ICSID tribunal held that Enron's investments in Argentina had not been expropriated (because it continued to be in control of its shareholding in the local company).[36] However, it found that Argentinian actions violated the BIT's fair and equitable

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[32] *See, e.g.*, OPIC Insurance Contract Form, 234 KGT 12-85, 51 *Fed. Reg.* 3438, at 3447 (1986), (section 9.08.9) [hereinafter, *OPIC Contract Form*].

[33] *Id.*

[34] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic,* ICSID Case No. ARB/01/3, Award (2007) [hereinafter, *Enron/ICSID Award*].

[35] OPIC Memorandum of Determination, Expropriation Claim of Ponderosa Assets, L.P. – Argentina – Contract of Insurance No. D733 [hereinafter, *Enron/OPIC Determination*].

[36] *Enron/ICSID Award*, *supra* note 34, para 243.

treatment clause and umbrella clause.[37] It awarded US$ 106.2 million in compensation to Enron.[38] By contrast, OPIC found that Enron's assets had been expropriated (the fact that it continued to be in control of the investments did not seem to matter much to OPIC).[39] Accordingly, it made a payment of US$ 50 million to Enron.[40]

Enron's example shows that investor-State tribunals and PRI can vary in their assessment of the same political events. Given that, insurers need to actively design their policies and claim determination processes in ways that make them more amenable to the use of subrogation rights. As explained in Chapter 4, a common way in which insurers achieve this objective is by requiring, at least in the context of expropriation, that the investor shows that not only the conditions of the policy have been met, but also that the government measures violate international law.[41]

If PRI providers such as OPIC are organs of States and regularly engage with international law (as demonstrated by the fact that OPIC's determinations repeatedly refer to various sources of international law), it must be the case that their practice contributes to the development of international law. In particular, as explained in Chapter 5, the practice of State-sponsored insurers can constitute "subsequent practice" of that State, which when combined with the acts of the host State where the insured investor has made its investment, can give rise to an "agreement regarding interpretation" of any investment treaty between the home State of the insurer and the

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37 *Id.* at para. 379.

38 *Id.* at para. 450.

39 *Enron/OPIC Determination*, *supra* note 35, p. 14.

40 *Id.* at p. 19.

41 *See*, e.g., *OPIC Contract Form*, *supra* note 32, at §4.01.

host State.[42] In fact, Chapter 6 analyses two major, and relatively recent, OPIC determinations – the *Mid-American Holding Determination*[43] and the *BoA Determination*[44] – in order to demonstrate how OPIC's practice might contribute to the development of international law.

Finally, Chapters 7 and 8 study the contribution that OPIC's jurisprudence has made to the international law of state responsibility, in particular in the areas of attribution of conduct and calculation of compensation. In certain cases, OPIC simply applies well-accepted rules of international law, thus reaffirming their customary status. In other instances, OPIC elaborates on those principles of general international that have not been widely applied by international tribunals. In such cases, OPIC's jurisprudence can guide future tribunals when they face similar issues. Finally, there are certain areas where OPIC departs from established rules of international law. While OPIC's departure does not necessarily raise questions about the customary status of international law rules, it provides an opportunity to comment on OPIC's motivations and the structural differences between the PRI and BIT regimes.

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[42] Vienna Convention on the Law of Treaties art. 31(3)(b), May 23, 1969, 1155 U.N.T.S. 331 [hereinafter, *VCLT*]. See generally, Georg Nolte, International Law Commission, *First Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/660, (2013) [hereinafter, *First ILC Report*]; Georg Nolte, International Law Commission, *Second Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/671 (2014) [hereinafter, *Second ILC Report*]; Anthea Roberts, *Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States*, 104 Am. J. Int'l. L. 179 (2010) [hereinafter, *Roberts, Power and Persuasion*].

[43] OPIC, Memorandum of Determinations, Expropriation Claim of Mid-American Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527 and E759 (10 Nov. 1999) [hereinafter, *Mid-American Holding Determination*].

[44] OPIC, Memorandum of Determinations: Expropriation Claim of Bank of America as Trustee India – Contract of Insurance No. F401 (30 Sep. 2003) [hereinafter, *OPIC, BoA Determination*].

CHAPTER 1: POLITICAL RISK INSURANCE AND BILATERAL INVESTMENT TREATIES

1. Introduction

One of the main objectives of this thesis is to compare expropriation coverage available under the policies of the Overseas Private Investment Corporation (OPIC), on the one hand, and the United States' bilateral investment treaties, on the other. The purpose of this chapter is to lay the conceptual foundations of the comparative methodology that will be followed in subsequent chapters.

Most comparative law enquiries involve three major stages: (1) selection of, first, a concept that will be compared and, second, legal systems across which that

concept will be compared; (2) description of the concept and the legal systems under consideration and (3) analysis.[1] The first step of the enquiry therefore is choosing the concept that will be compared, i.e. choosing the basis of comparison. This thesis employs the concept of expropriation as that basis. Over the last few decades, the focus of expropriation law has shifted from direct expropriations to indirect or creeping expropriations. Outright taking of property, as in the case of Mexican nationalisation of the 1920s or the Iranian and Libyan cancellation of oil concessions in the 1970s, has become rather rare.[2] Instead, nowadays states generally enact legislative and regulatory measures that indirectly deprive investors of their property.[3]

Despite numerous investment treaty awards[4] and academic writings[5] on this subject, many areas of international law on expropriation remain unsettled. These

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1 Gerhard Dannemann, *Comparative Law: Study of Similarities or Differences?*, in OXFORD HANDBOOK ON COMPARATIVE LAW 406 (OUP, 2006) [hererinafter, *Dannemann, Comparative Law*].

2 On nationalization of foreign-held property, *see* R.B. Lillich, THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW (Charlottesville: University Press of Virginia, 1972).

3 *But see* recent cases of direct expropriation in countries like Venezuela, Belize and Zimbabwe. In case of Belize, "[t]he government expropriated a major telecommunications provider and the electricity company owned by foreign investors in 2011 (the telecommunications provider had been nationalized in 2009 and was renationalized in 2011 to overcome a court ruling that the 2009 nationalization was illegal)" (U.S. Department of State, 2013 Investment Climate Statement – Belize, available at: http://www.state.gov/e/eb/rls/othr/ics/2013/204602.htm); see also *British Caribbean Bank Limited v. The Government of Belize*, UNCITRAL (2015). In case of Zimbabwe, "[d]espite provisions in Zimbabwe's previous constitution that prohibit the acquisition of private property without compensation, in 2000 the government began to sanction uncompensated seizures of privately owned agricultural land, serially amending the constitution to grant the government increasingly broad authorities to do so after the fact". (U.S. Department of State, 2014 Investment Climate Statement – Zimbabwe, available at: http://www.state.gov/e/eb/rls/othr/ics/2014/229115.htm); see also *Bernhard von Pezold and Others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15 (2015).

4 *See, e.g CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL (Partial Award) (2001); *Eureko B.V. v. Republic of Poland* (Partial Award) (2005); *CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8* (Award) (2005); *Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12* (Award) (2007); Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic, ICSID Case No. ARB/97/3 (award) (2007); *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic,* ICSID Case No. ARB/01/3, Award (2007).

5 On indirect expropriation *see* G.C. Christie, *What Constitutes a Taking of Property under International Law*, 33 BYIL 307 (1962); B.H. Weston, '*Constructive Takings' under International Law:*

factors make it an ideal concept for comparative analysis as insights gained from a different legal system can genuinely inform the development of international law regarding expropriation.[6]

Having chosen the concept that will form the basis of comparison, the next step of the enquiry involves choosing the legal systems across which the concept of expropriation will be compared. Typically, comparative law scholars choose domestic laws of two or more countries as the legal systems across which they compare a specific rule.[7] This and the next chapter do not purport to perform the usual cross-

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A Modest Foray into the Problem of Creeping Expropriation 16 VJIL 103 (1975); D.F. Vagts, *Coercion and Foreign Investment Rearrangements* 72 AJIL 17 (1978); R. Higgins, *The Taking of Property by the State: Recent Developments in International Law* 176 RDCADI 259 (1982); V. Been & J. C. Beauvais, *The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine'* 78 NYULR 30 (2003) [hereinafter, *Been & Beauvais*]; R. Dolzer, *Indirect Expropriation of Alien Property* 1 ICSID Rev 41 (1988); R. Dolzer, *New Foundations of the Law of Expropriation of Alien Property*, 75 AJIL 553 (1981); V. Lowe, *Regulation or Expropriation?*, 55 Current Legal Problems 447 (2002); R. Dolzer, *Indirect Expropriations: New Developments?* 11 NYUELJ 64 (2003); L.Y. Fortier & S.L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor* 19 ICSID Rev 293 (2004); A. Newcombe, *The Boundaries of Regulatory Expropriation* 20 ICSID Review 1 (2005); A. Reinisch, *Legality of Expropriation*, in A. Reinisch, ed., STANDARDS OF INVESTMENT PROTECTION (OUP, 2008).

[6] Several academics have previously compared aspects of the expropriation concept across different legal systems. *See, e.g.*, *Been & Beauvais*, *supra* note 5 (comparing expropriation decisions under NAFTA's Article 1110 with regulatory takings under the Fifth Amendment of the U.S. Constitution); Nicholas Birch, *Comparative Compensation for Expropriation*, in Stephan Schill (ed.) INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (OUP, 2010) (comparing compensation standards for expropriation in international investment law, international human rights law and domestic laws of the United States, Germany and France); Markus Perkams, *The Concept of Indirect Expropriation in Comparative Public Law – Searching for Light in Dark*, in Stephan Schill (ed.) INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (OUP, 2010) (comparing approaches of ECtHR, ECJ, U.S. and German courts on indirect expropriation to extract principles that can be used to interpret expropriation provisions in BITs). *See also* Gus V. Harten, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (OUP, 2007) (calling for structural reform of the dispute settlement mechanism in investment treaties on the basis of a comparative public law analysis) [hereinafter, *G. V. Harten*].

[7] *See, e.g.,* G.H. Trietel, REMEDIES FOR BREACH OF CONTRACT: A COMPARATIVE ACCOUNT (1988) (Clarendon, 1992); Ran Hirschl, TOWARDS JURISTROCRACY, THE ORIGINS AND CONSEQUENCES OF THE NEW CONSTITUTIONALISM (Harvard University Press, 2004) (discussing the adoption of judicial review in four nations in the late twentieth century); Ernst Rabel, THE CONFLICT OF LAWS: A COMPARATIVE STUDY (1945 – 58) (University of Michigan Press, 1945) (a classic four-volume work presenting a comparative review of rules of private international law applicable in roughly hundred jurisdictions throughout the world).

country analysis. Instead, the aim of these chapters is to compare expropriation coverage across two separate legal instruments, each of which in its own unique way protects foreign investor's interests. Those two legal instruments are international investment agreements ("IIAs") and political risk insurance ("PRI").

The choice of these two instruments raises another methodological challenge. Neither investment treaties nor PRI constitute a homogeneous system. There are over 3,000 IIA, comprising both bilateral investment treaties ("BITs") as well as multilateral investment treaties ("MITs") between over 120 countries. And while these treaties share important common features, they are not identical. Similarly, there are over 50 well-established PRI programmes at multilateral, public and private levels, all of which roughly cover the same risks, but there are nevertheless important differences between them. To carry out the purported research, this thesis must therefore choose a case study (unit of analysis) within each set to which generalisation can be applied.

Upon reviewing the various PRI systems, the U.S. government-sponsored Overseas Private Investment Corporation ("OPIC") stands out as the natural case choice. That is so because OPIC has many common attributes with the population of interest (i.e. other providers in the PRI industry).[8] As discussed in detail later, OPIC is the oldest and the most comprehensive political risk insurance programme, that has become the model for other insurance providers to follow.

Having chosen OPIC as the case choice within the PRI industry, the next step is to choose a similarly representative unit of analysis within the world of investment

[8] *See* Mary M Kennedy, *Generalizing from Single Case Studies*, in Matthew David (ed.), CASE STUDY RESEARCH, vol. II, 3-17 (Sage, 2006) (discussing how to choose case studies for purposes of generalisation and comparison).

treaties. There appear to be several options here, which could be placed on a spectrum. A multilateral system based on converging principles of investment protection will be on one end of this spectrum.[9] At this end, there would be no need to choose one specific treaty or group of treaties. Instead, one could carry out the present analysis on the basis of general principles that are relatively uniform across the myriad number of bilateral treaty relationships. At the other end of the spectrum would be individual BITs/ MITs or a small grouping of BITs/MITs. Here, one would proceed on the basis that international investment law contains very few, if any, uniform principles. Instead, what we have are numerous, largely bilateral/multilateral treaties that are implemented by arbitral tribunals established on a case-by-case basis. Therefore one has to look at a specific treaty to establish what level of protection is afforded to the investor.[10] This thesis adopts an approach that is somewhere in the middle. The focus of the analysis will be the U.S. BITs, including U.S. Free Trade Agreements ("FTAs"), such as the North American Free Trade Agreement ("NAFTA") or the Dominican Republic-Central America FTA ("CAFTA-DR").[11] But because tribunals interpreting and applying U.S. BITs routinely refer to arbitral decisions based on wholly unrelated

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9 *See,* S.W. Schill, THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW (CUP, 2009) [hereinafter, *Schill*] (arguing that investment treaties, taken together, "function analogously to a truly multilateral system" because: (i) they generally conform to an archetype; (ii) any differences between treaties are levelled out by the operation of the most-favoured-nation (MFN) clause; (iii) treaties contain a lax definition of "investors" which promotes treaty shopping; and (iv) arbitral tribunals routinely rely on awards made on the basis on unrelated treaties). *See also* Sergey Ripinsky, *Book Review: The Multilateralization of International Investment Law*, 22 Eur. J. Int'l L. 598 (2011).

10 *See, e.g.,* J. Alvarez, *A BIT on Custom*, 42 N.Y.U. J. Int'l L. & Pol. 17, 24 (2009).

11 Like in other countries, U.S. BITs are negotiated on the basis of a model BIT text. The first model text was drafted in 1984. That model was revised significantly in 2004 and 2012.

treaties, the thesis will also look at awards issued in cases where U.S. BITs were not at issue.[12]

The choice of U.S. BITs can be defended on several grounds. First, in a comparative analysis of the type envisaged here, it is generally advisable to choose legal systems that are broadly similar in economic, social and political respects.[13] Because OPIC and the U.S. BIT program are both American solutions to the same problem – how to protect U.S. investment abroad and, at the same time, de-politicise investor-state disputes – they share many similarities which simply would not exist if BITs of any other State were chosen.[14] Second, exactly the same measures can fall within the jurisdictional reach of both U.S. BITs and OPIC as a potential breach of the expropriation coverage and may even be adjudicated simultaneously. That could not be the case with non-U.S. BITs as U.S. investors do not qualify for protection under those treaties. Finally, an important aspect of this thesis is the examination of the role played by the U.S. government in the OPIC insurance program and the extent to which that contributes towards U.S. state practice on expropriation. Again, U.S. state practice is most relevant to disputes brought under a U.S. treaty, further justifying the choice of U.S. BITs.

Having defended the methodology followed by this thesis, the next task is to briefly explain the purpose of undertaking this comparative study. Broadly speaking,

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12 Despite differences in the text of the treaties, the reasoning patterns of arbitral tribunals adjudicating investor-state disputes suggest that they see the multitude of BITs as part of a uniform regime. Tribunals constituted pursuant to a U.S. BIT routinely refer to other arbitral decisions based on wholly unrelated BITs. See *Schill*, *supra* note 9, ch. 7. Given the arbitral practice, it is justifiable for this thesis to review even those arbitral awards on expropriation that were not based on a U.S. BIT.

13 Dannemann, *Comparative Law*, *supra* note 1, at 409.

14 *See*, further section 3.1 below.

there are four main purposes. Firstly, a comparative perspective can help "facilitate" an investor's "choice between different legal systems".[15] By highlighting similarities and differences between U.S. BITs and OPIC insurance program, this study can raise awareness within the investor community as to which legal system is more favourable for protecting against the risk of expropriation. Secondly, a comparative study can offer new perspectives that can be used to improve the current international investment law system (in particular, the law surrounding the concept of expropriation). Thirdly, this study can assist academics, tribunals and practitioners in understanding the circumstances in which cross-fertilisation between the two regimes is, or is not, appropriate. Claim determinations issued by a state-run insurance provider raise questions about whether such determinations reflect state practice and, if so, should such practice be taken into account by investment treaty tribunals. Conversely, upon being assigned the task of interpreting insurance contracts, should PRI providers be looking to investment treaty awards for guidance? These are important issues, which will be discussed later in this thesis.

Finally, aside from practical application of the comparative analysis, this study serves a very straightforward, yet important, academic purpose – understanding the PRI industry and, in particular, OPIC. Given the paucity of literature on either topic, and the fact that most of the over hundred OPIC determinations[16] reviewed in this

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15 *Id.* at 404-5.

16 In total, OPIC and its predecessor AID have issued in excess of 280 determinations so far. These determinations can be divided into three broad categories based on the three main political risks against which OPIC provides coverage: expropriation (over 70 determinations), political violence (over 30 determinations) and currency inconvertibility (over 170 determinations).

study were until recently not even available in the public domain,[17] this thesis makes an important contribution to an area of investment protection that has so far largely been ignored.

This Chapter proceeds as follows. Section 2 introduces the concept of political risk, the main types of political risks and the tools that are routinely used to mitigate that risk. Section 3 discusses one such risk-mitigation tool: political risk insurance. PRI providers can be divided into three broad categories: State-controlled or public insurers, multilateral insurers and private insurers. On the public front, the section briefly describes the origins of and products offered by the three biggest public PRI providers – OPIC (U.S.), NEXI (Japan) and PwC (Germany). On the multilateral front, the section undertakes the same analysis with respect to World Bank's Multilateral Investment Guaranty Agency (MIGA). With respect to private players, historically, they have been outnumbered by public providers; however, in the past few decades, not only has there been a dramatic growth in the size of the private insurance industry, there has also been a convergence in the insurance policies offered by public and private providers. The final part of Section 3 explores reasons for these developments in the private PRI industry.

Having discussed political risk insurance, Section 4 moves on to discussing the other risk-mitigation tool that forms the focus of this thesis: investment treaties, and in particular U.S. BITs. Much has already been written about investment treaties, their

[17] The OPIC determinations reviewed in this study were obtained directly from the OPIC staff in Washington D.C. However, during the course of writing this thesis, Oxford University Press (OUP) published a two-volume series containing all those determinations. See Mark Kantor, Karl Sauvan & Michael Nolan (eds.), REPORTS OF OVERSEAS PRIVATE INVESTMENT CORPORATION DETERMINATIONS (OUP, 2011). This publication, however, does not undermine the importance or the novelty of the current study as OUP's books largely provide the text of the determinations only.

origins and the protections they provide. This section will therefore only very briefly discuss the BIT regime leaving it up to successive chapters to explore the finer details of this regime. Finally, Section 5 will conclude by summarising various issued discussed in Sections 1-4.

2. The concept of political risk

There has been a remarkable increase in foreign direct investment (FDI) in the last three decades. From an average of $50 billion per year in 1980-85, global FDI inflows had increased by more than a factor of 20, to $1.23 trillion in 2014.[18] Although these flows started plummeting in 2008 as global economic uncertainty affected companies' willingness to expand abroad, the central role of FDI in economic growth and development cannot be doubted. FDI continues to be an important means by which host countries, especially developing countries, acquire tangible and intangible assets, including capital, employment, technological know-how, new management techniques, skills, and access to markets.[19]

Because of the long gestation period and the need to establish assets on the ground, FDI is often more vulnerable to "political risk" than other types of cross-border capital flows. Political risk is the probability of disruption to the operation of multi-national businesses by political forces or events, whether they occur in host countries or result from changes in the international environment.[20] Political risks

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[18] UNCTAD, *World Investment Reforming International Investment Governance* (2015), at 2, available at: http://unctad.org/en/PublicationChapters/wir2015ch1_en.pdf

[19] See UNCTAD, WORLD INVESTMENT REPORT 2011: NON-EQUITY MODES OF INTERNATIONAL PRODUCTION AND DEVELOPMENT (2011).

[20] MIGA, WORLD INVESTMENT AND POLITICAL RISK 15 (World Bank, 2010) [hereinafter, *MIGA, World Investment*].

include, but are not limited to, breach of contract, adverse regulatory changes, restriction on currency transfers and convertibility, expropriation, political violence (war or civil disturbance such as revolution, insurrection, sabotage and terrorism) and non-honouring of sovereign obligations.[21]

Developing countries have traditionally been known to carry more political risk than developed markets. Moreover, even though developing countries have been steadily moving towards greater investment liberalisation,[22] the onset of the financial crisis has re-ignited the debate over the role of FDI, leading many countries to introduce new limitations and restriction on FDI flows. A study conducted by MIGA showed that out of the 77 regulatory changes pertaining to FDI introduced by developing countries in 2009, 26 of them were restrictive of such investments, the highest share recorded in several years.[23] These developments, coupled with global economic uncertainty and the dramatic increase in treaty-based investment disputes between MNEs and host States,[24] many of which are highly publicised, have significantly raised investors' risk perceptions. In fact, according to a recent World Bank survey, over the medium term, political risk is the second most important constraint for investment into developing countries, only after 'macroeconomic instability'.[25] The same survey also found significant differences in perceptions across

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21 *See, e.g., OPIC, What we Offer: Political Risk Insurance, at: https://www.opic.gov/what-we-*offer/political-risk-insurance.

22 *See* World Bank, DOING BUSINESS 2011: MAKING A DIFFERENCE FOR ENTREPRENEURS (World Bank, 2010).

23 *MIGA, World Investment*, *supra* note 20, at 18.

24 *See infra* note 92 for statistics regarding investment disputes.

25 MIGA, WORLD INVESTMENT AND POLITICAL RISK 18 (2013), available at: https://www.miga.org/documents/WIPR13.pdf [hereinafter, *MIGA, World Investment, 2013*].

firms operating in different sectors. The proportion of firms who operate in the primary sector – basically, agriculture and extractive sectors – that found political risk to be the main constraint to investment was larger than in any other sector.[26] This finding does not seem surprising as those firms that are dependent on host State's natural recourses often operate in some of the most risky environments with significant sunk costs and long gestation periods. In fact, distribution of International Centre for Settlement of Investment Dispute ("ICSID") cases across various economic sectors also shows that, as of 31 December 2015, firms operating in the primary sector were responsible for 26% of all ICSID cases so far – more than any other economic sector.[27]

The importance that businesses give to political risk in their investment decisions obviously raises the question of what, if anything, they are doing to control that risk. There are several ways to manage political risk, including assessing the level of risk (through internal analysis or the use of external consultants); non-contractual mitigation strategies (such as, engagement with local governments, communities and NGOs; joint ventures with local entities, etc.) and contractual risk-mitigation tools (such as PRI and credit default swaps).[28] According to the World Bank survey mentioned above, non-contractual strategies are most commonly used, with the survey showing that nearly 54% of the firms prefer to have an open dialogue with the local

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[26] *Id.*

[27] The ICSID Caseload Statistics (Issue 2016-1), p. 12, available at: https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/ICSID%20Web%20Stats%202016-1%20(English)%20final.pdf.

[28] *MIGA, World Investment*, *supra* note 20, at 37.

government in order to minimise political risk.[29] Among the contractual risk-mitigation tools, 15% of the respondent firms used PRI.

The number of firms that use PRI is relatively low – only one in seven firms buys insurance coverage. There are several reasons why PRI has not yet become the most popular risk-mitigation tool. Many of these reasons will be discussed later in the thesis, but they can vary from lack of availability (for example, insurers generally do not cover the risk of breach of contract even though that is one of the most common forms of political risk faced by investors), lack of knowledge (amongst investors) about availability of PRI and pricing.

The same World Bank study also found that investors when investing abroad often employ "scenario planning" and "risk analysis" strategies; these strategies include seeking protections included under investment treaties.[30] In a survey of 602 senior executives of MNEs conducted in 2007, roughly one-fifth of the recipients indicated that the existence of a BIT influenced their locational decisions "to a very great extent" while an equal share said that such agreements influenced their decisions "not at all". At the same time, roughly half of the respondents indicated that BITs influenced locational decisions "to a limited extent," suggesting that other factors needed to be present.[31] Aside from conducting qualitative surveys, scholars have also

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29 *Id.*

30 *Id.* While BITs are the dominant type of international investment agreements (IIAs), there are other types of IIAs as well. Notable among them are the double taxation treaties (DTTs), multilateral free trade agreements with an investment component, such as the North American Free Trade Agreement (NAFTA) and sectoral treaties with an investment component, such as the Energy Charter Treaty (ECT).

31 L. Sachs & K. Sauvant, *BITs, DTTs and FDI inflows: An Overview*, in L. Sachs & K. Sauvant (eds.), THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES AND INVESTMENT FLOWS 22-23 (OUP, 2009) (discussing a survey conducted by the Economic Intelligence Unit).

attempted to determine the influence of BITs on investor's locational decisions by quantitatively studying the relationship between BITs and investment flows. The results of these studies vary significantly, however, ranging from "strong positive effect" to "weak positive effect" to "no effect" at all.[32]

Having described the concept of political risk, the main types of political risks and the various tools used to mitigate that risk, the next section will now turn to describing the two tools that will be compared in this thesis – PRI and BITs.

3. Political risk insurance

PRI, as the name suggests, is an insurance against non-commercials risks. It covers both export/trade credit and investment insurance; however, for the purposes of this study, PRI refers to investment insurance only. Today, PRI is available against most political risks, including expropriation, currency transferability, political violence, arbitral award default and non-honouring of sovereign financial obligations. In addition to providing the investor with compensation in case one of the covered events occurs, PRI also helps investors gain financing for their projects. Many lenders, in fact, require as a condition of financing that the investors take out PRI coverage.[33] Moreover, as will be discussed in detail later, when coverage is provided by national or multilateral agencies, PRI can also help deter harmful actions by host governments and assist in resolving investment disputes.

The PRI industry consists of three broad categories of providers:[34]

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[32] *See Id.*, chs. 5-14 (containing quantitative studies of various academics).

[33] Scott L. Hoffman, THE LAW AND BUSINESS OF INTERNATIONAL PROJECT FINANCE 256-7 (CUP, 2008).

[34] See *MIGA, World Investment*, *supra* note 20, at 55.

- *National PRI Providers*: They comprise national export credit agencies (ECAs) and government sponsored investment insurance entities. Most developed countries, and a few of the fastest growing developing economies like China and India, have their own PRI providers.
- *Multilateral PRI Providers*: In order to plug the gaps left by national PRI providers, which only provide coverage to investors from their own respective countries, multilateral agencies were set-up, starting from 1980s onward. Today, multilaterals comprise a significant share of the market.
- *Private PRI Providers*: The private market has traditionally been of little importance as national and multilateral providers have dominated this industry. But that has changed now, and private players have a market share that is almost equal to the market share of public providers.

Historically, public and multilateral insurance providers had a substantially larger share of the market as compared to private providers. In fact, according to one study, the size of the entire private PRI industry was around the same as OPIC's business alone in the mid-1990s.[35] In stark contrast, a study done in 2000 showed that national insurers account for about 36% and private insurers for 55% of the total political risk insurance market.[36] Another study showed that, as of 2001, all public source insurance—including OPIC, MIGA and other agencies' products—accounted for 52% of the global PRI market, while private insurance companies accounted for 48

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35 M. Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation*, 36 Virg. J. Int'l L. 511, 536 (1995) [hereinafter, *M. Perry, A Model for Efficient Foreign Aid*].

36 Asian Development Bank, *Review of the Partial Risk Guarantee of the Asian Development Bank*, November 2000, p. 3.

percent—with AIG garnering 15%, Lloyd's 16%, Sovereign 7%, Zurich 7% and other private insurances accounting for the remaining 3% of the market.[37] These studies also show that, among the national insurers, OPIC (U.S.), PwC (Germany) and NEXI (Japan) are the most commonly used insurers, accounting for almost 30% of all outstanding national insurance coverage. MIGA accounts for another 9% of the market share in this sector.[38] Given their respective market shares, it is evident that OPIC, PwC, NEXI and MIGA are the four most important sources of PRI in the world. The next section therefore will provide a brief overview of these four insurers, though greater emphasis will be laid on the history and experience of OPIC as it is the focus of this thesis.

3.1. Overseas Private Investment Corporation

OPIC is a federal agency of the U.S. Government. It was established by Congress in 1969 and became operational in 1971.[39] OPIC's business is primarily to provide political risk insurance and financing for U.S. private investors. A discussion of OPIC's history is beyond the scope of this work; however, it suffices to say that although its immediate predecessor in providing PRI was the United States Agency for International Development (USAID), OPIC grew out of what was originally the investment guaranty component of the post World War II Marshall Plan.[40]

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37 *See*, Christina Westholm-Schroder, *The Expanding Role of Private Insurers in Covering Political Risks*, 822 PLI/COMM 33, 42 (2001) (cited in Pieter Bekker & Akiko Ogawa, *The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the 'BIT Bang'*, 28 ICSID REVIEW 314, 316-317 (2013) [hereinafter, *Bekker & Ogawa, PRI and BITs*].

38 *Id.*

39 The Foreign Assistance Act, Pub. L. 87-195, 75 Stat., 22 U.S.C. § 2151 et seq (1969).

40 J. De Leonardo, *Are Public and Private Political Risk Insurance Two of a Kind-Suggestions for a New Direction for Government Coverage*, 45 Virg. J. Int'l L. 737, 740-1 (2005) [hereinafter,

The OPIC insurance programme has three principal purposes. First, promotion of U.S. investment flows to various countries. According to its enabling statute, OPIC is "to mobilise and facilitate the participation of the United States private capital and skills in the economic and social development of less developed countries and areas".[41] OPIC's "additionality" or its marginal benefit therefore lies in mobilizing those U.S. investments that are considered so risky that they would not have occurred but for OPIC's support.[42]

Second purpose is assistance in the host State's development. Because FDI is widely believed to carry several tangible and intangible benefits for the recipient state, any additional investment that occurs because of OPIC support will supposedly contribute to that state's economic growth. OPIC's developmental mandate is further strengthened by the statutory requirement that the agency must give preferential consideration to investments in developing countries with a low per capita income.[43] Moreover, each project supported by OPIC must meet a high developmental threshold, which is calculated by the underwriting staff by examining the expected developmental effects of the proposed project.[44]

Leonardo, Political Risk Insurance]. For a detailed discussion of OPIC's background, including the various legislative amendments and congressional hearings, *see* M. Gordon, *Overseas Private Investment Corporation: Risk Management Principles*, 48 Tul. L. Rev. 480 (1973); S. Franklin and G. West, *The Overseas Private Investment Corporation Amendments Act of 1978*, 14 Tex. Int'l L. J. 1 (1979); Alen C. Brennglass, OVERSEAS PRIVATE INVESTMENT CORPORATION: A STUDY IN POLITICAL RISK (Praeger, 1983); *M. Perry, A Model for Efficient Foreign Aid, supra note* 35.

41 Congressional statement of purpose; creation and functions of Corporation, 22 U.S.C. §2191 (1994).

42 *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, 527-8; *Leonardo, Political Risk Insurance, supra* note 40, at 741.

43 OPIC, *Development Update: Expanding the Overseas Private Investment Corporation's Development Impact Assessment*, at 14 (June 2003), available at: http://www.opic.gov/sites/default/files/docs/02_DevelopmentReport.pdf.

44 *Id.*

Third, and final, purpose is de-politicisation of investment disputes. Traditionally, all remedies available to U.S. investors – military, diplomatic, legal or economic – required some involvement of the U.S. government. This, however, was considered unsatisfactory because, from the government's perspective, it complicated the conduct of foreign policy, and, from the investor's perspective, it meant losing control over the claim.[45] OPIC's insurance programme reduces, although not eliminate, these problems. Under the insurance programme, in case U.S. investment is harmed by the host State, the investor does not have to request U.S. government's involvement; instead, it can directly seek compensation from OPIC. The insurance programme does not, however, completely eliminate the U.S. government's involvement as the U.S. State Department can, and often does, obtain compensation from the host State on behalf of OPIC.

In pursuing these three objectives, OPIC benefits greatly from its "unusual" mixture of public and private sectors.[46] According to its enabling statute, OPIC is not meant to compete with the private sector; instead, it is meant to be an insurer of last resort.[47] Nevertheless, to enable smooth functioning of the agency and to minimise the risk to U.S. taxpayers, OPIC was adorned with several business-like qualities. For example, OPIC is subject to the oversight of a Board of Directors,[48] it is required to

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45 K. Vandevelde, UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE 23 (Kluwer, 1992).

46 *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, at 518.

47 *Id.* at 514 & n. 2 ("OPIC will not participate in projects that can secure adequate financing from commercial sources) (*quoting* OPIC, Program Handbook 3-4 (April 1994)); *Leonardo, Political Risk Insurance*, *supra* note 40, at 741.

48 Organization and management, 22 U.S.C. §2193 (1994); *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, at 518.

publish profit and loss statements and balance sheets annually,[49] and it is instructed to earn sufficient revenue from its activities so that it can operate on a "self-sustaining" basis.[50] As a result of these features, OPIC is able to operate like any other for-profit company insuring only those projects that make business sense. In fact, since it became functional in 1971, OPIC has earned a profit in each year of its operation.[51]

However, despite its status as a government corporation, OPIC still operates very much like any other federal entity. For example, OPIC is subject to the "policy guidance" of the U.S. Secretary of State,[52] U.S. government regularly negotiates bilateral treaties with other countries on OPIC's behalf,[53] and OPIC regularly commits the "full faith and credit" of the U.S. government in support of the projects it approves.[54] The "full faith and credit" of the U.S. government is crucial as it reduces the risk associated with OPIC contracts both by deterring events leading to claims and by obtaining compensation for claims payments. It is therefore not surprising that OPIC has such a stunning recovery record. According to the agency's own statement[55]:

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49 General provisions and powers, 22 U.S.C. §2199(c)(2) (1994); *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, at 518.

50 Congressional statement of purpose; creation and functions of Corporation, 22 USC s. 2191(a) (1994); *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 36, at 518.

51 *See* OPIC Annual Reports, http://www.opic.gov/publications/reports-handbooks/annual.

52 Congressional statement of purpose; creation and functions of Corporation, 22 USC s. 2191 (1994); *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, 518.

53 *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 36, at 518; *see infra* Chapter 2, 2.8.1 discussing bilateral incentive agreements concluded between the U.S. and over 130 countries to facilitate OPIC's work in those countries.

54 General provisions relating to insurance, guaranty, financing, and reinsurance programs, 22 USC s. 2197(c); *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, at 518.

55 OPIC, *Insurance Claims Experience To Date: OPIC and its Predecessor Agency* (Sep 30, 2014), available at: https://www.opic.gov/sites/default/files/files/2014%20Annual%20Claims%20Report.pdf.

> Since 1971, OPIC has made 295 insurance claims settlements totalling $976.8 million. . . . OPIC cash recoveries on claims total $754 million (without regard to reinsurance reimbursements). Additional recoveries in the form of OPIC guaranteed obligations ($226 million) bring OPIC's total recoveries to $980.1 million, or 100% of total claims settlements.

3.2. Japan: NEXI

Inspired by the U.S. investment insurance programme, the Japanese government established their investment insurance programme in 1956.[56] From its inception until 2001, the Japanese Ministry of Trade and Industry (MITI) administered the programme.[57] In April 2001, Nippon Export and Investment Insurance (NEXI), an independent administrative agency, was created as a 100% state-owned agency to "manage the program in unity with the Government".[58] Nowadays, all operations concerning the insurance programme are conducted by NEXI, with the Japanese government providing crucial financial and institutional backing. Among other things, the government provides NEXI's annual capital, reinsures insurance accepted by NEXI - which enhances NEXI's creditworthiness - and, on behalf of NEXI, undertakes negotiations with other countries.[59]

The official mission of NEXI is to "efficiently and effectively conduct insurance business of covering risks which arise in foreign transactions and which are

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[56] Export Insurance Law (Law No. 67 of March 31, 1950) established the Japanese trade insurance program. That program was extended in to the insurance of FDI in 1956. *See* W.C. Brewer, *The Proposal for Investment Guarantees by an International Agency*, 58 Am. J. Int'l L. 62, 67 & n. 20 [hereinafter, *Brewer*]; N. Rubins & N.S. Kinsella, INTERNATIONAL INVESTMENT, POLITICAL RISK AND DISPUTE RESOLUTION: A PRACTITIONER'S GUIDE 91 (Oceana Publications: 2005) [hereinafter, *Rubins & Kinsella*].

[57] *Id.*

[58] NEXI, History, available at: http://www.nexi.go.jp/en/corporate/history.html.

[59] NEXI, Products and Services, available at: http://www.nexi.go.jp/en/products/.

not covered by commercial insurance".[60] In pursuit of this objective, NEXI offers a large variety of insurance and finance products to Japanese investors and exporters.[61] As in the case of OPIC, NEXI also functions as an insurer of last resort and, as such, does not compete with the private sector or try to make a profit.[62]

3.3. Germany: PwC

Germany followed the American and Japanese example, and established its own investment insurance programme in 1959.[63] Until recently, the German federal government administered the programme through Truearbeit AG, an agency headquartered in Hamburg.[64] Truearbeit offered both investment insurance and export credit guarantees and loans with equity features to those investors who were domiciled in Germany.[65] Today, the German federal government offers the same products through a consortium of private agents: PwC and Euler Hermes. PwC has the primary responsibility for administration of the German government's investment insurance programme, while Euler Hermes is responsible for administration of the export credits scheme. [66]

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60 NEXI, Profile, available at: http://www.nexi.go.jp/en/corporate/profile.html.

61 *See*, *Rubins & Kinsella*, *supra* note 56, at 91-94.

62 James Waters, *A Comparative Analysis of Public and Private Political Risk Insurance Policies with Strategic Applications for Risk Mitigation*, 25 Duke J. Comp. & Int'l L. 361, 369 (2015).

63 Budget Law of 1959, Art. 18, para. 1, (1959), Bundesgesetzblatt, Part II, p. 793 (When it began in 1949, the German program, like its Japanese counterpart, only offered insurance for exports. However, ten year later, in 1959, the program also started offering investment insurance).

64 *See Rubins & Kinsella*, *supra* note 56, at 94.

65 *Id.*

66 The full names of the agents are: Euler Hermes Kreditversicherungs-AG and PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprugungsesells-chaft.

Despite private management of the scheme, the German government is involved in three decisive ways in the workings of the insurance programme. First, and most crucially, the German government has the overall budgetary responsibility for the schemes. Thus, the government makes most of the important budgetary decisions, including the decision to set the maximum amount up to which the consortium may grant coverage.[67] Second, while the two agents are responsible for evaluating and preparing notes on applications for guarantees, the ultimate decision on whether to grant coverage is made by an inter-ministerial committee of the German government.[68] Finally, the German government signs BITs with other countries, which are usually considered as a pre-condition for granting investment guarantees. In fact, the German government views BITs as the fundamental means of protecting German investments abroad; investment insurance is seen as a subsidiary means of protection.[69] However, in case of host countries with which Germany has not concluded a BIT - such as Brazil and Colombia - the inter-ministerial committee undertakes a "country risk assessment" to ascertain whether, in light of the prevailing economic and political conditions, the legal system of the host State is sufficiently capable of protecting the investment.[70]

3.4. World Bank: MIGA

MIGA was established on 12 April 1988 as a member of the World Bank Group with

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67 *See* C. Moser, T. Nestmann & M. Weddow, Political Risk and Export Promotion: Evidence from Germany, Discussion Paper Series 1: Economic Studies No. 36/2006 (2006), at 6, available at: http://econstor.eu/bitstream/10419/19665/1/200636dkp.pdf.

68 AGAPortal, IMC, available at: http://www.agaportal.de/en/aga/ima.html.

69 *See Rubins & Kinsella*, *supra* note 56, at 95.

70 AGAPortal, Country Risk Assessment, available at: http://www.agaportal.de/en/dia/deckungspraxis/laenderdeckungspraxis.html.

the objective of providing investment insurance to investors from member countries.[71] The initial proposals for the establishment of a MIGA-type agency made from as early as 1948, the same year in which the U.S. government launched the Marshall programme that gave birth to OPIC.[72] But it was not until the early 1960s, when the World Bank's report on the advantages and disadvantages of an international guarantee plan was published, that the international community began seriously considering the need for such an agency.[73] Despite strong economic arguments in favour of international guarantees, due to disagreement between developing and developed countries over the functioning of such any agency, no consensus could be reached for another two decades.[74] During those decades many developments took place that, at least partially, obviated the need for such guarantees.

In the 1960s, investors had very few formal protections against political risk.[75] Among other things, there were virtually no BITs,[76] there was significant disagreement between nations over remedies for unlawful expropriation, there was no dedicated

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71 MIGA was established by the Convention Establishing the Multilateral Investment Guarantee Agency, 24 I.L.M. 1598 (1988) [hereinafter, *MIGA Convention*].

72 M. D. Rowat, *Multimateral Approaches to Improving Investment Climate of Developing Countries: The Cases of ICSID and MIGA*, 33 Harv. Int'l L. J. 103, 119 (1992) [hereinafter, *Rowat*]. For a detailed discussion of the origins and operations of MIGA, see I.F.I. Shihata, MIGA AND FOREIGN INVESTMENT (Martinus Nijhoff, 1988) [hereinafter, *Shihata*].

73 At the request of the O.E.C.D. the World Bank published the report in March 1962. The report, however, did not make any specific recommendations. For an in-depth discussion of the report, *see Shihata*, *supra* note 72; *Brewer*, *supra* note 56.

74 *Rowat*, *supra* note 72, 127 (1992); *Shihata*, *supra* note 72, 31-99.

75 *Rowat*, *supra* note 72, 126-7.

76 Although certain countries like the U.S. had concluded the so-called Friendship, Commerce and Navigation (**FCN**) treaties, which had a significant investor-protection component. *See, e.g.*, see J. F. Coyle, *The Treaty of Friendship, Commerce and Navigation in the Modern Era*, 51 Col. J. Trnst'l. L. 2, 302 (2013).

forum available for settlement of investor-state disputes,[77] and, aside from the American, Japanese and German insurance programmes, there were virtually no investment insurance programmes. Fast forward 20 years and the landscape had changed considerably. The International Finance Corporation ("IFC"), a member of the World Bank Group specialising in the promotion and financing of the private sector, had been set up; ICSID, another member of the World Bank Group, had been established to provide a dedicated forum for the settlement of investor-state disputes; thousands of BITs had been concluded; there was increasing consensus amongst states over remedies for expropriation; and many new national and private PRI programmes had been set up. In many respects, therefore, the need for a MIGA-type agency in the 1980s was not as acute as in the past.

Despite these developments, the MIGA Convention was finally concluded on 11 October 1985 and it came into force on 12 April 1988, after receiving the necessary number of ratifications. One of MIGA's basic objectives is: "to enhance the flow to developing countries of capital and technology . . . [by] complementing national and regional investment guarantee programmes and private insurers of non-commercial risk".[78] Thus, MIGA is not meant to compete with national and private insurers; rather, it is supposed to fill-gaps in existing programmes. Chapter 2 will discuss the extent to which MIGA has been successful in fulfilling this mandate.

3.5. Private Political Risk Insurance Providers

Even though Lloyd's of London has been providing coverage for political risks since

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[77] As discussed later, under customary international law of diplomatic protection, host States could espouse the claims of the investors and pursue them directly with the home state.

[78] *MIGA Convention*, *supra* note 71 Preamble.

the 1930s, the private industry is believed to have expanded "meaningfully" only in the 1970s.[79] Prior to the 1970s, private products were considered as being an inferior choice. That was the case primarily because public insurers, like OPIC, had certain inherent advantages stemming from their quasi-governmental status. First, government backing meant that public insurers could do more with their recourses because they were not bound by the reserves requirement and were therefore not forced to seek reinsurance.[80] Second, the "aura" of government participation would generally deter foreign governments from expropriating investments supported by government-backed insurers.[81] Third, in cases where host governments did expropriate investments insured by public providers, the government status of these providers put them in a superior position to pursue subrogated claims against foreign governments.[82] Finally, as a government agency, public providers could capitalise on their respective government's experience and expertise in both analysing political risks and in negotiating with host State decision makers.[83]

However, in recent years, this trend has changed and private insurance market has expanded substantially. According to one study, and as noted above, while in the mid-1990s the size of the entire private market for political risk insurance was barely larger than OPIC's business alone, by 2001 private insurance companies accounted for

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79 *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, at 531 & n. 18. First, in 1971, Lloyd's concluded a reinsurance agreement with OPIC and then in 1978, American International Group (AIG) entered the market, paving the way for several other private insurance providers to make a foray into this industry. *Id.*

80 *Leonardo, Political Risk Insurance*, *supra* note 40, at 743.

81 *Id.* at 744.

82 *See, e.g.*, *supra* note 52 and accompanying text discussing OPIC's excellent recovery record.

83 *Leonardo, Political Risk Insurance*, *supra* note 40, at 744.

nearly 50% of the global PRI market.[84] There are several developments that have contributed to the success of the private PRI provider's vis-à-vis the public PRI providers. These include proliferation of private consultants and risk companies that provide private insurers with the kind of information regarding a State's political situation that was earlier available only to government agencies; improvements in private insurer's ability to recover their claims due to favourable developments in international law, in particular, the advent of BITs; and, finally, change in investors' sensitivities to risk after 11th September and other terrorist attacks, which has spurred a growth in the demand for political risk insurance.[85]

In the past few decades, not only has there been a dramatic growth in the size of the private insurance industry, there has also been a convergence in the insurance policies offered by public and private providers. For example, a fact-finding survey of 63 private insurance companies listed on the website of MIGA's "PRI Center" showed that both types of insurance policies cover the same set of political risks.[86] Another survey that compared form contracts of two private providers - Zurich Emerging Markets Solutions and Sovereign Risk Insurance Limited - with the form contract of OPIC found significant similarities between the three contracts.[87] This convergence between public and private insurance schemes means that private products can no longer be viewed as inferior to their public counterpart. This development also implies that public insurers can now act, as in many cases they are

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84 *Id.* at 745.

85 For a more detailed discussion of each of these factors, see *id.* at 751-773.

86 K. Gordon, *Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development*, OECD Inv. Pol'y Perspectives, at 103 (2008).

87 *Leonardo, Political Risk Insurance, supra* note 40, at 746-751.

required to, like "insurers of last resort" (i.e., they offer insurance cover only when it is not available from the private sector).

Despite convergence in the substance of these policies, there are nevertheless important structural differences between private and public insurance policies. For example, unlike public policies, private insurers do not have nationality requirements other than that the insured not be a citizen of the host State. Under a private policy, the insured generally has more flexibility to negotiate the terms of the coverage; government insurers, on the other hand, are statutorily bound and are therefore less likely to alter their standard form policies. Private policies also tend to be more secretive and often prohibit investors from disclosing the fact of the coverage. In fact, in certain cases disclosure can nullify the policy. The underlying logic behind the non-disclosure policy is that host governments who know about the coverage are more likely to harm the investment as they know that the insurer will compensate the injured investor.[88] Government insurers, on the other hand, like to publicise their policies as they feel that a foreign government is less likely to harm an investment if they know their actions will lead to a direct claim by and potential conflict with the other government. These and other differences between private and public policies will be discussed in greater detail in Chapter 2.

4. Bilateral investment treaties

Many authors have already discussed the history of the BIT phenomenon, and this

[88] *M. Perry, A Model for Efficient Foreign Aid*, *supra* note 35, at 531 & n. 17; Alan Berlin, *Managing Political Risk*, 12 Internet Journal 5, available at: http://www.dundee.ac.uk/cepmlp/journal/html/vol12/vol12-5.html at 4.

thesis will not repeat it.[89] Since 1959, states have signed over 3,200 broadly similar treaties with the vast bulk of those treaties signed from 1990 onwards.[90] BITs share a number of common features. They are bilateral in nature, i.e. they apply between two States, usually a capital-exporting State and a capital-importing State.[91] They are also reciprocal in nature, i.e. treaty rights apply equally to investors of both contracting states.[92] The substantive rights typically include a guarantee of prompt, adequate, and effective compensation for expropriation, freedom from unreasonable or discriminatory measures, a promise of "fair and equitable treatment" for foreign investments, guaranteed national and most-favoured-nation treatment for investments, and assured full protection and security of investments. BITs couple these substantive rights with an important procedural guarantee: the right of the investor to initiate binding arbitration against the host State for alleged treaty breaches.[93] The coupling of investment guarantees with effective procedures for international arbitration has, not surprisingly, led to an explosion in investor-state disputes. World Bank' ICSID, which was created specifically for administering investor-state disputes, has seen its caseload increase from only 35 cases in its first thirty year of operations (1966-96) to

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89 *See, e.g.,* Newcombe & Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 41-57 (Kluwer, 2009)[hereinafter, *Newcombe & Paradell*]; K. J. Vandevelde, *A Brief History of International Investment Agreements,* 12 U.C. Davis J. Int'l L. & Pol'y 157; *G. V. Harten, supra* note 6, at 13-43.

90 UNCTAD Issue Note, *Recent Trends in IIAs and ISDS* (2015), available at: http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf.

91 As noted above, BITs are the dominant type of IIAs. However, there are other types of IIAs too, such as multilateral investment treaties (e.g. NAFTA) and sectoral treaties (e.g. ECT), which apply between more than two States.

92 *Newcombe & Paradell*, *supra* note 89, at 1-2.

93 *Id.* at 2-3.

nearly 550 registered cases as of December 2015.[94]

Because the focus of this thesis is on the U.S. BITs, it is worth re-telling a few facts about those treaties. The U.S. BIT programme was launched in 1977 as a successor to the 190-year-old Friendship, Commerce and Navigation ("FCN") treaty programme.[95] As in the case of OPIC, the purpose of the U.S. BIT programme was threefold. First, to counter the claim made during the 1970s by many developing countries at, among other places, the United Nations General Assembly that customary international law no longer required that expropriation be accompanied by prompt, adequate, and effective compensation.[96] Second, to protect U.S. investments abroad and, in the process, promote the flow of investments to countries that sign U.S. BITs. Third, to de-politicise investor-state disputes by eliminating the need for U.S. government involvement in such disputes.[97]

U.S. BITs are negotiated with the help of a model negotiating text. The first U.S. Model BIT was designed in 1984 and has been referred to as the "most investor-protective treaty in the world".[98] The majority of the U.S. BITs, including the BIT between the U.S. and Argentina, which is the world's most arbitrated BIT, are based on the 1984 model. A new model BIT was released in 2004. The 2004 model, however, takes a very different approach. It was inspired by the U.S. experience over

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94 ICSID, The ICSID Caseload – Statistics (2016), available at: https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/ICSID%20Web%20Stats%202016-1%20(English)%20final.pdf.

95 *See* K. Vandevelde, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 Mich. J. Int'l L. 621, 624 (1993).

96 *Id.* at 625.

97 *Id.* at 626.

98 J. Alvarez, *The Return of the State*, 20 Minn. J. Int'l L. 223, 231 (2011).

the foregoing/previous 20 years, particularly as a defendant in many NAFTA disputes, and purports to "re-balance" treaty rights by eliminating or shrinking certain guarantees available to investors under the 1984 model and by expanding the host State's power to regulate investment.[99] The 2004 model formed the basis for successful treaty negotiations with many countries, including Uruguay, Singapore, Chile and Morocco.

The 2004 model was revised in 2012.[100] While certain revisions were made in the 2012 model, these revisions are not particularly drastic; as one commentator has noted: "the 2012 Model BIT is relatively unchanged from its previous form, maintaining the balance that the 2004 text struck among investor, state, and other stakeholders' rights and interests".[101]

In total, as of March 2017, there are 43 U.S. BITs in force.[102] In addition, the U.S. has concluded 20 free trade agreements with other countries, many of which contain investment chapters.[103]

5. Conclusion

This Chapter outlined the comparative methodology that will be followed in the thesis. Most comparative law enquiries involve three major stages: (1) selection of the

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99 *Id.* at 235-7.

100 The 2012 model BIT can be accessed here: https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf.

101 Lise Johnson, *The 2012 US Model BIT and What the Changes (or Lack Thereof) Suggest about Future Investment Treaties*, 7 Political Risk Insurance Newsletter 2, at p. 2 (Nov. 2012), available at: http://ccsi.columbia.edu/files/2014/01/johnson_2012usmodelBIT.pdf.

102 U.S. Trade Compliance Centre, Bilateral Investment Treaties, at http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp.

103 Office of the U.S. Trade Representative, Free Trade Agreements, at http://www.ustr.gov/trade-agreements/free-trade-agreements.

relevant parameters; (2) description of those parameters and (3) analysis.[104] This Chapter has accomplished the first two stages. It explained and defended the choice of the concept of expropriation as the basis of comparison and the choice of OPIC and U.S. BITs as the two legal systems across which the comparison will be conducted. Having defended the methodology, the Chapter went on to introduce the concept of political risk and the various tools used to mitigate that risk, particularly political risk insurance.

Academic literature in the area of international investment law has largely ignored PRI, with the result that very little is known about the industry. Such ignorance is particularly surprising given that, ultimately, both PRI and BITs serve roughly the same purpose; yet, so much has been written about BITs and so little about PRI.[105] This Chapter makes a modest contribution towards filling that void by discussing the four major PRI providers – OPIC, NEXI, PwC and MIGA. The Chapter also discussed the rise of the private PRI industry. Historically, State sponsored insurers like OPIC have been better situated to provide PRI due to informational advantages, greater authority with transgressor countries, and better opportunities to capture the salvage values of claims. However, private source insurers are now able to provide insurance coverage at par with their governmental counterparts.[106]

From the next Chapter onwards, the focus would shift towards analysing the differences and similarities between the two regimes and understanding what, if

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104 *See, Dannemann, Comparative Law, supra* note 1.

105 For recent literature on PRI, *see, Bekker & Ogawa, PRI and BITs, supra* note 37; *see also, supra* note 40.

106 *See supra* s. 3.5

anything, one system can learn from the other. During the course of that analysis, references will repeatedly be made to some of the core concepts explained in this chapter and to descriptions of various PRI providers included therein.

CHAPTER 2: STRUCTURAL DIFFERENCES BETWEEN PRI SCHEMES AND BITS

1. Introduction

The first chapter of the thesis introduced the three main State-sponsored and multilateral PRI providers – OPIC (USA), PwC (Germany) and NEXI (Japan) – and the main multilateral insurer (MIGA (World Bank)). Of all State-sponsored insurers, OPIC is by far the most influential. It is the world's first national insurance programme, which provided the inspiration for other countries to establish similar

programmes.[1] It also has the most experience on the claim determination front: having settled, since its establishment in 1971, over 300 claims, totaling nearly $1 billion.[2] Similarly, MIGA is the most influential of all multilateral insurers, again because it is the oldest such insurer, with the most experience and business.[3]

This chapter compares OPIC and MIGA, on the one hand, and BITs,[4] on the other hand, across certain basic parameters.[5]

The purpose of this chapter is to provide an overview of the structural differences between PRI and BITs. As explained in the previous chapter, the two schemes have the same overarching purpose: to increase investment flows by enabling investors to manage political risk.[6] Yet, their origins and structures are very different. This section aims to evaluate those differences. In doing so, however, it does not purport to provide a comprehensive analysis of the relevant legal principles. Such analysis is beyond the scope of the thesis. Instead, this section is meant to shed light on the broader differences between PRI and BITs and, in the process, set the grounding

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1 *See*, *supra* Chapter 1, s.3.1.

2 *See*, *supra* Chapter 1, s. 3.1.

3 *See*, *supra* Chapter 1, s. 3.4.

4 As explained in Chapter 1, International Investment Agreements comprise Multilateral Investment Treaties, Free Trade Agreements that contain investment chapters and Bilateral Investment Treaties. However, for the purposes of this thesis, the nomenclature of BITs will be used throughout to refer to all kinds of International Investment Agreements.

5 In addition, where necessary, the other two State sponsored insurers –NEXI and PwC – are also discussed. For these insurers, most of the information has been obtained using a survey conducted by the Berne Union in 1988 and summarized in a tabular form in M. D. Rowat, *Multilateral Approaches to Improving Investment Climate of Developing Countries: The Cases of ICSID and MIGA*, 33 Harv. Int'l L. J. 103, 140-43 (1992) [hereinafter, *Rowat*]. Given the length of time that has passed since the Berne Union survey, the information presented here has been updated wherever appropriate, by reviewing the insurers' websites and reading other relevant sources.

6 *See supra* Chapter 1, s.1.

for the following chapters which focus on analysing expropriation coverage across OPIC policies and U.S. BITs.

2. Comparison between PRI schemes and investment treaties

2.1. Eligible investors

2.1.1. Political risk insurance

The single most important limitation in all national insurance programmes is that they require investors to have some link with the sponsoring State. OPIC, for example, requires an investor to be either a U.S. citizen or a U.S. corporation (defined as a corporation that is organized under the laws of a U.S. state, with more than 50% of the shares beneficially owned by U.S. citizens and corporations).[7] A non-U.S. corporation can qualify for OPIC support only if U.S. citizens own 95% of its shares.[8] Thus, U.S. subsidiaries of foreign corporations, which are not at least 95% owned by U.S. citizens, cannot receive insurance coverage from OPIC. The other two insurance providers also contain OPIC-style link - in case of NEXI, a Japanese citizenship requirement, and in case of PwC, a German domicile requirement.[9] Finally, all three insurance providers extend coverage to overseas subsidiaries of domestic corporations.[10]

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[7] OPIC HANDBOOK 17 (2007), at p. 12 available at: http://opic.pfsfinance.com/pdf/OPIC_Handbook.pdf [hereinafter, *OPIC Handboo*k].

[8] *Id.* at 11-12.

[9] *Rowat*, *supra* note 5, at 140-143; *see also*, PwC, Requirements, available at: http://www.agaportal.de/en/dia/grundlagen/garantievoraussetzungen.html.

[10] *Id.*

Unlike all national programmes, MIGA only requires that the investor be a national of a member State other than the host State.[11] MIGA's liberal stand on eligibility is understandable given that the agency was created primarily to fill a gap in the market caused by the unavailability of insurance coverage for a large number of investors who did not qualify under any of the national schemes.[12] In case of corporations, MIGA requires that both the place of incorporation and the principal place of business must be located in one of MIGA's member States.[13] Alternatively, a corporation can qualify for MIGA coverage provided nationals of member countries other than the host State own majority of their shares.[14] In that sense, therefore, MIGA's eligibility criterion is broader than OPIC's requirement of 95% ownership by U.S. nationals (as explained above).

2.1.2. Bilateral investment treaties

BITs, generally speaking, protect investors who are nationals of a contracting State other that the host State in which the investment is made.[15] In that sense, BITs are like national insurance schemes that provide coverage only to their own nationals. Although determining nationality of natural persons is usually a straightforward task,[16]

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11 Convention Establishing the Multilateral Investment Guarantee Agency, art. 13(a), 24 I.L.M. 1598 (1988) [hereinafter, *MIGA Convention*]

12 *See supra* Chapter 1, s 3.4.

13 *MIGA Convention*, *supra* note 11, art. 13(b).

14 *Id.*, art. 13(c).

15 On nationality requirements in BITs, *see generally*, McLachlan, Shore & Weineger, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 131-162 (OUP, 2007) [hereinafter, *McLachlan, Shore & Weineger*]; Zachary Douglas, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS 285-325 (CUP, 2009) [hereinafter, *Zachary Douglas*]; Dolzer & Schreur, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 46-59 (OUP; 2nd ed., 2008) [hereinafter, *Dolzer & Schreur*].

16 *But see Hussein Nuaman Soufraki v. The United Arab Emirates*, ICSID Case No. ARB/02/7 (2007).

this is not necessarily the case for corporations. Almost all BITs require that a corporation must be incorporated in the contracting State other than the host State for it to be protected under the treaty. However, several treaties impose additional criteria as well, such as local control[17] and local management (seat) of the company.[18] In case of the 2012 US Model BIT, in addition to the incorporation test, the treaty requires that "a branch is located in the territory of a Party and carrying out business activities there".[19] Therefore, as compared to OPIC, while the US Model BIT does not impose a 95% U.S. ownership requirement, it does require the firm to have some operations locally.

The situation is trickier in case of non-US companies that are "controlled" by US nationals. According to the US Model BIT, even enterprises which are incorporated in the host State can bring claims under the BIT provided they are "own[ed] or control[led] directly or indirectly" by US nationals.[20] The reference to "direct or indirect control" is generally understood to extend a tribunal's *ratione personae* jurisdiction to claimants who exercise indirect control by holding their investment through intermediate companies that may be based in a non-contracting state.[21] As compared to OPIC, which will only insure non-US companies when they

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17 *See, e.g.*, Netherlands Model BIT, Art.1 (b)(iii).

18 *See, e.g.*, German Model BIT, Art. 1(3)(a).

19 U.S. Model BIT (2012), art. 1, available at: https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf [hereinafter, *2012 Model BIT*].

20 *Id.*, art. 24(1)(b).

21 *See, e.g., Zachary Douglas, supra* note 15, at 310; *see also, EnCana Corporation v. Republic of Ecuador,* LCIA Case No. UN3481, UNCITRAL, Award (2006), paras. 115-122 (interpreting a similar clause in the Canada – Ecuador BIT, the tribunal held that the treaty protected Canadian investments made in Ecuador through third State corporations); *Mr. Franz Sedelmayer v. The Russian Federation,* SCC, Award, pp. 26-28 (1998) (despite no reference to the possibility of holding the

are 95% owned by U.S. citizens, the BIT standard is substantially more lenient, making it easier for investors to engage in "nationality planning" or "treaty shopping" to gain specific treaty protections.[22]

The practice of restructuring investments in order to gain the protection of favourable treaties was recently analysed in the case of *Philip Morris Asia v Australia*.[23] There, the claimant, PM Asia, a Hong Kong based entity, had acquired shareholding in PM Australia (the investment in Australia) after the Australian government began the consultation process regarding plain packaging of tobacco products. As the regulation that emerged from that consultation process was the subject matter of the arbitration, the Australian government argued that the corporate restructuring was an 'abuse of process' as it was done purely to bring a claim under the Hong-Kong/ Australia BIT when a dispute was already existing or was at least foreseeable. The Tribunal agreed with Australia and ruled that the claimant's abuse of process rendered the claims inadmissible.[24]

2.2. Eligible Investments

2.2.1. Political risk insurance

investment "directly or indirectly" in the Germany-Soviet Union BIT, the tribunal found that the claimant's investment in Russia made through a U.S. subsidiary was protected).

[22] *Compare Aguas del Tunari, S.A. v. Republic of Bolivia,* ICSID Case No. ARB/02/3, Jurisdiction (2005), paras. 160-180 (accepting migration of the controlling company from one state to another before the dispute arose) *with Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo,* ICSID Case No. ARB/98/7, Award (2000), (refusing to accept jurisdiction where the migration occurred after the dispute arose).

[23] *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12, Award on Admissibility and Jurisdiction (2016).

[24] *See, Id*., para. 554.

OPIC provides coverage for both equity investments and shareholder loans in "new" projects.[25] "New" projects include privatization, expansion and modernization of existing plants.[26] PwC similarly covers only "new direct investments" and, therefore, no insurance is available for portfolio investments.[27] MIGA provides coverage for both "equity interests" and "non-equity direct investment".[28] Neither OPIC nor MIGA, however, define the term "investment". Instead, they leave it up to the underwriting staff to decide what kind of investments is covered. The MIGA Operational Regulations state that, in making that determination, the MIGA staff must give special attention to investment arrangements for "long duration" (i.e. minimum three years) and "high developmental potential".[29]

Private providers will generally insure any type of investment as long as it makes business sense. One particular difference between national and multilateral providers, on the one hand, and private providers, on the other, is that the latter will insure both existing and new investments, whereas the former, given their mandate to increase investment flows to developing countries, will usually only insure new investments.[30]

2.2.2. Bilateral investment treaties

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25 *OPIC Handbook*, *supra* note 7, at 17.

26 *Id.*

27 PwC, Requirements, available at: http://www.agaportal.de/en/dia/grundlagen/garantievoraussetzungen.html..

28 Multilateral Investment Guarantee Agency, Operational Regulations (2002), s. 1.02, available at: https://www.miga.org/Documents/miga_documents/Operations-Regulations-030115.pdf [hereinafter, *MIGA Operational Regulations*].

29 *Id.*, s. 1.06; *see* s. 2.4 *infra* discussing MIGA's assessment criteria.

30 *Rowat*, *supra* note 5, at 140-143.

The question of what constitutes an investment has become increasingly important as a threshold jurisdictional question (*ratione materiae*) in treaty arbitrations.[31] ICSID tribunals often have to consider the definition of investment under two separate instruments: (1) the BIT; and (2) Article 25 of the ICSID Convention. The latter limits the Centre's jurisdiction to legal disputes arising "directly out of an investment", without providing a definition of the term "investment". Yet, tribunals have been inclined to interpret the term "investment" in Article 25 of the Convention autonomously, as if it has a meaning independent of the investment clause in the BIT.[32] In doing so, they have relied on the so-called *Salini* test (a reference to the case of *Salini et al v Morocco*, which summarised the criteria) as well as Christoph Schreuer's seminal treatise on the ICSID Convention. In his discussion of Article 25, Schreuer posited five "features" that are "typical" to "most of the operations" that have been the subject of ICSID proceedings: (i) "a certain duration" of the enterprise, (ii) "a certain regularity of profit and return," (iii) an "assumption of risk," (iv) a "substantial" commitment by the investor, and (v) some "significance for the host State's development." [33] Even though Schreuer was careful in describing these criteria as "features", many tribunals have treated them as jurisdictional requirements.[34] In the

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[31] *See, generally, McLachlan, Shore & Weineger, supra* note 15, 163-196; Zachary Douglas, *supra* note 15, 233-283; *Dolzer & Schreur, supra* note 15, 60-71.

[32] But *see, e.g., Gruslin v. Malaysia* (Merits) 5 ICSID Rep. 483 (2006) (asserting the ICSID definition of investment simply merges with the question of party consent); *Lanco Int'l, Inc. v. Argentina,* (Jurisdiction) 40 I.L.M. 457 (2001) (same).

[33] C. Schreur, ICSID CONVENTION: A COMMENTARY 122 (CUP; 1st ed., 2000); see also C. Schreur, ICSID CONVENTION: A COMMENTARY 122 (CUP, 2000; 2nd ed., 2009).

[34] *See, e.g., Fedax v. Venezuela* (Jurisdiction) 37 I.L.M. 1378 (1998); *Salini Costruttori, S.p.A. v. Morocco* (Jurisdiction) 42 I.L.M. 609 (2003); *Helnan Int'l Hotels, A.S. v. Egypt* (Jurisdiction); *Saipem, S.p.A. v. Bangladesh* (Jurisdiction); In the recent case of *Quiborax v. Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction (2012), attempted to advance a new definition of investment, which does not view 'economic development' as a necessary element of investment.

process, ICSID arbitrators are treating covered investments in ways very similar to MIGA's underwriting staff – despite a definition for the term investment, both require the investor to show that their operations meet certain development-friendly criteria.

Like the operational policies of political risk insurers, BITs also do not precisely define the term investment, save for providing a wide inclusive phrase (such as "investment includes every kind of asset") followed by a list of specific categories of rights.[35] The 2012 Model US BIT takes a slightly different approach. It defines investment broadly, as every asset owned or controlled, directly or indirectly, by an investor, which has "the characteristics of an investment". In addition, it provides a non-exhaustive list of "forms" such investments may take, which includes, *inter alia*, shares, intellectual property rights and various debt instruments such as "futures, options and other derivatives". Finally, the model BIT contains explanatory notes, designed to clarify and narrow down the seemingly boundless definition. Hence, the "characteristics of an investment" include "the commitment of capital, the expectation of gain or profit, or the assumption of risk", while in case of debt instruments, these would normally have to be long term.[36] In many respects, this definition of investment is similar to OPIC's policy of insuring most forms of investment, provided they are "new" (i.e., there is a fresh injection of capital) and they contribute to the State's economic growth.

2.3. Eligible host countries

35 *See, e.g.*, UK Model BIT (2008), art. 1.

36 *2012 Model BIT*, *supra* note 19 at art. 1.

2.3.1. Political risk insurance

Of the three national schemes, it appears that NEXI has the most liberal and OPIC has the strictest rules in terms of host State eligibility. NEXI has no specific eligibility test other than requiring that the host State approves the project - a requirement that is shared by the other two insurance providers as well. In addition to host State approval, PwC requires that the host State must be able to offer adequate legal protection for the investment. In case of countries with which Germany has concluded a BIT, the requirement for sufficient legal protection is met automatically. However, in case of countries with which Germany has not yet concluded a BIT – countries such as Brazil and Colombia – PwC undertakes a country risk assessment to determine whether the domestic legal system can sufficiently protect the investment.[37]

As to OPIC, apart from insisting that the host State must give its approval and sign an OPIC incentive agreement, the agency also gives preference to investment projects in LDCs with low per capita incomes,[38] and requires that the host State observes human rights and internationally-recognized workers' rights.[39]

In case of MIGA, coverage is only available for investments made in the territory of developing member countries.[40] MIGA also requires that the host State

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37 *Rowat*, *supra* note 5, at 140-143; *See also*, PwC, Requirements, available at: http://www.agaportal.de/en/dia/grundlagen/garantievoraussetzungen.html.

38 *See*, Congressional statement of purpose; creation and functions of Corporation, 22 U.S.C.§ 2191. The current version of the statute states that OPIC should give preference to projects in LDCs that have per capita incomes of $984 or less in 1986 U.S. dollars. *See* 22 U.S.C. §2191(2). The previous version of the statute, aside from stating the per-capita income threshold, also required OPIC to give preference to projects destined for "friendly" LDCs.

39 *Id.*

40 *MIGA Convention*, *supra* note 11 at art. 14

affords "fair and equitable treatment" and "legal protection" to the investment.[41] If such treatment is not available under host State's domestic laws or under BITs, the Agency will extend coverage only after specific agreements have been concluded between MIGA and the host State concerning investment protection.[42]

2.3.2. Bilateral investment treaties

The question of host State eligibility does not really arise in the context of BITs because, once a treaty has been concluded, the investor does not have to demonstrate that the contracting State meets certain criteria for the treaty's protections to apply. The question of host State approval of the investment, however, is more interesting. PRI policies typically insist on host State approval and it is self-evident why they do so – if the host State objects to the investment at the time of its establishment, it is more likely to harm the investment in the future.[43] In case of BITs, the answer is less clear. Broadly speaking, there are two dominant models with respect to admission of investment: pre-entry and post-entry. The pre-entry model, which attempts to liberalize restrictions on foreign investment, typically accords national and MFN treatment with respect to admission and establishment, subject to certain enumerated exceptions. This is the approach followed by U.S. BITs.[44] The post-entry model, on the other hand, emphasises the host State's prerogative to control admission in accordance with domestic policy. Treaties following this model impose a whole range

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41 *Id.*, art. 12 (e) (iv).

42 *Id.*; *see also* Commentary on the Convention Establishing the Multilateral Investment Guarantee Agency, para 21 [hereinafter, *MIGA Commentary*].

43 *See*, e.g., OPIC Contract of Insurance -Form 234 KGT 12-85 SBC NS (Rev. 9/05), s. 9.01(15).

44 *See 2012 Model BIT*, *supra* note 18 art. 3.

of restrictions, including requiring that investment be admitted in conformity with the local laws or local laws plus local administrative practices or, in case of a small minority of treaties, with the written approval of the host State.[45]

In sum, BITs, and especially U.S. BITs, are more liberal than insurance schemes, but there are a few BITs which, like insurance schemes, require host State approval for BIT protections to apply.

2.4. Assessment criteria

2.4.1. Political risk insurance

Broadly speaking, all State-sponsored and multilateral insurance providers look at three criteria before approving a project: (i) economic soundness; (ii) contribution to the development of the host State and compliance with the local laws; and (iii) contribution to the home State's economy.[46] The first criterion is self-explanatory. As to the second and third criteria, OPIC provides the best illustration. Before extending coverage, OPIC conducts a development impact analysis in which it studies the beneficial net impact of the proposed investment on the economic and social development of the project's host State. Factors considered include human capacity building and job creation, social policies and corporate social responsibility initiatives,

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45 *See* Newcombe & Paradell, Law and Practice of Investment Treaties: Standards of Treatment 133-4 (Kluwer, 2009) [hereinafter, *Newcombe & Paradell*](giving examples of different treaties following the post-entry model). For an example of a recent case exploring these issues, *see Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia*, ICSID Case No. ARB/12/14 and 12/40 (2016).

46 *See*, in particular, *MIGA Operational Regulations*, *supra* note 27, s. 3.04 (note: the third criterion – contribution to home state's economy – obviously does not apply in case of MIGA).

infrastructure improvements, and technology and knowledge transfer.[47] In case of certain sectors, such as gambling, tobacco, alcohol, and munitions production, OPIC categorically denies coverage.[48] OPIC also screens applications to identify the risk of adverse environmental and social impact of proposed projects, and in case any adverse impact is identified, the agency imposes conditions to mitigate it.[49]

In addition to looking at the effect of the investment on the host State, OPIC is also statutorily required to take into account the proposed project's effect on the U.S. economy. For example, OPIC denies coverage to projects likely to have a negative impact on U.S. employment and to projects that adversely affect U.S. balance of payments.[50] Similarly, OPIC categorically denies protection to "run away" projects that intend to reduce or eliminate U.S. operations by moving production overseas.[51]

2.4.2. Bilateral investment treaties

BITs typically do not contain any investment screening criteria. Investors, and not States, decide to make investments based on their assessment of the economic and financial viability of the project. Nevertheless, under some BITs, contracting States have tried to ensure that only socially and economically desirable foreign investment receives treaty protections. They do so in a number of ways. First, the preamble to many BITs lay down the contracting States' aspirations that foreign investment will

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47 OPIC, Economic Analysis, available at: http://www.opic.gov/doing-business/investment/economic-analysis.

48 *Id.*

49 OPIC, The Environment, available at: http://www.opic.gov/doing-business/investment/environment.

50 *OPIC Handbook*, *supra* note 7, at 7.

51 *Id.*

spur the host State's economic growth in a manner consistent with broader social goals, such as protection of health, safety, and the environment.[52] Second, as discussed above, in case of certain BITs, although not U.S. BITs, treaty protections are contingent on getting host State's approval for the proposed project, giving that state an opportunity to only permit those investments that are desirable. And finally, certain treaties, though again not U.S. BITs,[53] permit states to impose performance requirements. Performance requirements are basically conditions that a State imposes upon the establishment and operation of an investment in order to ensure that the investor acts in ways that are consistent with the state's developmental goals.[54] For example, a State may require a foreign investor to have local partnership, hire local personnel, use domestically produced raw materials, export a certain proportion of the output or import certain technology.[55]

In sum, given the U.S. BITs' pro-liberalisation objective, there are very few restrictions that host States can impose on investments covered by treaties. But that is not true for BITs of other countries, which generally permit host States to impose numerous conditions, mirroring some of the procedures followed by PRI providers before they approve a proposed project.

2.5. Types of political risks covered

This section identifies few important differences between, on the one hand, coverage

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52 *See, e.g., 2012 Model BIT*, *supra* note 18, Preamble.

53 *See id.*, art. 8.

54 *See* Kenneth J. Vandevelde, *Investment Liberalization and Economic Development*, 36 Colum. J. Transnat'l. L.501, at 518 (1998).

55 *See Newcombe & Paradel*, *supra* note 45, at 422-430 (discussing performance requirements in different BITs).

for political risks under PRI policies and, on the other hand, protections for those risks under BITs. In the chapters that follow these differences – in particular, differencs in respect of expropropriation coverage – are discussed in greater detail.

2.5.1. Political risk insurance

Typically, national insurance programmes as well as MIGA provide coverage for three major political risks: expropriation, political violence and currency inconvertibility. In terms of expropriation coverage, while broadly speaking all insurance programmes provide roughly the same coverage, insuring against both direct and creeping expropriations, there are some notable differences. For example, to explain what constitutes an expropriatory act, OPIC refers to "international law", but NEXI, PwC and MIGA do not.[56] Also, MIGA's expropriation coverage excludes "non-discriminatory measures of general application which governments normally take for the purpose of regulating their economic activity in their territories", but policies of other insurers do not.[57] Thus, MIGA does not compensate for *bona fide* imposition of general taxes, tariffs and price controls, environmental and labour legislation and measures for maintenance of public safety.[58] According to one commentator, "[t]his provision reflects a sensitivity to LDCs that may wish to regulate economic activity on a non-discriminatiry basis without being accused of engaging in 'creeping' expropriation".[59]

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56 OPIC, Insurance Contract Form, 51 FR 3438-03, s. 4.10.

57 *MIGA Convention*, *supra* note 11 art. 11(a)(ii).

58 *See MIGA Operational Regulations*, *supra* note 28, s. 1.36.

59 *Rowat*, *supra* note 5, at 129. Interestingly, in the past, OPIC contained a similar exclusion for an expropriatory action that is "reasonably related to constitutionally sanctioned governmental objectives, is not arbitrary, is based upon a reasonable classification of entities . . . and does not violate

(i) Risk of breach of contract

Aside from providing coverage for the three major risks - expropriation, political violence and currency inconvertibility – some insurers treat breach-of-contact loss as a separate, identified class of risk coverage. MIGA was the first insurer, amongst the four insurers included in this study, to cover the risk of repudiation or breach of a State contract by the host State. However, in practice, MIGA's coverage is linked to the host State's responsibility for denial of justice, such that in addition to showing breach of contract, the investor will also have to show one of the following: (i) the investor does not have access to judicial or arbitral forum to determine its claim of breach; or (ii) a decision by such forum is not rendered within a reasonable period of time (what is reasonable would be specified in each individual MIGA contract, but, at the very minimum, there should be a two years gap between initiation of the proceeding and final decision by the forum); or (iii) a final decision cannot be enforced (the investor must have tried to enforce the decision for 90 days before bringing a claim to MIGA).[60]

Thus, MIGA does not permit investors to bring a claim for a simple breach-of-contract; instead, investors must first exhaust (or at least attempt to exhaust) local remedies or obtain an unenforceable award. In that sense, MIGA's breach-of-contract coverage is very similar to the arbitral award default coverage, which, as will be discussed later in more detail, has become an increasingly popular type of coverage offered by many insurers, including OPIC.

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generally accepted principles of international law". OPIC Form 234 KGT 12-70, art 1.13(1). This provision has been dropped in OPIC's new standard form contract.

60 *MIGA Convention*, *supra* note 11 art. 11(a)(iii); Operational Regulations, para. 1.42-1.45.

Unlike MIGA, OPIC does not offer a separate breach-of-contract coverage, except in limited cases.[61] However, it does attempt to address the issue through interpretation of the term "violation of international law" in its expropriation coverage. Specifically, as explained below, OPIC has stated in a number of determinations that, as provided in Section 712 of American Law Institute's Restatement (Third) on Foreign Relations:

> A state is responsible under international law for injury resulting from a repudiation or breach by the state of a contract with a national of another state: (a) where the repudiation or breach is (i) discriminatory; or (ii) motivated by non-commercial considerations, and compensatory damages are not paid; or (b) where the foreign national is not given an adequate forum to determine his claim of repudiation or breach, or is not compensated for any repdudiation or breach determined to have occurred.

According to Section 712(2)(a)(ii) of the *Restatement*, every uncompensated non-commercial breach of a state contact is a violation of international law. However, to be covered by OPIC's expropriation coverage, the breach must also deprive the investor of fundamental rights in the investment, a standard that, as will be discussed in detail later, is akin to a BIT's "substantial deprivation of interests in the investment" standard. As a result, only very few breaches would potentially be covered. Moreover, the contract breach must be carried out by the host government acting in its commercial capacity, rather than governmental capacity, an important restriction that is not only included in the *Restatement* but also in OPIC contracts specifically.

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[61] For certain specific industries, OPIC offers "special coverages" which tend to cover breach of contract as well. For example, an investor can take out a special coverage for petroleum exploration and development projects, which covers the investor for the risk of repudiation or breach of the concession agreement. Similarly, U.S. companies that are acting as contractors in international construction, sales or service contracts, and U.S. exporters, can take out a special coverage, which covers losses suffered by U.S. contractors and exporters due to breach of contract by the foreign counter-party. See OPIC, Types of Coverage, available at: https://www.opic.gov/what-we-offer/political-risk-insurance/types-of-coverage/specialty-products.

While MIGA and OPIC policies seem restrictive, they nevertheless make sense from a commercial perspective. A breach-of-contract coverage blurs the boundary between commercial risks (which, as political risk insurers, these agencies are not allowed to cover) and political risks (which they do cover). Moreover, a pure breach-of-contract coverage will expose insurers to significant liability, thereby making their operations financially unviable. In fact, MIGA and OPIC appear to be more protective than other insurers. For example, one sample private PRI policy reviewed by a commentator completely excluded breach-of-contact risk from its expropriation coverage. Specifically, the policy excluded[62]:

> the material breach by the Host Government of any contractual agreements with the Insured or the Foreign Enterprise.

(ii) Risk of terrorism

Another important difference across the various schemes is the availability of a separate coverage for terrorism risk. The demand for a policy that covers terrorism risk has increased dramatically since the September 11 attacks.[63] As a result, OPIC has recently started offering a stand-alone terrorism insurance, which protects investments against violent acts - such as use of use of chemical, biological, radiological or other weapons of mass destruction - undertaken by individuals or groups that do not constitute national or international armed forces.[64] While NEXI,

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62 M. Kantor, *Are You in Good Hands with Your Insurance Company? Regulatory Expropriation and Political Risk Insurance Policies*, in T.H. Moran, G.T. West & K. Martin (eds.), INTERNATIONAL POLITICAL RISK MANAGEMENT: NEEDS OF THE PRESENT, CHALLENGES FOR THE FUTURE 144, 151 (World Bank Group, Fall 2007) (discussing various relevant OPIC cases).

63 *Discussion of New Products*, in T.H. Moran, G.T. West (eds.), INTERNATIONAL POLITICAL RISK MANAGEMENT: LOOKING TO THE FUTURE 198 (World Bank Group, 2005).

64 OPIC, Standalone Terrorism Insurance, available at: http://www.opic.gov/insurance/coverage-types/standalone-terrorism.

PwC and MIGA do not yet offer such standalone coverage, terrorism risk is arguably subsumed under the "political violence" coverage offered by these agencies.[65]

2.5.2. Bilateral investment treaties

Like PRI policies, most BITs, including U.S. BITs, protect investors against the risk of expropriation,[66] currency inconvertibility[67] and political violence.[68] There are of course differences in the way BITs protect against these risks, as compared to PRI policies. The remaining chapters will explore those differences with respect to the expropriation coverage; however, as mentioned earlier, the thesis will not discuss the risks of currency transferability and political violence.

As to protection against the risk of breach-of-contract, many investment treaties, including U.S. treaties, require that host States observe any obligations or commitments undertaken towards investment.[69] This type of clause is often referred to as the "umbrella clause" because it brings host State's contractual obligations under

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65 *See* Chapter 7 *infra* for discussion regarding political violence coverage.

66 *See, e,g., 2012 Model BIT*, *supra* note 18, art. 6.

67 *Id.* art. 7

68 BITs do not expressly protect against political violence but the treaty guarantee concerning "minimum standard of treatment" normally includes a requirement to provide "full protection and security" to the investment. *See, e.g.,* U.S. 2012 Model BIT *2012 Model BIT, supra* note 18, art. 5(1); *t*ribunals have consistently found that protection and security obligations in BITs impose on the host State an obligation of due diligence or vigilance with respect to the physical protection of the investment. *See, e.g., Asian Agricultural Products Limited (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, Award of June 21, 1990, 30 I.L.M. 577 (1991), paras. 72-86; *American Manufacturing and Trading (AMT) v. Zaire* ICSID Case No. ARB/93/1, Award of Feb. 21, 1997, 36 I.L.M. 1531 (1997) paras. 6.05-6.19; *Wena v. Egypt*, paras. 84-95.

69 Article 2 of the1984 Model US BIT provided that "[e]ach Party shall observe any obligation it may have entered into with regard to investments". However, the 2004 and 2012 US Models formulate the protection differently, providing that "the claimant may submit to arbitration . . . a claim that the respondent has breached . . . c) an investment agreement". (art. 24(1)).

the umbrella of the treaty's protection.[70] While there is significant disagreement over how umbrella clauses should be interpreted and applied, most tribunals and commentators agree that these clauses cover contractual undertakings entered into by the host State, or by an entity whose actions are attributable to the State, with respect to foreign investments or investors.[71] Moreover, in case of most BITs, including U.S. BITs, there is no need to exhaust contractual or local remedies before invoking the treaty's protections.[72] Because, as also discussed in detail later in the thesis, PRI policies insure against the risk of breach-of-contract only in those cases where the investor was denied contractual remedies, it is safe to say that BITs provide a far more comprehensive coverage against that risk as compared to PRI policies.

2.6. Amount and duration of insurance

2.6.1. Political risk insurance

The three national programmes – OPIC, PwC and NEXI – impose a variety of restrictions concerning the amount and duration of insurance available under their respective schemes. Such restrictions are a common feature of the insurance industry as they reduce the insured's "moral hazard", i.e. the "incentive for additional risk taking [that] arises from the fact that parties to the contract are protected against

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70 *See generally Newcombe & Paradell*, *supra* note 45, ch. 9.

71 *See, e.g.*, *Fedax v. Venezuela* (Merits), para. 29; *SGS v. Pakistan* (Jurisdiction), para. 172; *SGS v. Philippines* (Jurisdiction), para. 127; *Joy Mining v. Egypt* (Jurisdiction), para. 81. As to academic commentary in support of the notion that contractual undertakings are covered by umbrella clauses, *see* various journal articles mentioned in *Newcombe & Paradel*, *supra* note 45, at 452 & n. 94.

72 Notable exceptions are German and Indian BITs that state that treaty remedies shall only be available in the absence of normal local judicial remedies. *See, e.g.*, Germany-India BIT, art. 13(2); India-Austria BIT, art. 8(2).

loss".[73] Moral hazard is particularly prevalent in case of PRI because covered investors may choose to invest in riskier industries and may take a less-accommodating stand when a dispute arises with the host State.[74]

Insurers typically impose a number of restrictions in their insurance policies to deal with the problem of moral hazard. One such commonly imposed restriction is the use of "deductibles" or "self-insurance" which means that the insured is compensated for only part of the loss resulting from the covered event. By requiring the insured to bear part of the loss, the insurer aims to align the interests of the insured with those of the insurer and avoid irresponsible behaviour on the part of the insured.[75] As will be discussed later in the thesis, OPIC, for instance, requires the investor to pay the first 10% of the book value of the expropriated property; OPIC would only cover the remaining 90%.[76] MIGA insurance policies similarly require a 10% deductible.[77]

With respect to duration, OPIC, NEXI, PwC and MIGA offer long-term coverage in the 15-20 year range.[78] Private sector policies are generally of a shorter length, usually three years, but can be renewed at the end of each year for another year.[79]

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73 K. Gordon, *Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development*, OECD Inv. Policy Perspectives, at 93 (2008) (quoting from The International Association of Deposit Insurers, http://www.iadi.org/searchresults.aspx?id=53&term=glossary).

74 *Id.*

75 *Id.*

76 OPIC, Insurance Contract Form, 51 FR 3438-03, s. 9.01(3).

77 *MIGA Operational Regulations*, *supra* note 28, s. 2.09.

78 *Rowat*, *supra* note 5, at 140-143.

79 Alan Berlin, *Managing Political Risk*, 12 Internet Journal 5, available at: http://www.dundee.ac.uk/cepmlp/journal/html/vol12/vol12-5.html at 4.

2.6.2. Bilateral investment treaties

BITs do not require investors to self-insure. Thus, unlike PRI policies that only cover up to 90% of the value of investments, under BITs, host States are required to compensate the investor the full value of the investment. The lack of something akin to a self-insurance requirement in BITs arguably increases the moral hazard by incentivizing investors to make excessive investments in risky industries.

As to duration, BITs typically last for 10-15 years after which either State party can terminate the treaty, usually by providing one year's notice. In case of the 2012 U.S. Model BIT, the period of initial duration is 10 years.[80] In the absence of exceptional circumstances, the treaty cannot be terminated before the expiry of the initial term.[81] BITs also typically contain the so-called "survival clause", which guarantees that BIT protections will continue to apply to all covered investments for a certain period of time – in case of the US Model BIT, 10 years – even after termination of the treaty.[82] Thus, BIT protections, like PRI policies issued by public providers, usually apply for a long period of time.

2.7. Cost of insurance

2.7.1. Political risk insurance

The premium rates and processing fees charged by insurers vary significantly. Moreover, the providers differ in how they charge premiums. OPIC determines

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80 US Model BIT (2012), Art. 22(2).

81 *See* Vienna Convention on the Law of Treaties art. 60-64, May 23, 1969, 1155 U.N.T.S. 331.

82 *2012 Model BIT*, *supra* note 18, art. 22(3).

premium rates on a case-by-case basis, depending on the risk profile of the project. In fact, OPIC publishes on its website example base rates that differ according to the relevant industry and type of risk covered.[83] On the other hand, PwC charges a flat rate of 0.5% annually for all risks.[84] In case of MIGA, the premium rates are not published on the agency's website, but its Operational Regulations require that it must consider almost sixty rating factors when determining the underwriting premiums rates for expropriation.[85] These factors are divided across 6 broad categories: (i) characteristics of the investment; (ii) characteristics of the investment project; (iii) characteristics of the applicant; (iv) conditions of host State; (v) terms and conditions of the guarantee; and (vi) potential for recoupment.[86] Interestingly, one of the factors under the fourth category (i.e. conditions of host State) is the existence of an investment treaty between the host State and the home state of the investor covering the risk of expropriation. But given that none of these factors are necessary conditions for receiving insurance coverage, the underwriting staff at MIGA is unlikely to deny coverage simply due to the non-existence of a relevant investment treaty.

2.7.2. Bilateral investment treaties

Unlike PRI policies for which investors have to pay regular insurance premiums, BIT protections do not cost investors anything. These protections are negotiated by the contracting states without the involvement of, or contribution from, the investors.

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83 OPIC, Premium Base Rates, available at: http://www.opic.gov/insurance/details-costs/example-rates.

84 PwC, Fees and Premiums, available at: http://www.agaportal.de/en/dia/grundlagen/entgelt_und_praemie.html.

85 *MIGA Operational Regulations*, *supra* note 28, Annex A.

86 *Id.*

2.8. Indemnification and recoveries

2.8.1. Political risk insurance

Generally, the claims indemnification and recovery process for all national insurance providers works in the following way: after an insured investor submits a claim, the insurer investigates it and attempts to facilitate a settlement between the investor and the host State. If a settlement is not possible then the insurer either pays the investor or denies the claim. In the latter case, the investor can seek a formal review of the insurer's determination, either by suing the insurer in local courts, or as is usually the case in most insurance policies, by seeking arbitration. Once the insurer has paid the insured – either on its own or after being forced to do so by an arbitral tribunal – the insurer is subrogated to the investor's rights in the investment. The insurer may then assert those rights against the host government, using either certain specially negotiated mechanisms or the same mechanisms that were originally available to the investor, such as binding arbitration under the investment contract or a BIT.[87]

While the above is true for OPIC as well, there are a few special characteristics of OPIC's recovery process that deserve detailed treatment here. As a preliminary matter, OPIC's contract requires that the expropriatory effect of government actions must continue for one year and that during this period the investor must pursue local remedies, both judicial and administrative, and cooperate with OPIC.[88] After the one-year waiting period is over, and the investor formally submits a claim application,[89]

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87 These procedures are discussed in detail in s. 2 in Chapter 4 *infra*.

88 OPIC Form 234 KGT 12-85, ss. 4.01,(d) and 9.01(9).

89 The investor must file an expropriation claim "within six months" after the one-year waiting period has expired. *Id.*, s. 8.01(b).

OPIC carries out an internal claim determination process. At the end of that process, if OPIC decides to pay the investor then, under the insurance policy, the investor must "transfer to OPIC all interests attributable to the insured investment . . . including claims arising out of expropriation . . . ."[90] Upon assignment of investor's interests and claims related to the investment, OPIC negotiates recovery of claims with the host government. However, in the event that negotiations fail, the matter may be submitted to arbitration under Bilateral Investment Incentive Agreements ("Incentive Agreements").

Because OPIC operates on a self-sustaining basis at no net cost to the U.S. taxpayers, it cannot afford to provide insurance for projects where there is no hope of recovery. In fact, OPIC is mandated by the Congress to ensure that "suitable arrangements" exist to protect its interests.[91] These commercial and political constraints have led OPIC to insist that it will only operate in those countries that have signed an Incentive Agreement with the United States. In practice, however, this is not really a constraint on OPIC's ability to function as an insurer, because the U.S. government has concluded nearly 130 such agreements with countries all over the world.[92]

An OPIC Incentive Agreement essentially does two things. First, it codifies as an international law obligation the well-recognized insurance law doctrine of

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90 *Id.*, s. 8.02.

91 General provisions relating to insurance, guaranty, financing, and reinsurance programs, 22 U.S.C. § 2197(b).

92 OPIC Press Release, Insurance Claims Expertise to Date: OPIC and Its Predecessor Agency, Sep. 30, 2009, available at: http://www.opic.gov/sites/default/files/docs/2009_claims_history_report.PDF.

subrogation.[93] By signing the Agreement, the host State therefore promises to recognize the assignment of investor's right to OPIC and agrees to the enforcement of those rights by the U.S. government.[94] Second, the Incentive Agreement provides a detailed dispute resolution mechanism. Specifically, the Agreement states that the two governments must first try to resolve the dispute through negotiations. If, after six months from the date a government requests such negotiations, no resolution has been reached, then either government may submit the dispute to *ad hoc* arbitration.[95] So far, the U.S. government has only once requested arbitration against a host State under an Incentive Agreement – that was against India in a dispute relating to the Dabhol Power Project. (That dispute and the U.S. government's efforts to recoup OPIC's investment will be discussed at length in Chapter 7.)

While most OPIC Incentive Agreements look very similar, there is one distinct difference in case of agreements concluded with countries in Latin America. Latin American countries have traditionally endorsed the Calvo Doctrine, which provides that investment disputes between foreign investors and host governments should be resolved in local courts under domestic law. As a result, these States were initially opposed to signing Incentive Agreements that, contrary to the principles of the Calvo Doctrine, permit U.S. government to espouse an investor's claim and seek international arbitration against the host government.[96] To placate the concerns of

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93 *See* Robert C O' Sullivan, *Model OPIC Investment Incentive Agreement*, 1 B.D.I.E.L. 665, (1994) (reproducing the Model Incentive Agreement that is sent by the U.S. government to the host government at the start of the negotiations) [hereinafter, *Sullivan, Model OPIC Incentive Agreement*]; *see also* Mark Kantor, *Arbitration Award May Alter Dabhol Debate*, OGEL 4, at 3 (2003).

94 *See Sullivan, Model OPIC Incentive Agreement*, *supra* note 93, art. 3(b).

95 *Id.*, art. 6(a).

96 *See* J.S. Diaconis, *Political Risk Insurance: OPIC's Use of a Fiduciary Agent to Facilitate Resolution of Subrogation Claims*, 23 Int'l L. 271 (1989) (noting that OPIC was required by South

these States, and to satisfy the demands of U.S. investors operating in Latin America, OPIC decided to amend its Incentive Agreement. Specifically, under the Agreements signed with countries like Ecuador, Colombia and Argentina, the U.S. government does not have the right to immediately seek international arbitration against the host government.[97] Instead, it must first exhaust local remedies in the host State before seeking arbitration.[98] The treaty also provides that OPIC will assign its subrogated rights to a "fiduciary agent", which will then pursue the claim in local courts.[99] This provision was considered necessary to avoid a direct politicized dispute between the U.S. government and the host State in a local court.[100]

The same concern that led OPIC to develop the "fiduciary agent" concept for its Incentive Agreements with Latin American countries, also led MIGA to develop a special mechanism for those countries. Normally, MIGA's disputes with host governments are settled through a relatively straightforward mechanism, which requires MIGA (acting as a subrogee) and the host government to negotiate for 120 days, after which they have the choice to either go for conciliation followed by arbitration, or directly seek arbitration.[101] However, in case of Latin American countries, the Convention permits MIGA to conclude special agreements with the host governments that will satisfy those countries' concerns against international

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American countries to demonstrate that its insurance policies were consistent with the Calvo Doctrine) [hereinafter, *Diaconis*].

97 All OPIC Incentive Agreements are available on OPIC's website at http://www.opic.gov/doing-business/where-we-work.

98 *See, e.g.*, U.S.-Argentina Incentive Agreement, art. 2; U.S. – Ecuador Incentive Agreement, art. 6(b).

99 *See, e.g.*, U.S. – Ecuador Incentive Agreement, art. 3(a).

100 *See Diaconis*, *supra* note 96, at 278.

101 *MIGA Convention*, *supra* note 11, arts. 2-4.

arbitration.[102] Although MIGA has not yet signed any such agreements, Commentary to the MIGA Convention states that these agreements may require the Agency to "first seek remedies under the local laws of the host State" before seeking arbitration.[103] The Commentary also states that MIGA may consider abandoning arbitration altogether, and instead explore other avenues, including seeking an advisory opinion from the ICJ.[104]

2.8.2. Bilateral investment treaties

Unlike PRI schemes, BITs do not contain any mechanism for indemnification. And it is obvious why that is the case. Insurers like to be indemnified because they were not the ones responsible for investors' loss – host States, however, were responsible for those losses. And, as explained above,[105] even after the insurer has paid out the claim, host State's responsibility for breach of a treaty obligation continues to exist. The insurer can therefore step into the shoes of the investor and recover the amount from the host State. But there is no fourth party from whom the host State can recover the amount it paid to the investor or the insurer. And nor can there be, given that it is the host State that was adjudged to be in breach.

3. Conclusion

This Chapter has compared insurance policies of four major players – OPIC, NEXI, PwC and MIGA – with BITs across important structural parameters such as eligibility

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102 *MIGA Commentary*, *supra* note 41, para. 78; s*ee also*, *Shihata*, *supra* note 73 at 261-264; *see also* P.M. Protopsaltis, *Multilateral Guarantee Agency*, TDM 3 (2005), at 276-77.

103 *MIGA Commentary*, *supra* note 41, para. 76(c).

104 *Id.*

105 *See supra* notes 68-70 and accompanying text.

criteria and types of risks covered. The comparison reveals some important similarities and differences. To highlight a few similarities, both BITs and national insurance schemes restrict coverage to their own nationals, though exception is made for foreign corporations that are locally owned.[106] Neither insurance schemes nor BITs define the term "investment", which leaves both the underwriting staff and the investment tribunals with significant wriggle room. Nevertheless, BITs and the ICSID Convention (as applied by tribunals) and national insurance schemes do impose certain broadly similar conditions, which include the requirement that the investment involves fresh injection of capital and makes a contribution to host State's development.[107] Finally, both instruments provide coverage against the same broad categories of political risks: expropriation, currency inconvertibility and political violence. With respect to other types of political risks, such as breach of contract, however, there is less consistency. Certain insurers, like MIGA and PwC, directly cover the risk of breach of contract, whereas other insurers, like OPIC, provide limited coverage against the risk through their expropriation policies.[108] In any event, BITs, with their broadly worded umbrella clauses, usually provide a far more comprehensive coverage against the risk of breach of contract than PRI policies.[109]

As to differences, the first and most obvious difference is that PRI coverage comes at a cost to the investor (in the form of insurance premiums), whereas treaty

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106 MIGA is slightly different, however. Because it is a multilateral scheme that is not linked to any specific country, it can provide coverage to any investor provided that investor operates on a commercial basis and is a national of a member country, other than the host State. See *supra* note 11 and accompanying text.

107 *See supra* s. 2.2.

108 *See supra* notes 60 – 62 and accompanying text.

109 *See supra* notes 69 – 72 and accompanying text.

protections are free, given that they are negotiated by States for the benefit of investors. The next major difference pertains to the assessment criteria employed by the two instruments. National insurance schemes usually require underwriting staff to assess the proposed investment's net impact on the host State's economic and social development.[110] That includes assessing whether the project complies with labour, human rights and environmental standards.[111] BITs, on the other hand, do not directly impose any such criteria; treaty protections are usually available to all types of investments, irrespective of their impact.[112] Finally, BIT protections apply on a bilateral basis, such that they are available for investments established only in signatory States. On the other hand, PRI policies are, in theory, available for investments established in any host State. In practice, however, there are certain limitations. For example, OPIC is required by the U.S. Foreign Assistance Act to ensure that the host State observes human rights and internationally-recognized workers' rights,[113] while MIGA coverage is only available for investments made in the territory of developing member countries.[114]

An understanding of the structural differences between the PRI regime and investment treaties is crucial. Not only does it illustrate two different methods of achieving the same objective (viz. protection and promotion of foreign investment), it

110 *See supra* notes 46 – 51 and accompanying text.

111 *Id.*

112 *See supra* notes 52 – 55 and accompanying text.

113 *See supra* notes 38 – 39 and accompanying text.

114 *See supra* note 40.

also provides the necessary context for the analytical chapters that follow in which expropriation coverage across OPIC policies and U.S. BITs are compared.

PART B:

PRI AND

INTERNATIONAL LAW

CHAPTER 3: POLITICAL RISK INSURANCE AND RIGHTS OF INSURED, INSURER AND HOST STATES

1. Introduction

Chapters 1 and 2 provided an introduction to the concept of political risk insurance ("PRI") and identified the principal differences and similarities between PRI schemes and international investment agreements ("IIAs"). They also identified the various ways in which PRI schemes and IIAs interact with each other, of which the most important is the law of subrogation. It is most important because without subrogation rights IIAs would be of little use to insurers. Normally, only a qualifying investor who

has made a qualifying investment in the territory of the host State can use the protections available under an IIA. As the insurer is not making any investment, it would not qualify for treaty protections. Nevertheless, because the IIA provides the insurer with subrogation rights, it is able to rely on treaty protections – albeit indirectly – and enforce them against the host State. Put differently, subrogation is that principle which binds BITs and PRI schemes together.

This Chapter, therefore, explains how subrogation works under domestic law and how it might apply in the context of IIAs. It proceeds as follows: sections 2 and 3 briefly explain the principle of subrogation: specifically, section 2 considers subrogation principles under English law, whereas section 3 considers subrogation from the point of view of international law. The chapter starts with domestic law (section 2) because there is very little international law on insurance. Domestic law usually governs insurance contracts and there are no international treaties or conventions on insurance (in the same way as there are, for example, international treaties on tax law or maritime law). The law of subrogation therefore cannot be studied in isolation from domestic law. Nevertheless, having decided that domestic law must be considered, one has to then decide which domestic system should be considered. Clearly, it is not possible to study subrogation under every domestic system. A choice has to be made between the various possible domestic systems and that choice is likely to be somewhat arbitrary. In this regard, there are certain parameters that one can follow to limit the arbitrariness of that choice. In particular, one could choose a system that has a well-developed body of law on this area, is used extensively by the insurance industry (both in terms of the law governing the insurance contacts and the courts to which disputes arising under these contracts are submitted)

and the influence that the system has had in generating principles that are practiced by other systems as well. As explained further below, English law satisfies all of these parameters.

After considering subrogation under English law, the chapter then looks at, in section 3, subrogation under international law. International tribunals have also rarely ruled on matters relating to insurance and even more rarely on matters pertaining to subrogation. Moreover, surprisingly, despite the widespread use of subrogation clauses in BITs, there is no publicly available treaty award that discusses subrogation clauses. As a result, there is very little international law on questions relating to subrogation. Against that backdrop, section 3 looks at the historic decisions of international tribunals that could be of relevance. In particular, it considers in depth the International Court of Justice ("ICJ") *Case concerning the Aerial Incident of July 27th, 1955*, where subrogation was one of the issues put to the ICJ.[1] While the ICJ eventually decided not to rule on the issue, submissions made by both parties in the proceedings are nevertheless relevant for present purposes.

Having introduced the topic of subrogation in sections 2 and 3 below, section 4 then looks at subrogation clauses under IIAs. As noted previously, there are over 3,000 IIAs in force. Most of these treaties contain subrogation clauses. And, while subrogation clauses, like most other clauses in IIAs, look similar on the surface, they do often vary in material ways. It would therefore be inappropriate to make general statements about these clauses; however, at the same time, it is simply not possible to

1 *Aerial Incident of 27 July 1955 (Israel v. Bulgaria) Preliminary Objections, Judgment*, [1959] ICJ Rep 127 [hereinafter, *Israel v Bulgaria*].

study all of these clauses separately. A reasonable compromise appears to be, instead, to study the most relevant aspects of these clauses and, in respect of each of those aspects, identify major variations. Section 4 considers the following aspects of subrogation clauses by dividing them into four separate categories: (i) the class of insurers who are protected (e.g. only designated insurers or all public insurers); (ii) the scope of coverage (e.g. all types of insurance or only political risk insurance); (iii) rights of the investor (e.g. can the investor bring a claim on top of a claim brought by the insurer?); and (iv) rights of the home State (e.g. how does the treaty protect the host State against possible double recovery?). The purpose of this categorisation is to capture, to the extent possible within the bounds of this chapter, divergences in the text of treaties' subrogation clauses, and the practical effects that follow from such differences.

In addition to studying the most relevant aspects of IIAs' subrogation clauses, section 4 also separately discusses, as special cases, the Energy Charter Treaty ("ECT"), MIGA and ICSID. ECT provides a useful case study because it is a multilateral treaty that contains a subrogation clause, which means that, in comparison to BITs, the class of protected insures under ECT is much wider. The case of MIGA is interesting because it provides an example of a multilateral political risk insurer that is able to operate outside of the IIA system and yet able to take advantage of virtually all of the protections that are available to national insurers under IIAs. Finally, ICSID is relevant because that is the forum where many investor-State disputes are decided; however, as explained further below, because of certain restrictions in the ICSID Convention, political risk insurers may not be able to submit disputes to ICSID. Section 5 concludes this chapter with some final observations.

2. Subrogation rights

2.1. What is meant by subrogation?

Black's Law Dictionary defines subrogation as "the principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to any loss covered by the policy".[2] Put differently, subrogation means substitution of one person for another, such that the subrogated person (usually, the insurer) is "allowed to stand in the shoes" of another (the insured person) and assert that person's rights against the defendant.[3]

2.2. General principles under English law

Subrogation is a complex area of law. The purpose of this section is not to analyse that body of law in detail. Rather, it is to identify the key principles, as applied under English law, so that they can be employed for understanding subrogation in the

[2] BLACK'S LAW DICTIONARY (10th ed. 2014).

[3] 1 Dan B. Dobbs, *Law of Remedies* § 4.3(4), at 604 (2d ed. 1993); *see also, Niru Battery Manufacturing Co v. Milestone Trading Ltd (No 2)* (2004) EWCA Civ 487.

international context.[4] These principles are, however, subject to modification depending on the language of the insurance policy.[5]

(a) The insurer is entitled to "stand in the shoes" of the insured and enforce any claims possessed by the insured against third parties which will have the effect of reducing the loss;

(b) The insurer is also entitled to receive from the insured any benefits received by it from a third party in diminution of the loss;

(c) The insured is entitled to control any proceedings brought against the a third party prior to payment by the insurer under the policy. This principle also applies where an insured is not fully indemnified by the insurer because the sum insured and paid is inadequate to cover its loss;

(d) As a corollary to the third principle above, the insurer controls the proceedings where the insurer pursuant to the policy has indemnified the insured and there is no uninsured loss; and

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[4] The choice of English law is driven by the fact that London is one of the world's largest centres for insurance and re-insurance transactions. It accounts for nearly 10% of the world's insurance market. See Robert Merkin, INSURANCE LAW – AN INTRODUCTION 5 (London, Inform: 2007). It is common for insurance contracts that are arranged in the London market to be governed by English law and for disputes relating to such contracts to be heard by English courts or by arbitration in London. *Id.* at 6. As a result, there is a vast body of English law, including decisions of the UK courts, journal articles and books on the topic of insurance generally and subrogation in particular, and this makes English law an appropriate choice for present purposes. On subrogation under English law, see generally Charles Mitchell & Stephen Watterson, Subrogation: Law and Practice (OUP, 2007). I do not intend to cover this topic in detail in this thesis. Rather, the aim of this section is to simply provide an overview of the concept of subrogation, explain how it applies in the present context and discuss certain general principles that apply under English law and which are relevant to subrogation at the international level as well. I have not conducted an exhaustive survey to determine whether these principles apply in other important national jurisdictions as well (such as New York). However, my understanding, based on anecdotal experience, is that these principles do hold true in those jurisdictions as well. To the extent they do not, however, I point that out in footnotes below.

[5] These principles have been derived from Charles Mitchell & Stephen Watterson, SUBROGATION: LAW AND PRACTICE (OUP, 2007).

(e) Even where the insurer controls the action, the proceedings are brought in the name of the insured, which means that the insured must continue to exist at least until the subrogation proceedings have been initiated.

Another advantage of setting out these rules is that they could assist in establishing 'general principles of law', which is one of the formal sources of international law.[6] General principles of law may be established through a comparative study of national legal systems.[7] In practice, this means that arbitral tribunals and international courts will look at representative systems of the common-law and civil-law world (such as, the UK, US, Germany, Switzerland and France)[8] and, depending on the issue, other leading jurisdictions.[9]

A comparative study of national legal systems, however, can be cumbersome and time-consuming. Tribunals therefore often look for short cuts. One such short cut is to rely on general principles that have previously been identified in the rulings of

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[6] The formally recognized sources of international law are reflected in article 38 of the Statute of the International Court of Justice. 26 June 1945, 892 UNTS 119. On sources of international law, see generally, James Crawford, BROWNLIE'S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 20-47 (Oxford, 2008) [hereinafter, *Brownlie's Principles*]. On general principles of international law, see generally, *Id.* at 34-37; Howard S. Schrader, "*Custom and General Principles As Sources of International Law in American Federal Courts*", 82 Colum. L. Rev. 751, 752 (1982); Charles T. Kotuby Jr., *General Principles of Law, International Due Process, and the Modern Role of Private International Law*, 23 Duke J. Comp. & Int'l L. 411, 412 (2013) [hereinafter, *General Principles of Law*].

[7] But see *General Principles of Law*, *supra* note 6, at 411("When the ICJ 'finds' and applies a general principle of law, it typically does so without any formal reference or label. And when it does name the source, it never publicizes its comparative process in divining the principle applied, but rather *ipse dixit* simply states that the principle is 'admitted in all systems of law,' or that it is 'widely accepted as having been assimilated into the catalogue of general principles of law'") (internal footnotes removed).

[8] *See, e.g., Oil Platforms (Iran v. US)*, 2003 I.C.J. 161, 354 (Nov. 6) (separate opinion of Judge Simma) (looking at tort law in the U.S., the U.K., Canada, France, Germany and Switzerland to establish a general principle of law concerning joint-and-several liability).

[9] *See, e.g., Desert Line Projects LLC v. Yemen*, 2008 ICSID ARB/05/17, ¶ 207 (Feb. 6, 2008)[hereinafter, *Desert Line Projects*] (looking at Islamic law, in particular Yemeni law, to establish doctrine of estoppel as a general principle of law).

international courts and tribunals. The ICJ, for example, has identified a number of general principles of law.[10] Recent decisions of arbitral tribunals in investor-State disputes have also contributed in creating a corpus of general principles.[11] Based on these decisions, and writings of comparative scholars, certain principles are now firmly recognized as general principles of law. These include principles of good faith, *pacta sunt servanda*,[12] estoppel, *res judicata*, duty to mitigate losses, claimant's burden of proof and unjust enrichment.[13]

In the section that follows, relevant decisions of international tribunals are analysed, as they may assist in the identification of general principles of international law in relation to subrogation.

2.3. Subrogation principles as applied by international tribunals

In the context of the ICJ, the only instance where the question of subrogation had risen is the *Case concerning the Aerial Incident of July 27th, 1955*. There, Bulgaria raised a Preliminary Objection against Israel's claim for compensation of losses for shooting

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10 Early decisions of the ICJ have been summarized in Bin Cheng, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS (1953).

11 *See, e.g.*, *Desert Line Projects LLC v. Yemen*, 2008 ICSID ARB/05/17, ¶ 207 (Feb. 6, 2008) *Desert Line Projects*, *supra* note 10. (discussing the doctrine of estoppel); *Waste Mgmt., Inc. v. Mexico*, ICSID ARB(AF)/00/3, ¶ 39 (June 26, 2002) (confirming the status of *res judicata* as a general principle of law); *Mobil Corporation, et al. v. Bolivarian Republic of Venezuela*, 2010 ICSID ARB/07/27, Decision on Jurisdiction, ¶ 175 (discussing good faith and abuse of right as a general principle of law).

12 This refers to the rule that agreements and stipulations, especially those contained in treaties must be observed. BLACK'S LAW DICTIONARY (9th ed. 2009).

13 Various academics have provided a listing of well-known general principles of law. *See, e.g.*, Tarcisio Gazzini, General Principles of Law in the Field of Foreign Investment, 10 J. World Inv. & Trade 1, 111 (April 2009) (listing well-known general principles); Loukas Mistelis, General Principles of Law and Transnational Rules in International Arbitration: An English Perspective, 5 World Arb. & Mediation Rev. 201, 210-12 (2011); Klaus Peter Berger, General Principles of Law in International Commercial Arbitration: How to Find Them - How to Apply Them, 5 World Arb. & Mediation Rev. 97, 114-40 (2011); Felix Dasser, That Rare Bird: Non-National Legal Standards as Applicable Law in International Commercial Arbitration, 5 World Arb. & Mediation Rev. 143, 156-7 (2011); Emmanuel Gaillard, General Principles of Law in International Commercial Arbitration - Challenging Myths, 5 World Arb. & Mediation Rev. 161, 166-69 (2011).

down of an Israeli passenger plane by Bulgarian anti-aircraft missiles.[14] Specifically, Bulgaria argued that Israel lacked *jus standi* as non-Israeli insurance companies had compensated Israel for its losses. While the ICJ did not consider this argument as it denied jurisdiction on other grounds, submissions made by Mr Shabtai Rosenne on behalf of Israel are interesting and worth summarising here.

Specifically, Bulgaria argued, in Mr Rosenne's words, that[15]:

> [I]n effect, the Bulgarian Government is saying that although we, the Bulgarian Government, shot down an Israel aircraft, the Israel Government cannot bring any international claim to vindicate its rights, because all that counts is the material loss, and the material losses are, or are assumed to be, covered by foreign insurance companies.

In Mr Rosenne's view, Bulgaria's objection would "imply that a State could escape its international obligations to another State if foreign insurance companies by chance happen to have insured some of the consequential material losses not suffered by the State itself".[16] That is so because the insurer who has to pay compensation pursuant to an insurance policy has not suffered any "legal" injury (though of course much would depend on how subrogation works in the relevant domestic context).[17] Moreover, it may be that the facts giving rise to the insurance claim (in this case, for example, the shooting down of the Israeli aircraft) are so far removed from the insurer, that the insurer's state cannot bring an international claim on the insurer's behalf, either through diplomatic channels or in an international court. As such, the only person that

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14 *Israel v Bulgaria*, *supra* note 1, at 131.

15 *Aerial Incident of 27 July 1955 (Israel v. Bulgaria)*, Oral Proceedings at p. 162.

16 *Id.*

17 *Id*. at p. 171.

is capable of bringing a claim to an international court is the injured person's home State.

Mr Rosenne's submissions also briefly addressed the procedural aspects of subrogation. He noted that[18]:

> [W]hen you have subrogation . . . it is not, strictly speaking, an assignment of rights. What is involved from the substantive point of view, is that if an injured person recovers damages from the person who caused the injury, he is bound to refund the monies received from the insurers. From the procedural point of view the different domestic systems may vary in their rules regarding the possible substitution of the insurer for the insured in any legal proceedings. *No such system exists in international law, where the State of the individual, the individual who is a direct victim of the impugned actions of the foreign State, may bring an international claim*.

In the absence of an assignment of rights under international law, the insurer's State cannot bring an international claim, unless the insurer has suffered direct legal injury, which, as discussed above, is unlikely. So that leaves the home State of the individual who has suffered the injury as the only State capable of bringing an international claim.

Finally, Mr Rosenne briefly referred to the issue of "double recovery". Bulgaria was rightly concerned that in case it is ordered to pay compensation to Israel, it may end up paying twice, as the insurers may separately bring claims against Bulgaria for their losses (it was not clear from Mr Rosenne's submissions, however, how, and under which system of law, could the insurers could bring such claims). In this regard, he noted that[19]:

> [T]he Bulgarian government is entitled to protection against having to pay double damages. . . . . [I]f, by virtue of subrogation, any of the monies to be paid by the Bulgarian Government which might ultimately be distributed to the individuals [who suffered the injury]

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18 *Id.* at p. 172.

19 *Id.*

> would have to be transferred by those individuals, in whole or in part, to their insurers, that is the affair of those individuals, is covered by domestic law, and has nothing to do with this case.

It appears that Mr Rosenne's submissions above, while correct as a matter of principle, do not sufficiently engage with the problems of double recovery. In cases where the insurers (or their home States) are incapable of bringing a claim against the State that committed the internationally wrongful act, there is no practical problem of double recovery as recovery would flow to only one person (the home State of the injured individual), who can then decide, under its domestic law, how that money should be distributed amongst the injured individuals and insurance companies. However, where, as is the case under several BITs, the insurance companies have a separate right to bring a claim against the host State for their losses, it is not clear how the problem of double recovery can be resolved by relying on domestic law alone. That proposition is fraught with several issues, including, but not limited to, the fact that there may be several domestic systems of law at play (because the insured and the insurer, both of whom are entitled to bring international claims under BITs, are likely to have different nationalities, which may or may not be the of same State as the governing law of the insurance policy).

The Iran-U.S. Claims Tribunal has also had to consider subrogation, in an ancillary fashion, in a few cases. For example, in the *Phelps Dodge* case, Phelps Dodge Corporation, a U.S. investor, brought a claim against Iran after the Iranian government took over an investment made by Phelps Dodge in an Iranian firm called SICAB.[20] Because Phelps Dodge had obtained a guarantee from OPIC, both Phelps

[20] *Phelps Dodge International Corp. v The Islamic Republic of Iran*, Award No. 217-99-2 (1986) [hereinafter, *Phelps Dodge*].

Dodge and OPIC appeared as claimants before the Tribunal. Before the claim was brought, Phelps Dodge and OPIC had entered into a settlement agreement. According to the terms of that agreement, OPIC agreed to pay Phelps Dodge a sum of money and Phelps Dodge agreed to transfer to OPIC a beneficial interest in 90% of its shareholding in SICAB.[21] In response to an objection by Iran that OPIC's payment meant that Phelps Dodge no longer had the right to pursue its claim, the Tribunal noted[22]:

> According to the Tribunal, [Iran] further argues that Phelps Dodge somehow lost its right to pursue its claims before the Tribunal by entering into the settlement agreement with OPIC on 17 June 1981 pursuant to which it received partial compensation under OPIC's insurance policy and assigned to OPIC the beneficial interest in ninety percent of its claims, while retaining legal ownership of the claim. However, as noted above, Phelps Dodge did not transfer to OPIC all of its claims, retaining, in addition to legal ownership of all of the claims, beneficial ownership of the claim for the ten percent of its investment with respect to which it bore the risk of loss under the insurance contract. Moreover, it appears from clause 2 of the insurance contract that Phelps Dodge may well be able to retain any amount it recovers from the present arbitration that exceeds the total of the amount of insurance payment it received from OPIC and the amount of expenditures incurred by OPIC since 17 June 1981 with respect to the claims. Therefore, Phelps Dodge retains ownership of at least part of the claims in the present Case and has standing to assert them…. The Tribunal agrees that the amount of the insurance payment received by Phelps Dodge is irrelevant to the present proceeding. Therefore, the Tribunal declines to order the Claimants to disclose it.

Having held that Phelps Dodge had standing to bring a claim with respect to both the insured and uninsured components of its losses, the Tribunal dismissed OPIC as a claimant, leaving Phelps Dodge solely in charge of pursuing the claim. Similarly, in the *Foremost* case, which concerned an expropriation claim, the investor – Foremost

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21 *Id.*

22 *Id.*

– had taken out an insurance guarantee from OPIC covering only part (90%) of the investment.[23] Foremost and OPIC sued jointly with respect to the insured component of the loss, while Foremost sued separately with respect to the uninsured component of the loss. The Tribunal, following *Phelps Dodge*, upheld Foremost's standing to sue on its own behalf for the entire loss and therefore dismissed OPIC as a proper claimant.[24]

Despite the rise in the number of investor-State disputes, and the obvious overlap between investment treaties and political risk insurance (a topic that would explored further in the next chapter), investor-State tribunals have rarely had the opportunity to deal with political risk insurance. The most notable exception in this regard is the recent case of *Hochtief v Argentina*.[25] Hochtief, a German company, was part of an international consortium selected to construct and operate a road and bridge link between the Argentine cities of Rosario and Victoria. In the arbitration, the company alleged that measures taken during Argentina's financial crisis breached contractual commitments, which provided for the calculation of road-tolls in US Dollars, and for periodic adjustments of toll charges in line with US inflation indices. Prior to commencing the arbitration, "the German Government agreed to pay Claimant EUR 11,359 million under a political risk insurance policy that covered the losses encompassed within the claims made in the present case".[26]

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23 *Foremost Tehran, Inc. v. Islamic Republic of Iran,* 10 Iran U.S. Cl. Trib. Rep. 228, 1986 WL 424309 (1986). [hereinafter, *Foremost*].

24 *Id.*

25 *Hochtief v Argentina*, ICSID Case No. ARB/07/31 (2015) [hereinafter, *Hochtief*].

26 *Id.* at para. 185.

At the jurisdictional stage, Argentina argued that, as a result of the insurance payment, Germany had been subrogated to the rights of Hochtief and, accordingly, the latter could no longer pursue its treaty claim.[27] In support of this argument, Argentina relied on article 6 of the Argentina-Germany BIT, which obliges the respondent State to recognise the transfer of rights to an insurer after the insurance payment has been made.[28] The Tribunal correctly dismissed this argument, noting that article 6 does not require the "insuring State [to] succeed to and extinguish the rights of the insured investor once payment is made on the insurance policy".[29] If that were the case, the investor would have no avenue available to recover the uninsured losses and the respondent State would escape liability.

At the quantum phase, Argentina argued that the insurance payment should be deducted from any compensation awarded to Hotchief. However, the tribunal disagreed. According to the tribunal, no "principle of international law requires that such an arrangement [PRI policy], to which Respondent was not a party, should reduce Respondent's liability".[30] The tribunal's reasoning is discussed in detail in chapter 8.[31] For now, however, it suffices to say that there are striking similarities between the approach of the Iran-US Claims Tribunal (in the *Phelps Dodge* and *Foremost* cases discussed above) and ICSID tribunal's approach in the *Hochtief* case. In particular,

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27 *Id.*

28 *Id.*

29 *Id.* at para. 186.

30 *Id.* at para. 309.

31 *See infra* Chapter 8, s. 4.

these cases suggest that the emergence of certain general principles in relation to subrogation.

First, even if the insurer has made an insurance payment and has been subrogated to the rights of the investor, the investor does not lose the right to bring a claim on its own behalf. For both the Iran-US Claims Tribunal, as well as the ICSID tribunal, despite payment under the insurance policy, the investor continued to retain legal ownership over all of the claims.[32] Put differently, the insurance payment did not deprive the investor of its standing to bring a separate claim against the host State.[33] Secondly, there is a difference between legal ownership of the claim (which affects the claimant's standing to bring the claim) and beneficial ownership of the claim (which determines who receives the proceeds of the claim). After a payment under the insurance policy, the insurer is the beneficial owner of the claim (up to the value of the insurance payment made); however, the investor continues to be the legal owner of all of the claims. This is exactly what the Iran-US Claims Tribunal said in the *Phelps Dodge* case.[34] Moreover, it is consistent with the how 'assignment of claims' works under international law,[35] or how subrogation principles operate under English law.[36] Thirdly, it appears that international tribunals are less concerned about risks of double

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[32] *Phelps Dodge, supra* note 20; *Foremost, supra* note 23; *Hochtief, supra* note 25, at para 168.

[33] *Phelps Dodge, supra* note 20; *Foremost, supra* note 23; *Hochtief, supra* note 25, at para 168.

[34] *Phelps Dodge, supra* note 20.

[35] *See*, e.g., *Ceskoslovenska Obchodni Banka, A.S. (CSOB) v. Slovak Republic* [ICSID Case No. ARB/97/4, Decision on Jurisdiction, 24 May 1999, para. 32 (holding that, even in cases of assignments or subrogations of interest by investor-claimants, the "absence of beneficial ownership by a claimant in a claim or the transfer of the economic risk in the outcome of a dispute should not and has not been deemed to affect the standing of a claimant in an ICSID proceeding, regardless of whether or not the beneficial owner is a State Party or a private party".)

[36] *See supra* note 5 and accompanying text (in particular, see principle (c)).

recovery as it is assumed that the investor will have to transfer any proceeds from the arbitration to the insurer (except, of course, proceeds in excess of the insurance payment).[37] Again, this position is largely consistent with English law.[38]

The above analysis suggests that the principles of subrogation under international law (to the extent it can be said that such principles exist) are similar to subrogation principles under domestic law. In the sections that follow, these principles are applied to the specific context of investment treaty arbitration

3. Subrogation clauses under international investment agreements

Given that both IIAs and insurance schemes have the same underlying purpose – promotion and protection of foreign investment – it is not surprising that there is also a close relationship between the two. This relationship manifests itself in several ways. First, home states view IIAs as helping to reduce the risk profile of the project to a level where it becomes commercially feasible to insure the project. As a result, most insurers take the existence of an IIA into account when pricing their insurance policies. For example, MIGA's Operational Regulations *require* MIGA to look at BITs as one the 34 factors at the time of pricing the insurance coverage.[39] Moreover, in case of at least one important public insurer – Germany's Euler/Hermes – BITs are a pre-requisite to getting insurance coverage.

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37 *Phelps Dodge*, *supra* note 20; *Foremost*, *supra* note 23; *Hochtief*, *supra* note 25; *Israel v. Bulgaria*, *supra* note 1 (submission of Shabatti Rosenne).

38 *See supra* note 5 and accompanying text (in particular, see principle (c)).

39 Multilateral Investment Guarantee Agency, Operational Regulations (2002), s. 1.38, available at: https://www.miga.org/Documents/miga_documents/Operations-Regulations-030115.pdf.

Second, most IIAs contain subrogation clauses, which allow insurers to 'step into the shoes' of the investors and sue the host State for compensation. U.S. BITs are an exception in this regard as they do not contain subrogation provisions. That is the case because, as explained earlier, the U.S. government has concluded agreements with a large number of countries around the world, under which those countries agree to recognise OPIC's subrogation rights and also agree to submit any disputes relating to OPIC's claim to international arbitration.[40]

In the context of foreign investment insurance, it is important that the host State agrees to recognise the insurer's subrogation rights. That is so because the assignment of the investor's rights and claims to the insurer may not be valid under the applicable law. In addition, if such recognition can be effected by a treaty, it will also become an international obligation on the host State. For example, one of the most common wording found in BITs states:

> If a Contracting Party makes a payment to any of its nationals or companies under a guarantee it has granted in respect to an investment, the other Contracting State shall, without prejudice to the rights of the former Contracting State . . . recognize the transfer of any right or title of such national or company to the former Contracting State and subrogation of former Contracting State to any right or title.[41]

The equivalent provisions of some other BITs do not refer in this way to one of the Contracting Parties as being the insurer. Instead, they refer to an insurer that provides insurance against non-commercial risks "under a system established by law". Specifically, these treaties provide:

> If the investments of a national of the other Contracting Party are insured against non-commercial risks under a system established by

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40 *See supra* Chapter 2, s. 2.8.

41 *See e.g.*, Sweden-Pakistan BIT (1981) at art. 6; Pakistan-China BIT (1990) at art. 7.

> law, and the insurer or the re-insurer makes a payment or agrees to make a payment pursuant to the terms of such insurance, any subrogation of the insurer or the re-insurer into the right of the said national shall be recognized by the other Contracting Party.[42]

The reference to an insurer that provides insurance against "non-commercial risks" and operates "under a system established by law" is essentially a reference to State-owned political risk insurers. These insurers are creation of a statute or legislation, which is not the case with, for example, private insurers.[43] Nor is an insurer like MIGA, which is established by treaty and not by national legislation, covered by this clause.[44]

Subrogation provisions of many other BITs are more elaborate than those quoted above. In these BITs, the provisions may refer to the insurer being either the State or one of its agencies, acknowledge that the subrogation may take place either by operation of law or in accordance with a particular transaction such as a contract of guarantee,[45] and make it explicit that the subrogee shall, as such, be entitled to exercise all rights of the indemnified investor (the term "indemnified investor" is also referred to as insurer's "predecessor in title" in a few BITs). The next section briefly explains the different types of subrogation provisions found in various BITs.

3.1. Subrogation provisions across various IIAs

The three main categories where one can draw distinctions between subrogation provisions found in various IIAs are as follows:

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42 *See, e.g.* Netherlands-Slovakia BIT (1992) at art. 8.

43 *See supra* Ch. 1, s. 3.5.

44 *See supra* Ch. 1, s. 3.4.

45 *See e.g,* Afghanistan-Germany BIT (2007) at art. 6;.

- identity of the Insurer;
- scope of coverage; and
- rights of the Investor

3.1.1. Identity of the insurer

A survey of model BITs and executed BITs of most major capital-exporting nations shows that the subrogation clauses refer to two different entities as potential insurers: (i) the home State of the investor (i.e. the "Contracting Party"); and (ii) the home State and its designated agencies. Private and multilateral insurers are generally excluded and, therefore, cannot take advantage of the treaties' subrogation clauses.

As to the first sub-category – where reference is made only to the home State – several treaties provide that subrogation rights belong to the Contracting Party that indemnifies the investor upon occurrence of an insured event. For example, Article 6 of the German Model BIT (2008)[46] provides that:

> If either Contracting State makes a payment to any of its investors under a guarantee it has assumed in respect of an investment in the territory of the other Contracting State, the latter Contracting State shall, without prejudice to the rights of the former Contracting State under Article 9 [Disputes], recognize the assignment, whether under a law or pursuant to a legal transaction, of any right or claim of such investors to the former Contracting State. The latter Contracting State shall also recognize the subrogation of the former Contracting State to any such right or claim (assigned claims) which that Contracting State shall be entitled to assert to the same extent as its predecessor in title. As regards the transfer of payments made by virtue of such assigned claims, Article 4(2) and (3) as well as Article 5 shall apply mutatis mutandis.

[46] German Model BIT (2008), art. 6.

The second sub-category – where reference is made to the home State and its designated agencies – is effectively the same as the previous sub-category. That is so because "designated agencies" are likely to be State-owned political risk insurance providers, who, by virtue of being organs of the home State, are in any event captured by the term "Contracting Party". It is nevertheless worth noting that none of the surveyed treaties explain what the term "designated" means. So, for instance, Article 10 of the UK Model BIT (2008)[47] provides that:

> 1. If one Contracting Party or its designated agency ('the first Contracting Party') makes a payment under an indemnity given in respect of an investment in the territory of the other Contracting Party ('the second Contracting Party'), the second Contracting Party shall recognise:
>
>   (a) The assignment to the first Contracting Party by law or by legal transaction of all the rights and claims of the party indemnified; and
>
>   (b) That the first Contracting Party is entitled to exercise such rights and enforce such claims by virtue of subrogation, to the same extent as the party indemnified.

On a spectrum, "designation" could mean a variety of things. At one end, it could imply a strict obligation that one treaty partner must notify the other treaty partner of the fact that one of its agencies has been designated for the purposes of the subrogation clause of the BIT. At the other end it could imply a fairly lose obligation that, as long as investors can identify, using publicly made statements or by accessing relevant local laws, that a certain agency has been designated for the purposes of the BIT, the subrogation clause will apply. Alternatively, it may be argued that, in the absence of any definition, the word "designated" does not add anything, such that any state entity, designated or otherwise, would be entitled to the benefits of BIT's subrogation clause.

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47 UK Model BIT (2008), art. 6.

Irrespective of what meaning one may give to the word "designated", it should be noted that none of the treaties contain a list of designated insurers or specify how such designations made be made. Here, an analogy can be drawn with the ICSID Convention. Article 25(1) of the Convention provides that the "jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre". This provision opens the possibility for subdivisions and agencies of a Contracting State to become parties in ICSID proceedings.[48] Although the Convention does not specify the form of designation, it appears that the designation must be made to Centre directly and can take any form as long as the intention of the Contracting Party in this regard is clear.[49] Several countries have in fact made designations under Article 25(1). A list of designated agencies is available on the ICSID website. The list includes both territorial entities/constituent sub-divisions (e.g., Australia has designated its states and the UK has designated its overseas territories) and agencies (e.g.. Nigeria has designated the state-owned oil company, Nigerian National Petroleum Corporation).[50] The advantage of a formal designation process is that it gives the investor an assurance that the agency/sub-division it is dealing with can in fact be a proper party to ICSID arbitration. Equally, the designation process gives the State assurance that none of its

48 C. Schreur, ICSID CONVENTION: A COMMENTARY 149 (CUP, 2000; 2nd ed., 2009).

49 *Id.*, p. 156.

50 *Id.* available at: https://icsid.worldbank.org/en/Pages/icsiddocs/Designations-by-Contracting-States-of-Constituent-Subdivisions-or-Agencies.aspx.

autonomous sub-divisions or agencies would be able to bring proceedings or become respondents in ICSID arbitration, without the State's prior consent.[51]

It would appear that, as with the ICSID Convention, BITs should also contain either a designation process and/or a list of designated insurers (which can be modified by the Contracting States unilaterally as and when they wish). That would give the subrogated insurers the assurance that they will be able to bring proceedings under the BIT without facing (additional) jurisdictional hurdles.[52] It will also give the Home State greater control over its insurers, ensuring that only those insurers that the State wishes to become claimants in BIT arbitrations are able to invoke treaty rights.

3.1.2. Scope of coverage

Here, the BITs differ in two principal respects. First, they differ based on the type of insurance product covered by the treaty. The wording used in the subrogation clauses of BITs tends to vary between whether an "indemnity",[53] a "guarantee",[54] or simply "insurance",[55] is being provided (with some of them referring to more than one of these products – e.g., "guarantee or a contract of insurance" in the case of Canada Model

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51 *See, e.g., Government of the Province of East Kalimantan v. PT Kaltim Prima Coal and others*, ICSID Case No. ARB/07/3, Award on Jurisdiction (2009) (the Government of Province of East Kalimantan (PEK) chose to initiate arbitration against the investor and argued that it had the jurisdiction to bring a claim as the ICSID Convention allowed "any constituent subdivision or agency of a Contracting State" to be a party to an ICSID arbitration. The arbitral tribunal, however, dismissed the case for lack of jurisdiction on the basis that Indonesia had not given the notice required under Article 25(3) of the ICSID Convention for allowing a sub-entity to file a claim under the Convention.).

52 Note that, in case of ICSID proceedings, the insurer would also have to be a designated agency under Article 25(1).

53 Indian Model BIT (2003), Italian Model BIT (2003).

54 Austrian Model BIT (2010); Danish Model BIT (2000).

55 Canadian Model BIT (2004).

BIT (2004)[56]). The Swiss Model BIT appears to be the only model BIT that uses the words "financial security". It is not clear what, if any, is the practical significance of this distinction. It may be that these terms are simply synonyms, such that they all convey the same meaning and can be used interchangeably (in the treaty context, an analogy can be drawn with the use of the words "creeping" and "indirect" expropriation, both of which convey the same meaning, which is that acts that are not aimed at, but have the effect of, expropriating an investment). Alternatively, it may be that these terms have real differences, and represent strong policy choices (again, in the treaty context, an analogy can be drawn with the use of different tests for corporate nationality, such that whether the treaty provides an incorporation test, a business activities test or a control test, can have a determinative effect on an investor's claim[57]). But before that inquiry can even begin one must ascertain the law applicable to the inquiry. As noted earlier, there is no international law on insurance. So, clearly, international law cannot provide the answer. Instead, the answer must lie in domestic law of the home State (i.e. the State in which the relevant insurer is incorporated).[58] If that is indeed the case, the variation in the words may in fact have some significance.

The second notable difference in the scope of coverage is with respect to the type of "risk" to which subrogation rights apply. Certain treaties specifically provide that treaty rights apply only where the insurer has provided insurance against "non-

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[56] But *see Generation Ukraine v Ukraine*, Award, 16 September 2003, 44 ILM (2005) 404 (describing 'creeping' expropriation as a form of indirect expropriation.

[57] *See, e.g.*, Rudolph Dolzer & Christoph Schreur, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 47-52 (OUP, 2008).

[58] For a comprehensive treatment of role of domestic law in investment treaty arbitration, see Jarrod Hepburn, DOMESTIC LAW IN INTERNATIONAL INVESTMENT ARBITRATION (OUP, 2017).

commercial risks", which is another way of referring to political risk insurance. So, for instance, article 8 of the India Model BIT (2015) provides that[59]:

> Where one Contracting Party or its designated agency has guaranteed any indemnity against non-commercial risks in respect of an investment by any of its investors in the territory of the other Contracting Party and has made payment to such investors in respect of their claims under this Agreement, the other Contracting Party agrees that the first Contracting Party or its designated agency is entitled by virtue of subrogation to exercise the rights and assert the claims of those investors. The subrogated rights or claims shall not exceed the original rights or claim of such investors.

The majority of the BITs, however, do not limit the scope of coverage in this way – that is, they do not say that the insurance contract should cover a certain type of risk.[60] In such cases, arguably, subrogation rights apply even where the insurer extends coverage against commercial risks (i.e. ordinary business risks, as opposed to political risks). Despite the difference in wording, however, in practice, it is unlikely that there will be much difference between clauses that cover only political risk insurance and those that provide broader coverage. That is so for two reasons. First, as noted earlier, most treaties limit subrogation rights to State-owned insurers, which generally only provide coverage against political risks. For example, as explained in chapter 2, the most common category of State-owned insurers – Export Credit Agencies (ECAs) – normally does not provide coverage against business risks. Secondly, the substantive protections contained in BITs are relevant only to political risks. So, even if a commercial insurer fell within the scope of the treaty's subrogation clause, the treaty's substantive protections are unlikely to be of much use to that insurer.

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59 *See also*, Italian Model BIT (2003), at art. 7; Netherlands Model BIT (2004), art 8.

60 *See, e.g.*, Energy Charter Treaty, art. 15..

3.1.3. Rights of the investor

After the insurer has been subrogated (i.e., stepped into the shoes of the investor), a question arises as to what, if any, rights the investor has under the treaty. As a general principle, under English law, once the insurer has paid the insured and has been subrogated, the insured cannot sue the tortfeasor with respect to that loss. The rule makes sense because otherwise the tortfeasor would have to pay twice – to both the insurer and the insured – and the insured would end up making a profit out of the insurance policy.[61] However, in cases where an insurance policy does not cover the entire loss, the insured retains the right to sue with respect to the uninsured part of the loss. Again, the rule makes sense because otherwise the insured would remain under-compensated.

To clarify, assume that a house is worth £1.5 million, but the insurance policy is only for £1 million. A neighbour has destroyed the house. In this case, the homeowner would first claim £1m from the insurer. Then, when the homeowner has been indemnified (i.e. received the £1m), the insurer is subrogated to the rights and claims of the homeowner and uses these rights to sue the neighbour. The homeowner would bring a claim alongside the insurer for the full amount (i.e £1.5 million). Upon recovery of £1.5 million, the homeowner would account to the insurer for the £1m paid out under the policy (as the principle of subrogation does not allow the insured to profit

[61] Legh Jones, Birds, & Owen, MACGILLIVRAY ON INSURANCE LAW (11th Ed., 2008) (noting that it is an instance of the fundamental principle of indemnity insurance that the assured shall receive no more than a full indemnity for his real loss, and must not be permitted to make a profit out of being insured); *see also Casterllain v Preston* (1883) 11 QBD 380 (where Preston recovered fire damage loss from his insurers and also the full purchase price after completion of the sale, making a profit out of this situation; Castellain, the insurers, were given the right to stand in the place of Preston and recover the amount paid in the claim to Preston); *see also, H Cousins & Co Ltd v D&C Carriers Limited* [1971] 2 QB 230, 242.

from the insured loss) and keep the surplus, as the insurer is only "subrogated" to the homeowner's rights up to the value of the policy.

Whilst the text of the BITs do not directly address this issue, the same rule is likely to apply under international law. In this regard, it must be noted that investment treaty tribunals have generally acknowledged the risk of double recovery and have confirmed that host governments need to be protected from double recovery.[62] However, the actual mechanisms to prevent double recovery have not been the subject of any real discussion. The only concrete mechanism discussed is the possibility that succeeding tribunals will take into account damages awarded by previous tribunals.[63]

The clearest illustration of this mechanism in operation is provided by the *Lauder v. Czech Republic*[64] and *CME v. Czech Republic*[65] arbitrations. Ronald Lauder, an American citizen, held approximately 30% of the shares of CME, a Dutch company, which in turn held 99% of the shares of a Czech media company (CNTS). After the Czech government revoked CNTS's TV license, both Mr Lauder and (six months later) CME started arbitration proceedings against the Czech Republic, under the US-Czech Republic BIT and the Netherlands-Czech Republic BIT, respectively. The Czech Republic argued that there was a possibility that Mr Lauder would recover twice for the same loss, because CME, which was owned by him, was raising similar claims in

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62 In fact, the prohibition against double recovery is recognised under public international law. *See* ILC Articles on State Responsibility, Commentary to art 36, Commentaries to the Draft Articles on the Responsibility of States for Internationally Wrongful Acts, 53 UN GAOR Supp (No 10), UN Doc A/56/10 (2001), para 33.

63 *See e.g.*, *Azurix v. Argentina* (Award) (2006) para 114.

64 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award (2001).

65 *CME Czech Republic B.V. v. The Czech Republic*, UNCITRAL, Final Award (2001) [hereinafter, *CME*].

a parallel arbitration. The tribunal rejected this assertion, noting that in case one of the two tribunals awards damages then the "second deciding court or arbitral tribunal could take this fact into consideration when assessing the final damage".[66] In any event, the risk of double recovery risk never came to fruition as Mr. Lauder's claims were dismissed in their entirety, while CME was awarded substantial damages.

The problem of double recovery in the subrogation context is even more acute, and difficult to disentangle, because at least in the *CME* and *Lauder* cases the claims were being brought under two separate treaties and therefore there were two separate international wrongs at play (granted, both claims arose out of the same set of governmental actions, but that fact, by itself, is not determinative because the wrongs committed, and therefore the legal injury suffered, was separate). In the subrogation context, however, not only are the underlying governmental actions the same, the wrong committed – breach of the ***same*** BIT – is also identical.

Further, in this regard, the only treaty which appears to contain a sophisticated solution to the problem of multiple claims is the North American Free Trade Agreement (NAFTA). NAFTA separates claims by shareholders from claims by the project enterprise and provides that, before a shareholder brings a claim for reflective loss, the project enterprise must waive its own claim for damages.[67] It also protects the rights of the creditors to the project enterprise by ensuring that any damages

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66 *CME*, *supra* note 65 at para 434.

67 *NAFTA*, art. 1121.

recovered by an action brought on behalf of the company are paid to the company and not to the sponsor/shareholder.[68]

3.2. Special case of ECT

As explained in chapter 2, under subrogation provisions of all BITs, investors receiving the insurance coverage must be incorporated in the same state as the insurer providing the guarantee. Thus, if a German insurer provides insurance to a French investor who makes an investment in Ghana, then the German insurer cannot rely on the subrogation provisions of the France-Ghana BIT. Normally, this is not a problem because State sponsored insurers only provide insurance to nationals of that State. However, in complex project finance transactions, it is often seen that a consortium of ECAs provides guarantees to a large number of entities (usually banks) that are not necessarily incorporated in the territory of any of the ECAs that are part of the consortium. In such cases, a BIT concluded by the home State of that ECA will not be of any benefit to the ECA, except if that State is a signatory to the ECT.

Under Article 15 of the ECT's subrogation provisions, all that the insurer has to establish to be able to step into the shoes of the investor is that:

(a) it is either a Contracting Party or a "designated agency" of a Contracting Party to the ECT; and

(b) it has made payment under an indemnity or guarantee given in respect of an investment of the type envisaged in the ECT to an investor in the host State.

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68 *Id.*

There is no legal authority as to what is meant by a "designated agency" in the context referred to in (i). The ECT Secretariat also does not maintain a list of designated insurers. But it is evident that the intention behind this clause is to cover national agencies that provide insurance coverage, such as the ECAs. Protected investments, referred to in (ii) above, are investments associated with "Economic Activity in the Energy Sector",[69] which includes the extraction, refining, production, storage, land transport, distribution, trade, marketing or sale of "Energy Materials and Products".

The important point about the ECT, however, is that there is no requirement in the treaty that the insurer and the investor must have the same nationality. As long as both of them – the insurer and the investor – are nationals of one of the 51 ECT states, the insurer is entitled to rely on the ECT's subrogation provision. In other words, if JBIC (the Japanese ECA) insures a British investor who invests into a Turkish project, then, upon making insurance payments to the British investor, JBIC can step into the shoes of the British investor and sue the Turkish government for breach of ECT protections.

3.3. Special case of MIGA

As explained in chapter 2, unlike national insurers, MIGA cannot benefit from subrogation clauses in BITs, Instead, MIGA can rely on the subrogation clause contained in the MIGA Convention. Specifically, article 18 of the Convention states that upon paying or agreeing to pay compensation to a holder of a guarantee MIGA "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 State and other obligors". The

69 *See ECT*, art. 1(5).

article goes on to say that the rights of MIGA pursuant to this section "shall be recognized by all members".

The forum for MIGA to enforce such rights is ad hoc arbitration pursuant to Annex II of the MIGA Convention. Indeed, MIGA is required to utilize this forum because article 57(b) of the Convention states that "[d]isputes concerning claims of the Agency acting as subrogee of an investor shall be settled in accordance with . . . the procedure set out in Annex II of [the] Convention". MIGA will be permitted to invoke BIT rights in any such arbitration because the law applicable will be the "applicable rules of international law, the domestic law of the member concerned as well as applicable provisions of the investment contract".[70] The reference to "rules of international law" clearly encompasses the host State's treaty obligations under an applicable BIT. Thus, by consenting to arbitration, the host State also consents to the enforcement of the investor's BIT rights by MIGA.

Moreover, it is not open for the host State to object that BIT obligations may only be enforced through the fora established under the BIT (as opposed to arbitration under Annex II of the Convention). This is because BITs rarely contain exclusive dispute resolution clauses. In contrast, treaties such as those negotiated under the auspices of the WTO do contain exclusive dispute resolution clauses.[71] Moreover, if

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[70] Article 4(g) of Annex II to the MIGA Convention.

[71] *See* e.g., Article 23 of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes:

> 1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding.
>
> 2. In such cases, Members shall:

the host State refuses to accept MIGA's ability to enforce BIT rights through binding arbitration, it would be in breach of Agreements on Legal Protection concluded between MIGA and the host State.[72] This is because national political risk insurers, who have access to binding arbitration to enforce rights that they obtain as subrogees, would receive more favorable treatment than MIGA.[73]

3.4. Special case of ICSID

Investment treaties usually contain two types of dispute resolution clauses: investor-State dispute resolution clause (for disputes between foreign investors and the host State) and State-to-State dispute resolution (for disputes between home States and host States). As explained above, subrogation clauses found in IIAs only apply to State-owned or State-controlled insurers. Whether or not the insurer, as subrogee of a guaranteed investor, can invoke the investor-State dispute resolution clause or the State-to-State dispute resolution clause would depend primarily on the type of functions the insurer is performing. Where it exercises commercial functions rather

a. not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding;

b. follow the procedures set forth in Article 21 to determine the reasonable period of time for the Member concerned to implement the recommendations and rulings; and

c. follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time.

[72] These agreements are concluded pursuant to Article 23(b)(ii) of the MIGA Convention.

[73] These agreements ensure that MIGA has the same rights that a government owned political risk insurer would have against the Host State under a BIT or an Investment Incentive Agreement.

than governmental functions, it will be treated as being separate to the host State and will therefore be able to bring a claim under the treaty's investor-state clause. Otherwise, it will be regarded as part of the State and would have to rely on the State-to-State dispute resolution clause.[74] Because ECAs typically provide assistance only in those situations where the private sector is unwilling or incapable of acting, it is arguable that all functions performed by ECAs are essentially of a governmental nature. The line between commercial and governmental functions, however, has not been drawn very clearly by tribunals that considered this issue,[75] and much will depend on the specific facts of the transaction.

Irrespective of whether the insurer is a State agency or the State, it will not be able to bring a claim at ICSID. That remains the case even if the insured investor may itself be entitled to resort to ICSID arbitration against the host State. During the negotiation of the ICSID Convention, the possibility was discussed of ICSID's arbitration facilities being made available to a governmental or inter-governmental (like MIGA) subrogee of a private investor on the basis of an ICSID clause between the investor (or his home State) and the host State.[76] In fact, successive drafts of the

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[74] *See* M. Feldman, *State-Owned Enterprises as Claimants in International Investment Arbitration*, 31 ICSID Review 1, 24-35 (2016) (discussing whether investor-State dispute settlement clauses o are available to State Owned Entities (SOEs) as claimants when acting in a governmental capacity and, if not, how to distinguish commercial from governmental conduct by SOEs); *see also CSOB v. The Slovak Republic*, ICSID Case No.ARB/97/4, Decision on Jurisdiction (1999) (noting that a SOE can submit a claim under the treaty's investor-State dispute resolution clause, rather than the State-to-State dispute resolution clause, as long as its activities are commercial in nature).

[75] *See*. *e.g.*, *HEP v Slovenia*, ICSID Case No. ARB/05/24 (2015) (involving a claim brought by the Croatian national electricity company against Slovenia under the ECT and a bilateral treaty between Slovenia and Croatia); *CDC v Seychelles*, ICSID Case No. ARB/02/14 (2015) (claim brought by UK Government owned entity established for the purposes of making investments in developing countries); *CSOB v. The Slovak Republic*, ICSID Case No.ARB/97/4, Decision on Jurisdiction (1999) (discussed above).

[76] *See* Aron Broches, SELECTED ESSAYS, WORLD BANK, ICSID, AND OTHER SUBJECTS OF PUBLIC AND PRIVATE INTERNATIONAL LAW 167 (Martinus Nijhoff & Publishers, 1995); s*ee also* Christoph

Convention contained provisions that would have enabled ICSID to administer disputes involving as subrogee a State or "public international institution".[77] For example, the Revised Draft of the Convention, submitted to the Executive Directors of the World Bank in late 1964, provided that[78]

> Notwithstanding the provisions of paragraph (1) of Article 25, a Contracting State which has consented to submit to the Centre a dispute with a national of another Contracting State may, at the time of such consent or at any time thereafter, consent to the substitution for such national, in proceedings in accordance with the provisions of this Convention, of the State of which he is a national or of a public international institution if such State or institution, having satisfied the claim of such national under an investment insurance scheme, is subrogated to the rights of such national; provided, however, that such consent may be withdrawn at any time before the State or institution shall have notified to the other State in respect of such dispute its written undertaking (a) to be bound by the provisions of this Convention in the same manner as such national and (b) to waive recourse to any other remedy to which it might otherwise be entitled.

Despite the option to withdraw consent, several developing countries expressed the concern that such a clause would lead to politicization of disputes at the Centre and was therefore contrary to one of the principal objectives of the Centre.[79] As a result, the drafters decided to remove the clause altogether from the final text of the Convention. That act is a clear indication of the drafters' intention to not permit State sponsored insurers from pursuing claims at the Centre. In fact, Christoph Schreuer's Commentary on the ICSID Convention clearly states that such claims are not permitted at the Centre and provides the following reasons for it[80]:

Schreuer et al., THE ICSID CONVENTION: A COMMENTARY 186-7 (Cambridge University Press, 2009). [Hereinafter, *Schreur's commentary*].

77 *Id.*

78 *Id.*

79 *Id.*

80 *Schreuer's commentary, supra* note 76.

> Can a State, a State agency administering [an] investment programme, or an international investment insurance organization become party to ICSID proceedings after having compensated the investor? The answer is clearly no. There are three main reasons for the denial of party status:
>
> (a) The Convention provides for the settlement of disputes between States and nationals of other States. The clear wording of Art. 25(1) cannot be re-interpreted to cover disputes involving States, State agencies or international organizations on the investor's side.
>
> (b) One of the Convention's objectives is to depoliticize disputes. This objective is expressed most clearly in Art. 27 prohibiting diplomatic protection in favour of the investor. This purpose would be defeated if the investor's State of nationality were to be given standing before the Centre.
>
> (c) The Convention's *travaux préparatoires* show unambiguously that a conscious decision was made to exclude States, State agencies or international organizations from access to ICSID proceedings on the investor's side.

However, it is still open to an insurer who had indemnified an investor to require that investor to pursue remedies at the Centre on behalf of the insurer. In this regard, ICSID Model Clause provides that[81]:

> If such a governmental or intergovernmental agency indemnifies an investor, the agency will normally become subrogated to the investor's rights. The agency may nevertheless be unable to avail itself of such agreement providing for the resolution of disputes under the Convention as may originally have been concluded between the investor and the host State. This is so because ICSID's facilities are not available for proceedings between governmental entities or between governments and intergovernmental organizations. It may therefore be necessary that in any dispute the proceeding be conducted by the investor. The following clause may be used to cover this situation.
>
> Clause 8
>
> It is hereby agreed that the right of the Investor to refer a dispute to the Centre pursuant to this agreement shall not be affected by the fact that

[81] ICSID Model Clauses, available at: http://icsidfiles.worldbank.org/icsid/icsid/staticfiles/model-clauses-en/main-eng.htm.

> the Investor has received full or partial compensation from any third party with respect to any loss or injury that is the subject of the dispute [provided that the Host State may require evidence that such third party agrees to the exercise of that right by the Investor].

4. Conclusion

Subrogation is key to understanding the interaction between BITs and PRI schemes. Without subrogation rights, BITs are of little relevance to political risk insurers. That is why this chapter focussed on subrogation. Specifically, section 2 considered subrogation at the domestic and the international levels. At the domestic level, the chapter focussed on English law as that is one of the most advanced bodies of law in this area. By contrast, at the international level, there is virtually no direct guidance on this issue.

Having identified some of the general principles pertaining to the issue of subrogation under English law and international law, section 3 of this chapter analysed textual differences between subrogation clauses of the various BITs. Although on their face, all treaties appear to provide for the same subrogation rights, there are real differences, which can have a determinative effect on a claim brought by an insurer. In particular, treaties differ in who gets the protection (for example, the Contacting State itself, one of its designated agencies, private insurers etc), the scope of coverage (for example, whether the only political risk insurance policies are covered, or any type insurance policy is covered), rights of the investor (i.e., is the investor entitled, despite subrogation, to bring its own claim) and rights of home state (for example, can the home state also bring a claim). Finally, section 3 considered the special cases of MIGA, ECT and ICSID.

This chapter made three principal contributions. First, it has identified key principles underpinning the law of subrogation under both domestic (English law) and international law. It is not without relevance that these principles tend to be similar because, as noted above, it is likely that when a tribunal is faced with a subrogation related it would have to draw upon the vast jurisprudence that is available on this issue in domestic systems. The technique that the tribunal must apply to achieve that objective, however, is not clear. The chapter considered the technique of using general principles of law and the usefulness of drawing analogies from domestic law. It may also be possible to look at the law governing the insurance contract and rely on that law in particular to guide the tribunal's analysis. Second, this chapter identified the key issues that are likely to arise when applying subrogation clauses and offered a few solutions. As noted above, there is not yet a single treaty case that has had to apply subrogation clauses. Nevertheless, given the frequency with which such clauses appear in treaties, it is likely that sooner rather than later tribunals will have to consider these clauses. And at that occasion, the analysis presented in this chapter should prove valuable.

Finally, this chapter has laid the foundations that will guide the analysis in future chapters. For example, the next chapter considers the extent to which decisions of political risk insurers might contribute to the creation or development of international law. Without a sound understanding of how subrogation works under international law, it would not have been possible to understand the context in which political risk insurers reach those decisions or, for that matter, the context in which those decisions apply to treaty arbitration.

CHAPTER 4: POLITICAL RISK INSURANCE POLICIES AND INTERNATIONAL LAW

1. Introduction

Chapter 3 explained how the principle of subrogation works in the context of investment treaty arbitration. It also explained what effect that principle has on the rights of the various stakeholders, i.e. the investors, the insurers and the host State governments. It concluded that

subrogation rights are crucial to insurers. In the absence of such rights, investment treaties are of little relevance to insurers. In particular, without them, it would be very difficult for insurers to recover compensation from the host States.

However, from an insurer's perspective, having subrogation rights in treaties are not sufficient. Insurers need to actively design their policies and claim determination processes in a way that makes them more amenable to the use of subrogation rights. This can be explained by dividing the entire claim determination process into its four logical steps: first, the investor buys a political risk insurance ("PRI") policy to insure its investment; secondly, the host State government adopts certain adverse measures that lead the investor to make a claim under the policy; thirdly, the insurer, after reviewing the claim, makes a determination as to whether those measures do in fact fall within the purview of the policy and, accordingly, the insurer decides to award compensation to the investor; and finally, having indemnified the investor, the insurer "steps into the shoes" of the investor and seeks compensation from the host government via the dispute resolution provision of the investment treaty or under a specially agreed procedure (as in the case of MIGA or OPIC).

On the surface, it might appear that, of the four steps described above, the first three steps depend solely on the insurance policy and the treaty is of little relevance (except that, as explained in Chapter 2[1], the availability of the insurance and the premium that the investor has to pay for it might vary depending on whether the investment in question is protected under a treaty). Similarly, it might appear that the fourth step is completely dependent on the treaty and the insurance policy is of little relevance (except that, again as noted in chapter 3,[2] the insurance policy may be relevant in respect of certain procedural questions; for example, identity of the claimant, the level of cooperation that investor is required to provide etc).

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1 *See supra* Ch. 2, s.2.7.

2 *See supra* Ch. 3, s.3.

However, in reality, both the treaty and the insurance policy are relevant at all four stages. In fact, from the perspective of the insurer, for the treaty's subrogation rights to have any meaning, it is crucial that even at the first three stages due regard is paid to the text of the applicable investment treaty and any award issued under that treaty.

This can be illustrated by an example. Let us consider that a British investor decides to invest in the gold mining sector in Mongolia. There is a BIT between the UK and Mongolia[3]. However, in order to be extra cautious, the British investor decides to buy a PRI policy from ECGC, UK's main PRI provider.[4] A few years after the investment is made, the Mongolian government introduces a windfall profit tax on gold mining.[5] Under the new law, all companies have to pay 70% tax (as opposed to 40% tax under the former regime) to the government on profits made from gold mined in Mongolia. This has a significant impact on the investor's profitability. As a result, it decides to bring a claim for 'indirect expropriation' under the insurance policy.[6] ECGC's policy protects against expropriation;[7] let us assume that the insurer finds that the imposition of the windfall tax constitutes indirect expropriation for which the investor must be compensated $100 million (that is the maximum sum recoverable under the policy).[8] After the investor has been indemnified, the ECGC/investor decides to bring a claim against Mongolia under the subrogation provision of the UK-Mongolia BIT to recover the losses that the investor has suffered.[9] At the stage, there are two possibilities.

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3 UK-Mongolia BIT (1991).

4 Available at: https://www.gov.uk/government/organisations/uk-export-finance.

5 This fact pattern is based loosely on the facts of *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. The Government of Mongolia*, UNCITRAL (2011) [hereinafter, *Paushok v. Mongolia*].

6 On the relationship between taxation measures and claims for expropriation, see generally Ali Lazem,IliasBantekas, *The Treatment of Tax as Expropriation in International Investor-State Arbitration*, Arb. Int'l (2015).

7 Available at: https://www.gov.uk/government/organisations/uk-export-finance.

8 As explained in ch. 8, s. 3.5, PRI policies compensate up to the maximum insured limit only.

9 UK-Mongolia BIT (1991), at art. 10.

First, the investment tribunal might find against Mongolia and award compensation to ECGC/investor. Alternatively, the tribunal might find that the new tax does not amount to indirect expropriation because, say, the investor continues to enjoy control of its investment, nor has the investor been treated unfairly/inequitably because no assurances were given to the investor that the tax regime which existed at the time of making the investment would not change.[10]

In the former case, provided that the compensation is equal to or exceeds $100 million, ECGC would recover the sums it paid out to the investor. However, in the latter case, ECGC would fail to recover anything and may in fact be left with the additional bill relating to the costs of the arbitration.[11] Crucially, this failure would be the direct result of two inconsistent rulings in respect of the same matter – whilst ECGC found indirect expropriation, the treaty tribunal did not. In theory, there is no problem with that inconsistency – it is perfectly plausible that the same event might breach the terms of a contract, but not the terms of a treaty.[12] It depends on the wording and the law applicable to the contract and the treaty. From the perspective of the insurer, however, it makes sense to try to reduce the possibility of this

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[10] *See, e.g., Paushok v Mongolia, supra* note 5 (tribunal found that the windfall profit tax introduced by Mongolia was compatible with the FET standard under the Mongolia-Russia BIT); *See also,* the three Ecuadorian cases that considered whether a windfall tax on oil production (the so-called 'Law 42') breached protections contained in France-Ecuador and U.S. – Ecuador BITs: *Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador),* ICSID Case No. ARB/08/6 (2009); *Burlington Resources Inc. v. Republic of Ecuador,* ICSID Case No. ARB/08/5 (2009) and *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador,* ICSID Case No. ARB/06/11 (2012).

[11] As explained in chapter 8 below, PRI policies require the investor to assist the insurer in recovering its losses, including by prosecuting any treaty claims; however, in such cases, the insurer pays the investor's litigation expenses.

[12] In fact, tribunals have issued inconsistent awards even in the context of different treaties, let alone a contract and a treaty. *See, e.g., Lauder v. Czech Republic,* Final Award (2001) (UNCITRAL) and *CME Czech Rep. B.V. v. Czech Republic*, Partial Award, (Sept. 13, 2001) (the CME tribunal held there was a treaty violation because the Czech Republic frustrated the arrangements on which the investor relied when making its investment. The Lauder tribunal, on the other hand, held there was no inconsistent conduct amounting to unfair and inequitable treatment.) For commentary on the 'Lauder' cases, see, e.g., Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 Fordham L. Rev. 1521 (2005).

inconsistency because the greater the prospects of inconsistent decisions, the higher the risk that the insurer will not be able to recover the sums it has paid to the investor.

There are several ways in which the insurer could try to reduce this inconsistency. At its most extreme, the insurer could amend its policies to say that only those events that would constitute a breach of the applicable treaty will constitute covered events under the policy. At present, as explained in Chapter 2,[13] in order to prove expropriation under the OPIC policy (and many other insurance policies), the investor has to satisfy both the contractual criteria and show a breach of international law. A simple treaty based test would mean that the investor would not have to satisfy two separate criteria. It will also mean that the investor can rely on investment treaty law to assess the usefulness of the policy and the strength of its claim.

However, there are also several downsides to that approach. Investment treaty protections are vague and broad, particularly in the old-generation BITs.[14] By linking insurance policies to investment treaties directly, insurers risk transposing the same vagaries and breadth into their policies. Moreover, as noted in Chapter 2[15], investment treaties and insurance policies do not contain the same protections (whilst both instruments promise compensation in case of expropriation, there are several guarantees that are typically found in a treaty – such as 'full protection and security' and 'fair and equitable treatment' standards – that are missing in insurance policies).

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13 *See*, Ch.2, s. 2.8.

14 For instance, in the context of NAFTA, various commentators have noted that provisions of Chapter 11 are excessively broad and uncertain. *See* CONSTITUTIONALIZATION THROUGH THE BACK DOOR: A EUROPEAN PERSPECTIVE ON NAFTA'S INVESTMENT CHAPTER, 34 N.Y.U. J. INT'L L. & POL. 1, 4 (2001); J. Dhooge, *The North American Free Trade Agreement and the Environment: The Lessons of Metalclad Corporation v. United Mexican States*, 10 Minn. J. Global Trade 209, 283 (2001); Daniel M. Price, *NAFTA Chapter 11 Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 Can.-U.S. L.J. 107, 109 (2001); see also Bernardo M. Cremades & David J.A. Cairns, *The Brave New World of Global Arbitration*, 3 J. World Invest. 173, 194-95 (2002) (looking at the standard for expropriation and noting how the breadth of the standard creates uncertainty).

15 *See*, ch. 2, s. 2.5.2.

Given these difficulties, the more logical step to take, it would appear, is to require that in case of those events that are covered under both investment treaties and PRI policies (such as uncompensated expropriation), the investor must show breach of international law. In fact, OPIC and MIGA's insurance policies already provide for this.[16] But if the investor must show a violation of international law in order to recover under the policy, it raises questions about how international law is actually interpreted and applied by the insurer. That is important because by simply referring to international law in the policies, insurers cannot be certain that there will be no inconsistency in their claim determination process and any award issued by a BIT tribunal. In fact, if anything, the case of *CMS v Argentina*,[17] which is discussed below, shows the opposite.

This chapter, therefore, considers the manner in which OPIC applies international law in its determinations. As before, the focus is on OPIC because that is the only insurer with a large corpus of publicly available determinations. Nevertheless, wherever possible, reference is made to MIGA and other insurers and their claim determination processes. This chapter is structured as follows. Section 2 discusses OPIC standard form contracts and how they have evolved over the years. Here, the focus is specifically on the expropriation provision in the OPIC contracts as that is one provision for which there is a direct counterpart available in investment treaties. Section 3 discusses OPIC Incentive Agreements, which are effectively bilateral agreements that the U.S. government has concluded on behalf of OPIC with governments of various countries. Because the U.S. has signed such agreements, which facilitate OPIC's efforts to recover sums paid to investors under insurance policies, U.S. bilateral investment treaties do not contain subrogation rights for OPIC.[18] In any event, the

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16 *See supra* Chapter 2, s. 2.8.

17 *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (2005).

18 *See supra* Ch. 2,s. 2.8.

importance of international law remains paramount because OPIC Incentive Agreements too require a showing by the U.S. government that the host government's actions were in violation of international law. Section 4 discusses how OPIC applies international law in its determination. In particular, it reviews certain expropriation related determinations made by OPIC. This review finds that of all the sources of international law on which OPIC relies, maximum reliance is laid on the Restatement (Second) of the Foreign Relations Law of the United States (the "Restatement (Second)") and Restatement (Third) of the Foreign Relations Law of the United States (the "Restatement (Third)") (together, the "Restatements"), which in turn raises questions regarding the 'inward looking' approach that OPIC has adopted in its claim determination process. Finally, section 5 concludes by reiterating the important points discussed in this chapter and laying the ground for the chapter to follow.

2. OPIC contracts

This section introduces OPIC standard form contracts and discusses their evolution over the years. As noted above, the focus is on OPIC because that it is one of the few insurers that make their standard form contracts public; MIGA being the other insurer that does the same. However, unlike MIGA, OPIC also makes available the determinations it has made in respect of claims filed by investors. Those determinations will be reviewed in section 4 of this chapter. Also, within OPIC contracts, the focus is on the expropriation clause because of the ease of comparison with investment treaties.

2.1. An introduction to OPIC standard form contracts

OPIC provides insurance against three basic political risks: expropriation, political violence and currency inconvertibility.[19] To provide such insurance, OPIC relies on standard form contracts. These contracts, which must conform with the broadly defined provisions of the

[19] *See supra* Ch. 2, s. 2.5. Though, in certain limited cases, OPIC can extend insurance for breach of contract as well. *Id*.

U.S. Foreign Assistance Act of 1969,[20] can be revised by OPIC at any time depending on its business needs. If the changes to be made are minor, OPIC simply revises existing standard form contracts. However, if there are major changes to be made, OPIC may adopt a new contract, replacing all previously applicable contracts. In its over 40 years of existence, OPIC has only once adopted a new contract. In 1985, OPIC replaced the contract type 234 KGT 12-70 - which was adopted at OPIC's inception - with contract type 234 KGT 12-85.[21] Even though contract type 234 KGT 12-85 has undergone several minor revisions since 1985, with the most recent revision made in February 2009, it continues to be the model used by OPIC to draft all its insurance policies.

Contract type 234 KGT 12-85 is OPIC's most basic standard form contract providing coverage for expropriation, political violence and currency inconvertibility. In addition to the basic contract, OPIC uses a number of other standard form contracts, including special contract forms for coverage of loans, leases and oil and gas exploration projects.[22] Moreover, OPIC has the flexibility to, and often does, tailor the standard form contract according to the specifics of the project to be insured, provided any changes made fall within the provisions of the U.S. Foreign Assistance Act of 1969.[23] This Chapter only discusses the recent version of OPIC's basic contract – contract type 234 KGT 12-85 (rev. Feb. 2009), referred to hereinafter as simply the "OPIC Contract" – except when previous standard versions or project specific

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[20] Foreign Assistance Act of 1969 is OPIC's enabling statute. *See* Ch. 1, s. 3.1.

[21] *See* Notice of Adoption of Form Contract 234 KGT 12-85, 51 F.R. 3438 (1986). The new form contract (234 KGT 12-85) only applies to those investors who purchased policies from OPIC after 1985. Those who entered into insurance contracts in 1985 or before are subject to the old contract (234 KGT 12-70), though OPIC allowed some investors to substitute the new contract for their old ones. *Id.*

[22] Based on OPIC's website and Notice of Adoption of Form Contract (1985) [hereinafter, *OPIC contract*].

[23] For example, even though the insurance contracts at issue in the AAA arbitration between the Sponsors of the Dabhol Power Project and OPIC were standard form contracts of the type 234 KGT 12-85, they contained several additional provisions. In particular, the contracts included Sections 10.5 and 10.7 on local remedies that became central to the resolution of the dispute. *See* Ch. 6, s. 3 and accompanying text, discussing *Bechtel Enter. Int'l, et al. v. OPIC*, AAA Case No. 50 T1950050902 (2003).

versions contained important expropriation related provisions, in which case specific mention to the relevant contract type will be made.

2.2. Expropriation provision in OPIC contracts and evolution over the years

The Article concerning expropriation in the OPIC Contract is divided into two sections - "total expropriation" (section 4.01) and "expropriation of funds" (section 4.02).[24] In most cases, OPIC does not insure against partial expropriations.[25] An expropriation of a portion of the insured investment, or an action which partially impairs the investor's rights in the investment, is covered only if it meets the requirements for "total expropriation." To establish a *prima facie* claim for expropriation, OPIC requires the investor to show: (a) actions complained of are legally attributable to the government or a subdivision of it ("governmental nexus"); (b) such actions are illegal under local or international law ("international law renvoi"); (c) the illegal governmental actions directly deprive the investor of "fundamental rights" in the investment ("deprivation of fundamental rights"); and (d) the expropriatory effect continues for one year ("waiting period").[26]

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[24] *OPIC Contract*, *supra* note 22, s. 4.02, provides that: "Compensation is payable for an expropriation of funds that constitute a return of the insured investment or earnings on the insured investment (section 5.02) if an act or series of acts:(a) [s]atisfies the governmental action, illegality and duration requirements (section 4.01 (a), (b) and (d)); and (b) [d]irectly results in preventing the Investor from: (1) Repatriating the funds; and (2) Effectively controlling the funds in the country in which the project is located". A typical example of a situation in which an investor would benefit from the "expropriation of funds" coverage is when the host government unlawfully blocks funds intended to be remitted as returns of the insured investment or earnings on it. In such circumstances, OPIC would compensate the investor in an amount equal to the funds that have been blocked by the host government. "Expropriation of funds" is the only form of partial expropriation coverage offered by OPIC: in case of total expropriation, prior to receiving compensation from OPIC, the investor must assign to OPIC all of its interest in the project attributable to the insured investment, *Id.* at s. 8.02; however, in case of expropriation of funds only, the rights assigned to OPIC are only those related to the proceeds. *Id.* at s. 5.02. Because coverage for expropriation of funds is effectively a variant of the currency inconvertibility coverage, I discuss it along with currency inconvertibility coverage under Chapter IV, rather than discussing it here under expropriation coverage.

[25] *See* Notice of Adoption of Form Contract 234 KGT 12-85, 51 F.R. 3438, 3441 (1986). The only situation in which OPIC covers partial expropriation is in case of expropriation of proceeds from the insured investment. *See supra* note 7.

[26] OPIC Form 234 KGT 12-58, s. 4.01(a).

There are two important points about the formulation of expropriation coverage under the OPIC contract that are worth discussing. First, on the surface, the new form contract (234 KFT 12-85) appears to be very different to the old form contract (234 KFT 12-70) (as noted above, the old firm contract was in force between 1970 and 1985). For example, the old form referred to, and defined, the term "expropriatory action" and not "expropriation".[27] The old contract also contained definitions for related terms, such as "investment"[28] and "government of the project country".[29] The new contract, however, does not contain such definitions. Instead, it takes a more flexible approach, defining very few terms and therefore leaving it up to OPIC to define remaining terms in agency rulings.[30] Moreover, in an attempt to "simplify the standard OPIC contract and make it more readable", the new form contract reorganises the clauses along functional lines, such that all clauses relevant to a particular type of coverage are grouped together, making it easier to locate specific provisions.[31]

Despite these changes, OPIC has stated that the new form provides "materially the same coverage as the previous OPIC contracts."[32] This statement is important because it suggests that the omission of certain provisions from the old contract was more to do with the OPIC's desire to make its contracts simpler, rather than an underlying change in policy.[33] For

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27 Compare OPIC Form 234 KGT 12-58, s. 4.01(a) and OPIC Form 234 KGT 12-70, art. 1.13.

28 OPIC Form 234 KGT 12-70, s. 1.18.

29 OPIC Form 234 KGT 12-70, s. 1.16.

30 The previous OPIC contract began with Article I, titled "Governing Terms and Conditions", which contained definitions for 33 "governing terms" In the new contract, that Article has been omitted. While some definitions have been eliminated as "unnecessary," others have been incorporated into the substance of the relevant contract provisions. *See* Notice of Adoption of Form Contract 234 KGT 12-70, 51 F.R. 3438, 3439 (1986).

31 Notice of Adoption of Form Contract 234 KGT 12-85, 51 F.R. 3438 (1986).

32 *See id.*

33 Pablo M. Zylberglait, *OPIC's Investment Insurance: The Platypus of Governmental Programs and Its Jurisprudence*, 25 Law & Pol'y Int'l Bus. 359, 369 (1993) [hereinafter, *Zylberglait, OPIC's Investment Insurance*].

this reason, OPIC's determinations on cases under the old contract are important indicators of OPIC's policies, and will therefore form part of the analysis presented here.

The second important point about the definition of expropriation coverage under the OPIC contract is that it is significantly different to the corresponding definition found under OPIC's enabling Act, the Foreign Assistance Act of 1969 (the "Act"). Section 238 of the Act states that:

> the term "expropriation" includes, but is not limited to, any abrogation, repudiation, or impairment by a foreign government, a political subdivision of a foreign government, or a corporation owned or controlled by a foreign government, of its own contract with an investor with respect to a project, where such abrogation, repudiation, or impairment is not caused by the investor's own fault or misconduct, and materially adversely affects the continued operation of the project[.][34]

The Act's definition of expropriation is broader than the language used by OPIC in its contracts. Firstly, the statutory definition quoted above considers a breach of State contract by the host government, without more, to be expropriation. However, OPIC does not offer insurance for breach of contract, except in limited cases such as construction contracts.[35] Secondly, the Act considers any governmental act that "materially adversely effects" the investment as an expropriatory act. Even though the Act does not provide any guidance as to what is meant by the term "materially," it could definitely be read to imply that the statute covers even partial expropriations.[36] Nevertheless, OPIC has consistently taken the stand that it will only provide coverage for "total expropriation", and nothing less.[37]

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34 Definitions, 22 U.S.C. s. 2198(b) (2003).

35 In fact, an important difference between OPIC's and MIGA's political risk insurance schemes is that MIGA, unlike OPIC, provides coverage for breach of contract. *See supra* Chapter 2, s. 2.5.

36 *See* Vance R Koven, *Expropriation and the "Jurisprudence" of OPIC*, 22 Harv. Int'l L. J. 269, 281 and n.54 (1981) (noting that "[t]he phrase 'materially adversely affects' in the statute can certainly be read as authorising the agency to cover partial expropriation") [hereinafter, *Koven, Expropriation*].

37 *See* OPIC Contract, s. 4.01.

OPIC's decision to not afford expropriation coverage under its contract to the full extent authorised by the Act has sparked some controversy. In particular, investors have demanded broader coverage (in line with the statutory authorization) and academics and policy-makers have argued that, by not fully implementing the Act, OPIC may be acting in breach of its federal mandate.[38] Nevertheless, OPIC has not given into such demands, arguing that the Act is merely enabling in nature and therefore affords OPIC the flexibility to fashion insurance policies that are less broad than the statutory language.[39] In particular, OPIC has taken the position that providing expropriation coverage only to the extent it presently does is consistent with sound "principles of risk management."[40] Even though there have been no judicial decisions settling the interpretation questions under the Act, OPIC's position is somewhat strengthened by the fact that, despite having been made aware of the inconsistency between the Contract and the Act, the Congress has decided to not take any action. In fact, the Executive has requested the Congress, on at least one occasion, to amend the expansive definition of expropriation contained in the Act.[41] Congress, however, declined to accede to the Executive's proposal, finding the amendment to be "unnecessary".[42]

2.3. Reference to "International Law" in OPIC contracts

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38 *See* Goekjian, *A Critical Appraisal of United States Investment Guaranty Programs*, *in* INTERNATIONAL FINANCING AND INVESTMENT 127, 139 (J. McDaniel ed. 1964).

39 *Id.; see also Koven, Expropriation, supra* note 36 at 281 and n.54 (1981).

40 *See, id.;* The Foreign Assistance Act requires OPIC to follow "principles of risk management" in conducting its business. Specifically, 22 U.S.C. s. 2198(a) (4) provides that: "In carrying out its purpose, [OPIC], utilizing broad criteria, shall undertake — (d) to conduct its insurance operations with due regard to principles of risk management including efforts to share its insurance and reinsurance risks."

41 *See* Adams, *The Emerging Law of Dispute Settlement under the United States Investment Insurance Program*, 3 Law & Pol. in Int'l Bus. 101, 149 (1971) (noting that in 1969, the Executive requested the Congress to amend section 2198(b) to provide expropriation "may include" breach of contract by host government, rather than expropriation "includes" breach of contract. This change, the Executive argued, would make it clear to investors that Contract definition of expropriation could, and most probably would, be more limited than the statutory definition.)

42 *Id.*

The Foreign Assistance Act is unique in the sense that it is the only federal statute in the U.S. that defines expropriation. All other statutes that refer to the concept of expropriation do not attempt to define it and instead require courts to do the heavy lifting.[43] Yet, no U.S. court has ever relied on the Act's definition in determining whether there has been an expropriation under U.S. law.

Interestingly, in defining expropriation, the Act does not make any reference to the international law on expropriation. Indeed, OPIC's earliest contracts also did not refer to international law. They typically insured against "expropriatory action," defined as including any action by the foreign government that for a period of one year directly results in preventing the investor from exercising its "fundamental rights" in, or "effective control" over, the investment.[44] The contacts nevertheless went on to deny coverage for governmental regulation that did not violate international law.[45]

The current standard contract, adopted in 1986, defines expropriation explicitly in terms of international law. But rather than simply relying on customary international law, OPIC has added its own twist to the expropriation provision. The contract defines "Total Expropriation" as "violations of international law ... or material breaches of local law" that "directly deprive the Investor of fundamental rights in the insured investment (Rights are

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43 *See, e.g.*, Treatment of recoveries of foreign expropriation losses,26 U.S.C. §1351(b) (2006) (defining "foreign expropriation loss" for tax purposes), and Foreign Sovereign Immunities Act, 28 U.S.C. §1605(a)(3) (2006) (limiting immunity of foreign states in expropriation claims), and Second Hickenlooper Amendment, 22 U.S.C. §2370(e)(2) (2006) (prohibiting federal courts from relying upon the act of state doctrine in case of expropriation claims), and First Hickenlooper Amendment, 22 U.S.C. §2370(e)(1) (2006) (prohibiting foreign assistance to state that has expropriated U.S. property).

44 OPIC model contract §1.13, *quoted in Koven, Expropriation, supra* note 36 at pp. 321-22.

45 *Id*. at 322 (excluding "any law, decree, regulation or administrative action ... which is not by its ex-press terms for the purpose of nationalization, confiscation or expropriation (including ... intervention, condemnation or other taking), is reasonably related to constitutionally sanctioned governmental objectives, is not arbitrary, is based upon a reasonable classification of entities to which it applies and does not violate ... international law").

'fundamental' if without them the Investor is substantially deprived of the benefits of the investment)" and continue for a year.[46]

OPIC is in fact not alone in requiring that the conduct in question be in violation of international law. Even private PRI providers seem to have a similar requirement in their policies. While it is difficult to get access to private policies because of confidentiality concerns, one of the few policies publicly available define expropriation in terms that are very similar to OPIC, including requiring that the acts constitute "violations of international law".[47] In addition, even MIGA until recently defined expropriation in terms of international law.[48] The new MIGA policies, like the new OPIC policies,[49] however, do not require a violation of international law.[50]

The central role played by international law in OPIC's policies (and in fact policies of other PRI providers) raises many interesting and important questions. To start with, why has OPIC insisted on an international law *renvoi* in its contracts when the Foreign Assistance Act makes no recourse to international law? Moreover, having made that choice, on what sources of international law does and should OPIC rely? These questions are dealt with in the following two sections.

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46 OPIC Form 234 KGT 12-85, §4.01, (a).

47 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 & K. Martin (eds.), International Political Risk Management: Needs of the Present, Challenges for the Future 140 (World Bank Group, Fall 2007).

48 *Id.* at 144.

49 The most recent versions of the OPIC policy do not expressly refer to "international law" or "local law" in their definition of "expropriation". Instead, they simply require that the acts constitute either an "outright taking" or have the "effect of taking the investor's insured investment". Form 234 KGT 12-85 (Revised 2/09) NS, § 4.01(a). Nevertheless, application of customary international law may be required to interpret the term "taking".

50 The most recent version of MIGA's Contract of Guarantee for Equity Investment requires that the acts deprive the investor of its "ownership rights" or "effective control" in "substantial portion" of its investment. See Contract of Guarantee for Equity Investments Between the MIGA and Guarantee Holder, art. 4.1(a).

3. Importance of international law to insurance policies

Section 2 above introduced OPIC standard form contracts, specifically the provision on expropriation. It also explained how the language on expropriation has evolved over the years. Crucially, despite changes being made to the standard form contracts, OPIC standard form contracts continue to, either directly or indirectly, refer to international law. That is, to prevail on an expropriation claim under an OPIC policy, the investor must show that the host State's actions have violated international law. It would appear that this requirement has been introduced mostly to enable OPIC to recover from the host State sums paid to the insured. That is why this section explains the subrogation mechanism of OPIC, which will provide vital backdrop and motivation for the "violation of international law" requirement in OPIC contracts.[51] The latter half of this section, explains how the same requirement is relevant to the functioning of MIGA.

3.1. OPIC Bilateral Incentive Agreements

Typically, after an investor submits an expropriation claim to OPIC, the agency investigates the claim and attempts to facilitate a settlement between the investor and the host government.[52] OPIC's contract requires that the expropriatory effect of government actions must continue for one year and that during this period the investor pursues local remedies,

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[51] Although the OPIC contract provides "material breach of local law" as an alternative to the "violation of international law" requirement, in practice, OPIC has paid very attention to local law. All OPIC determinations that have found expropriation rely on the international law standard. The few instances on which OPIC has discussed the local law requirement, the agency's analysis has had no impact on its final conclusion. *See, e.g., Alliant Techsystems, Inc.-Belarus (1997)* at 7 (after concluding that the actions of the Government of Belarus violated international law, OPIC found that those actions also materially breached the local regime on foreign investments, including a stabilization clause which guaranteed that the laws that were in effect on the date of investment would apply for at least 5years); *Belfinance Haussman – Georgia (2004)* (noting that while transferring the insured's assets to another bank without a public auction violated local laws, this violation was not material because the insured was already insolvent).

[52] *See* John S. Diaconis, *Political Risk Insurance: OPIC's Use of a "Fiduciary Agent" to Facilitate Resolution of Subrogation Claims*, 23 Int'l L. J. 271, 275-6 (1989) [hereinafter, *Diaconis, Political Risk Insurance*].

both judicial and administrative, and cooperates with OPIC.[53] After the one-year waiting period is over, and the investor formally submits a claim application,[54] OPIC carries out an internal claim determination process. At the end of that process, if OPIC decides to pay the investor then, under the insurance policy, the investor must "transfer to OPIC all interests attributable to the insured investment including claims arising out of expropriation."[55] Upon assignment of investor's interests and claims related to the investment, OPIC negotiates recovery of claims with the host government. However, in the event that negotiations fail, the matter may be submitted to arbitration under Bilateral Investment Incentive Agreements ("Incentive Agreements").

An Incentive Agreement, which is typically concluded by the exchange of diplomatic notes between the two governments, refers to the insurance law doctrine of subrogation.[56] As explained in the chapter 3, subrogation is "[t]he principle under which an insurer that has paid a loss under an insurance policy is entitled to all the rights and remedies belonging to the insured against a third party with respect to any loss covered by the policy".[57] Thus, upon payment of the claim, OPIC is subrogated to the rights of the investor; rights that are recognized by the host government under the Incentive Agreement.[58] The U.S. Government can then enforce those rights against the host government, but only to the extent that those

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53 OPIC Form 234 KGT 12-85, §§ 4.01,(d) and 9.01(9). This provision is discussed in detailed in Chapter 8.

54 The investor must file an expropriation claim "within six months" after the one-year waiting period has expired. *Id.*, §8.01(b).

55 *Id.*, §8.02.

56 *See* Robert C O' Sullivan, *Model OPIC Investment Incentive Agreement*, 1 B.D.I.E.L. 665, (1994) (reproducing the Model Incentive Agreement that is sent by the U.S. government to the host government at the start of the negotiations) [hereinafter, *Model OPIC Incentive Agreeement*]; *see also* Mark Kantor, *Arbitration Award May Alter Dabhol Debate*, OGEL 4, at 3 (2003).

57 Subrogation, BLACK'S LAW DICTIONARY (9th ed., 2009).

58 *See Model OPIC Incentive Agreement*, *supra* note 56 art. 3(b).

rights were originally available to the investor.[59] In case of a dispute over the host government's liability, the Incentive Agreement provides a detailed dispute resolution mechanism. Specifically, the Agreement states that the two governments must first try to resolve the dispute through negotiations. If, after six months from the date a government requests such negotiations, no resolution has been reached, then either government may submit the dispute to *ad hoc* arbitration.

Because OPIC operates on a self-sustaining basis at no net cost to the U.S. taxpayers, it cannot afford to provide insurance for projects where there is no hope of recovery. In fact, OPIC is mandated by the Congress to ensure that "suitable arrangements" exist to protect its interests.[60] These commercial and political constraints have led OPIC to insist that it will only operate in those countries that have signed an Incentive Agreement with the United States.[61] At times, this policy has restricted the agency's ability to offer insurance in certain countries. Most notable amongst these are South American countries. States in South America have traditionally endorsed the Calvo Doctrine, which provides that investment disputes between foreign investors and host governments should be resolved in local courts under domestic law.[62] As a result, these countries were opposed to signing Incentive Agreements that, contrary to the principles of the Calvo Doctrine, permit U.S. government to espouse an investor's claim and seek international arbitration against the host government.[63]

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59 *Id.*, art. 3(c). In other words, OPIC or the U.S. government cannot assert rights that are greater than those of the investor.

60 General provisions relating to insurance, guaranty, financing, and reinsurance programs, 22 U.S.C. § 2197(b).

61 http://www.opic.gov/doing-business/ where-we-work.

62 Malcolm N Shaw, INTERNATIONAL LAW 824 (2008).

63 *See Diaconis, Political Risk Insurance, supra* note 52, at 277 (noting that OPIC was required by South American countries to demonstrate that its insurance policies were consistent with the Calvo Doctrine).

To placate the concerns of these States, and satisfy the demands of U.S. investors operating in Latin America, the agency decided to amend its Incentive Agreement. Specifically, under the Agreements signed with countries like Ecuador, Colombia and Argentina, the U.S. government does not have the right to immediately seek international arbitration against the host government.[64] Instead, it must first exhaust local remedies in the host State before seeking arbitration. The treaty also provides that OPIC will assign its subrogated rights to a "fiduciary agent", which will then pursue the claim in local courts. This provision was considered necessary to avoid a direct politicized dispute between the U.S. government and the host State in a local court.[65]

3.2. MIGA

Like OPIC, MIGA also requires the investor to assign its interests in the investment and claims against the host government to the agency after payment has been made.[66] Disputes concerning claims of the Agency acting as a subrogee of an investor may "be settled in accordance with either (i) the procedure set out in Annex II of the Convention, or (ii) an agreement entered into between the Agency and the member concerned on an alternative method of settlement of such disputes".[67] The first method of dispute resolution – the one provided in Annex II – has been discussed in the chapter 3. It is effectively an ad hoc arbitration between MIGA and the host State, and the law applicable to any such arbitration would be "applicable rules of international law, the domestic law of the member concerned as well as applicable provisions of the

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64 Investment Incentive Agreement-Colombia (1985); Investment Incentive Agreement-Venezuela (1990); Investment Incentive Agreement-Peru (1992).

65 *See Diaconis, Political Risk Insurance*, *supra* note 52, at 278.

66 MIGA Convention, art. 18(a).

67 Commentary on the Convention Establishing the Multilateral Investment Guarantee Agency, para 78 [hereinafter, *MIGA Commentary*].

investment contract".[68] For current purposes, the reference to international law is the crucial aspect of the applicable law.

The second method – an *ad-hoc* system based on an agreement entered into between the Agency and the member State – was included to accommodate the concerns of Latin American countries, who, as in the case of OPIC, opposed international arbitration as being contrary to the Calvo Doctrine.[69] While MIGA has not yet signed any agreements on dispute resolution with Latin American countries, Commentary to the MIGA Convention states that such agreements may require the Agency to "first seek remedies under the local laws of the host State" before seeking arbitration.[70] The Commentary also states that MIGA may consider abandoning arbitration altogether, and instead explore other avenues, including seeking an advisory opinion from the ICJ.[71] It is likely that if and when MIGA does sign any such agreements with Latin American countries, any arbitration conducted thereunder would require MIGA to show a violation of international law by the host State.

4. Various sources cited in OPIC's decisions

Section 3 above explained how the recovery mechanism works for OPIC and MIGA. It is evident that in order to recover under their respective schemes insurers have to establish a violation of international law and therefore it is imperative that they refer to the international law requirements in their policies as well. Having established the relevance of international law to insurance policies, this section will now consider how OPIC applies international law and, specifically, the sources on which it relies.

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68 MIGA Convention, Annex II, art. 4(g).

69 Shihata, I. F. I., *MIGA and Foreign Investment Origins, Operations, Policies and Basic Documents of the Multilateral Investment Guarantee Agency*, 261-264 (1988); *see also* P.M. Protopsaltis, *Multilateral Guarantee Agency*, TDM 3 (2005), at 276-77.

70 *MIGA Commentary*, *supra* note 67, at para. 76(c).

71 *Id.*

Commentators often distinguish between 'formal' and 'material' sources of international law.[72] Formal sources are those methods for the creation of rules that are binding on States (e.g., custom, treaties and general principles of international law). On the other hand, material sources are means by which the content of the formal sources is established (e.g. decision of international courts and tribunals, legal writing, restatements of law and non-biding codification efforts). A review of OPIC's determinations shows that it does not often rely on formal sources (treaties, which are discussed in section 4.1 below, are the only exception). Instead, it relies heavily on material sources – mostly, Restatements (section 4.2 below) and judicial decisions (section 4.3 below).

4.1. Treaties

Generally, OPIC cites treaties that either have a law-making dimension to them (i.e., those that tend to have a universal or general relevance) or bilateral treaties that govern economic relations between the U.S. and the host government. As explained further below, in the former category, OPIC has repeatedly cited treaties such as the New York Convention and the ICSID Convention. In the latter category, OPIC has cited the Iran-US Treaty of Amity, Economic Relations and Consular rights on a few occasions and a host of BITs.

The case of BITs is particularly interesting. Under BITs, host governments provide certain guarantees to foreign investors. These guarantees are part of the host government's international obligations. That raises the question whether violations of BIT guarantees also count as violations of "international law" under the OPIC contract. If they do then BITs get effectively incorporated into the OPIC contract and it becomes that much easier for the insured to show a violation of international law because a BIT contains many protections that are not otherwise available under the OPIC contract – the most notable examples are the requirements

[72] *See, e.g.*, James Crawford, BROWNLIE'S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 20 (OUP: 2008).

of fair and equitable treatment, national treatment and MFN treatment that are commonly found in U.S. BITs. This question was considered by OPIC in the *Marine Shipping* case.[73] In that case, discussed below in greater detail, the agency agreed with the insured that a BIT violation could count as a breach of international for the purposes of the OPIC contract.[74]

Between 1976 and 1993, Marine Shipping Corporation ("MSC") operated a facility for the unloading of grain and bulk commodities in Port Said, Egypt. This facility was run in collaboration with a Government of Egypt ("GOE") owned entity.[75] In 1993, after it became evident that the latter entity was going to withdraw from the grain importation business, MSC applied for a license to operate independently. MSC's license application, however, was denied after MSC failed to fulfil certain formalities, pay occupancy fees and settle past tax dues.[76] Thereafter, the Egyptian port authorities placed MSC's assets at the port under receivership. MSC, however, claimed that the rental fees that were to be charged by the port authority were significantly higher than the amount that would have been charged to an Egyptian company, and therefore such discriminatory treatment violated the US-Egypt BIT, and by extension, the OPIC contract.[77]

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[73] OPIC Memorandum of Determination, Confiscation Claim of Marine Shipping Corporation Contract of Insurance No. CO15 (2 July 1999), available at: https://www.opic.gov/sites/default/files/docs/claim_marine_shipping.pdf [hereinafter, *Marine Shipping*].

[74] Of the other cases in which OPIC has cited BITs, only *Alliant Techsystems Incorporated, Memorandum of determinations I, Belarus (OPIC),* (1997) contains any substantive discussion regarding the BIT. In that case, OPIC found that the actions of the Government of Belarus violated both customary international law and the U.S. – Belarus BIT. Even though the BIT had not entered into force at the time of the determination (and, in fact, has not entered into force to date), OPIC still found that governmental interference with the local investment was contrary to the treaty's "object and purpose" of creating a "stable framework of investment". Other cases in which OPIC has cited BITs are *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic,* ICSID Case No. ARB/01/3, Jurisdiction (2004); *Sears, Roebuck & Company, Memorandum of determinations, Nicaragua* (OPIC) (1980)*; Ralston Purina*, Memorandum of determinations, Nicaragua (OPIC) (1981).

[75] *Marine Shipping*, *supra* note 73, at p. 2.

[76] *Id.*

[77] *Id.* at p. 3.

In its determination, OPIC did not question the logic behind the insured's submission that a violation of a US-Egypt BIT could trigger a violation of the OPIC contract. The agency assumed that such could be the case and therefore directly went on to discuss whether GOE's actions violated the BIT. It found that even if the disparate fee allegations were factually correct, such treatment would not constitute a violation of the BIT. That was the case because "maritime agencies", "commercial activities" and "use of land" were all expressly excluded from the national treatment requirement of the BIT (BIT, Article II, 3(a), Annex) and the Port Authority's actions fell within all three of those exceptions.[78] OPIC also noted that MSC had the right under the BIT to pursue international arbitration against GOE but it chose not to.[79]

On the basis of these conclusions and certain defects OPIC had found in the documents submitted by MSC, the agency denied MSC's claim. That led MSC to seek AAA arbitration against OPIC pursuant to the OPIC contract. The arbitral tribunal upheld OPIC's ruling.[80] However, the AAA tribunal did not discuss MSC's allegations regarding BIT breaches in any detail because it found that both OPIC and MSC had failed to "produce [] persuasive evidence, or argument to establish the applicability, implementation or interpretation of the BIT with regard to MSC's operation in Egypt".[81]

4.2. Restatement on Foreign Relations

The most commonly cited source in OPIC's rulings on expropriation is Section 712 of the Restatement (Third).[82] As with restatements on other areas of law, the Restatements purport

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78 *Id.*

79 *Id.*

80 Mark Kantor, Karl Sauvan & Michael Nolan (eds.), REPORTS OF OVERSEAS PRIVATE INVESTMENT CORPORATION DETERMINATIONS724 (OUP, 2011).

81 *Id.*

82 RESTATEMENT (THIRD) ON FOREIGN RELATIONS LAW OF THE UNITED STATES (Americal Law Institutes, 1987) [hereinafter, *Restatement (third)*], Section 712 provides that:

> A state is responsible under international law for injury resulting from:
>
> (1) a taking by the state of the property of a national of another state that

to "state and clarify existing law" rather than "propose new rules for adoption".[83] Importantly, the Restatements are not an "official document of the United States"[84] and there may be areas where the views of the U.S. government on its legal obligations may differ to the rules set forth in the Restatement.[85] The Restatements merely "represent[] the opinion of The American Law Institute [a private body] as to the rules that an impartial tribunal would apply if charged with deciding a controversy in accordance with international law".[86] Yet, the Restatements

(a) is not for a public purpose, or

(b) is discriminatory, or

(c) is not accompanied by provision for just compensation.

(2) For compensation to be just under this Subsection, it must, in the absence of exceptional circumstances, be in an amount equivalent to the value of the property taken and be paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national;

(3) a repudiation or breach by the state of a contract with a national of another state.

(a) where the repudiation or breach is (i) discriminatory; or (ii) motivated by noncommercial considerations, and compensatory damages are not paid; or

(b) where the foreign national is not given an adequate forum to determine his claim of repudiation or breach, or is not compensated for any repudiation or breach determined to have occurred; or

(4) other arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests of a national of another state.

Apart from § 712 OPIC rulings have occasionally cited other sections of the *Restatement* as well. *See, e.g., Alliant Techs82ystems Incorporated, Memorandum of determinations I, Belarus (OPIC*),(1997).

[83] RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES, xi (American Law Institute, 1965) [hereinafter, *Restatement (Second)*]. *Restatement (Third)*, *supra* note 82, is a "comprehensive revision" of Restatement (Second).

[84] *Restatement (Third)*, *supra* note 82 Foreword at ix.

[85] *See Restatement (Third)*, *supra* note 82, Foreword at ix ("In a number of particulars the formulations in this Restatement are at variance with the positions that have been taken by the United States government"). *See also*, *id*. at 3 (quoting and incorporating statement from Restatement (Second) that "the positions or outlooks of particular states, including the United States, should not be confused with what a consensus of states would accept or support").

[86] *Id*., Introduction at 3. The American Law Institute (ALI) is a "nonprofit membership association whose members are selected on the basis of professional standing. Its members include judges, legal academicians, and lawyers in independent private practice, in government, and in law departments of business and other enterprises." *Id.* at xi.

have had enormous influence on U.S. judges and practitioners.[87] Arguably, that has been the case for two reasons. First, the American Law Institute ("ALI"), since its establishment in 1923, has issued many restatements on domestic law that have been extensively cited in U.S. courts. ALI's eminence in formulating rules of domestic law meant that its attempt to similarly formulate rules of international law was warmly welcomed by courts and practitioners.[88] Secondly, while judges and practitioners are usually experts in domestic law, they tend to be relatively unfamiliar with international law and find it difficult to find evidence of state practice and *opinio juris*.[89] It is therefore even more likely that they will follow a thoroughly and professionally drafted formulation of international law norms.

Despite its noble intentions, there are some obvious problems with OPIC relying excessively on the Restatements. First, when a judge or practitioner cites a provision of any restatement on domestic law, they assume that the cited provision correctly states the law. Specifically, in case of a provision from the Restatements, the assumption is that the cited provision correctly reflects customary international law. However, if the rules said to reflect custom in fact do not, judges and practitioners will replicate misstatements of law. In doing so, they will both create unreliable jurisprudence and cause damage to the party to whom that misstatement of law is less favourable. While the former concern does not apply in case of OPIC - given that OPIC rulings do not form part of the jurisprudence in the same way as rulings of the U.S. courts do - the latter concern definitely applies to OPIC.

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87 *See* David B. Massey, Note, *How the American Law Institute Influences Customary Law: The Reasonableness Requirement of the Restatement of Foreign Relations Law*, 22 Yale J. Int'l L. 419, 423-4 (1997) (citing various sources discussing the influence that the Restatement on Foreign Relations has had on U.S. court practice).

88 *See id.* at n. 34 (noting that in March 1994, the ALI estimated that there had been 125,000 judicial citations to its *Restatements*.).

89 International law scholars differ over the extent to which domestic courts contribute to the development of public international law. *See, e.g.*, Roger O'Keefe, *Domestic Courts as Agents of the Development of International Law of Jurisdiction*, 26 Leiden J. Int'l L. 3 (2013); Anthea Roberts, *Comparative International Law: The Role of National Courts in Creating and Enforcing International Law*, 60 Int'l. & Comp. L. Q. 1, 57-92 (2011).

For instance, if Section 712 - the expropriation provision of the Restatement (Third) that is most commonly cited by OPIC - is unduly investor-friendly, then OPIC's non-critical reliance on that provision would imply that more insurance claims will be successful. That in turn would require greater compensation to be paid out by the agency, but OPIC may not necessarily be able to recover that sum from the host State as in any arbitration brought pursuant to the Bilateral Incentive Agreement the less investor-friendly customary international law standard would apply. On the other hand, if the interests of investors are not protected under Section 712 to the same extent as under customary international law, then many valid claims will be rejected and investors will suffer (though indirectly OPIC will also suffer as investors will switch to other insurance providers whose policies are as protective, if not more, as customary international law).

It is difficult to say in the abstract whether the Restatements are more or less protective of an investor's interests than general international law. However, an analysis of OPIC's application of the Restatements in some of the claims discussed below does seem unduly investor friendly. For example, in the *Ponderosa Assets (Argentina)* case, while discussing the legality of the Argentine Emergency Act, which was enacted in response to a financial crisis in Argentina, OPIC did not even once discuss whether the customary law doctrine of necessity could preclude the wrongfulness of Argentina's actions.[90] Similarly, in the *Mid-American (Indonesia)* case, OPIC did not consider whether Indonesian government's allegedly expropriatory acts could be justified in light of the Asian financial crisis, and the pressure put by IMF on the Indonesian government to re-negotiate its contractual commitments with

[90] OPIC, Memorandum of Determinations, OPIC, *Expropriation Claim of Ponderosa Assets, L.P. Argentina-Contract of Insurance No. D733* (2 Aug. 2005) [hereinafter, *Ponderosa Assets, LP (Argentina, 2005)*]. *See also,* Kantor, Nolan & Sauvant, REPORTS OF OVERSEAS PRIVATE INVESTMENT CORPORATION, DETERMINATIONS, 1:844 (OUP, 2011) [hereinafter, *Kantor et al, OPIC determinations*] at 929-54.

foreign investors.[91] In contrast, all investment treaty tribunals presiding over claims brought by U.S. investors against Argentina under the BIT have spent significant time discussing – and in some cases upholding – Argentina's argument that its actions exempt under the BIT's non-precluded measures clause and/or the customary law doctrine of necessity.[92]

4.3. Judicial decisions

Although judicial decisions are, in the words of Article 38(1)(d) of the ICJ Statute,[93] to be used only as a subsidiary means for the determination of rules of law, and not as actual sources of law, they can nevertheless be of immense importance to international law making. It is well known that international law does not follow the doctrine of precedent; that is, the decision of an international tribunal has no binding force except as between the parties and in respect of the case under consideration.[94] Yet, international tribunals closely examine previous decisions and, in instances where they do not follow prior decisions, carefully distinguish them. That is true for the ICJ,[95] the WTO,[96] and, more importantly for our purposes, international investment

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91 OPIC, Memorandum of Determinations, Expropriation Claim of Mid-American Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527 and E759 (10 Nov. 1999) [hereinafter, *Mid-American Holding (Indonesia, 1999)*]; *See also*, Kantor et al., OPIC Determinations, *supra* note 90 at 728-43.

92 *See CMS Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005); *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006); *C*; *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8) (Annulment Proceeding), Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic (Sept. 25, 2007); *Sempra Energy Int'l v. Argentine Republic*, ICSID Case No. ARB/02/16, Award (Sept. 28, 2007); and *Continental Casualty v. Argentine Republic*, ICSID Case no. ARB/03/9, Award (Sept. 5, 2008).

93 Statute of the International Court of Justice, June 26, 1945, art. 38(1)(a)-(c), 33 U.N.T.S. 993 [hereinafter, *ICJ Statute*]. *See also* Tai-Heng Cheng, *Precedent and Control in Investment Treaty Arbitration*, 30 Fordham Int'l L.J. 1014, 1026-27 (2007) (discussing the relevance of this provision for the status of investment awards).

94 *See, e.g., ICJ Statute*, *supra* note 96, at art. 59; *See also*, Alexander Orakhelashvili, *Principles of Treaty Interpretation in the NAFTA Arbitral Award on Canadian Cattlemen*, 26 J. Int'l Arb. 159, 168-69 (2009).

95 M. Shahabuddeen, PRECEDENT IN THE WORLD COURT (Cambridge: 2007).

96 D. Palmeter and P. Mavroidis, *The WTO Legal System – Sources of Law*, 92 Am. J. Int'l. L. 3, 398-413 (1998) [hereinafter, *Palmeter et al, The WTO Legal System*].

tribunals.[97] In the latter case, a study of ICSID decisions conducted in 2006 noted that "[p]rior to 1990, there were only a handful of publicly available ICSID awards and decisions rendered, each of which cited few, if any, prior ICSID decisions or awards".[98] However, "since 2001, the frequency of citation to ICSID case law has increased exponentially" with 11.5 being the average number of citations to prior ICSID decisions in the eight new ICSID decisions rendered in 2006.[99] Another recent study on citations reviewed 644 investment treaty decisions that were publicly available as of July 2015, and found that those decisions contained 5,516 citations to past decisions, at an average rate of approximately 9 citations per decision.[100]

In its determinations, OPIC also often cites judicial and arbitral decisions. Citations have comprised decisions of international courts, such as decisions of the PCIJ,[101] ICJ,[102] and Iran-US Claims Tribunal;[103] arbitration awards, including awards issued by *ad hoc* tribunals

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97 *See, e.g.*, Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 Fordham L. Rev. 1521, 1532 (2005); Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity, or Excuse?*, 23 Arb. Int'l 357, 373-75 (2007); Christoph Schreuer & Matthew Weiniger, *A Doctrine of Precedent?*, *in* OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 1188 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008).

98 J. Commission, *Precedent in Investment Treaty Arbitration: A Citation Analysis of Developing Jurisprudence*, 24 J. Int'l. Arb. 129, at 149 (2007).

99 *Id*.

100 Rishab Gupta & Katrina Limond, *Who is the Most Influential Arbitrator in the World?*, Global Arb. Rev. (14 Jan 2016), available at: http://www.allenovery.com/SiteCollectionDocuments/Who_is_the_most_influential_arbitrator_in_the_world_.pdf.

101 *See, e.g., Case Concerning German Interests In Polish Upper Silesia* (Germany v. Poland)PCIJ Series A no 7 (25th May 1926) and *Norwegian Shipowners Case (Norway v. USA)*, 1 R.I.A.A. 307 (1922) *in Ponderosa Assets LP* (Argentina, 2003); *Panevezys – Saldutiskis Railway Case* (Estonia v. Lithuania), PCIJ series A./B. no. 76 (28th February 1939) *in Ralph Mathieu, J. Marlin, Roger P. Disilets*, Memorandum of Determination Haiti(OPIC) (1989); *Serbian and Brazillian Loans Case* (France v. Serbia) PCIJ series A no. 20/21 (12th July1929) *in Citibank, NA, Memorandum of determinations (Claim 2)* Sudan (OPIC) (2001).

102 *See, e.g., Libyan Am Oil Co v. Libyan Arab Republic*, 20 ILM 1 (1990) *in Mid-American Energy Holdings Co*, Memorandum of Determinations, Indonesia (OPIC) (1999); *Case Concerning US Diplomatic and Consular Staff in Tehran (U.S. v. Iran)* 19 ILM 553 (1980) *in Dresser, AG (Vaduz)*, Memorandum of Determinations, Iran (OPIC) (1980).

103 *See, e.g., Amoco Int'l Finance Corp v. Iran*, 15 Iran-US Cl Trib Rep 164, *in Belfinance Haussman LLC*, Memorandum of Determination Georgia (OPIC) (2009); *Islamic Republic of Iran v*

established pursuant to BITs[104] and state contracts;[105] decisions of national courts;[106] and OPIC's own prior determinations,[107] including arbitration awards issued by tribunals established pursuant to OPIC contracts.[108]

It is understandable, and in fact expected, that OPIC will cite decisions of international tribunals to inform its own understanding of international law. Prior decisions of international tribunals on relevant points of law create expectations among investors as to what constitutes a violation of international law, and what does not. Consistency between those decisions and OPIC's determinations affords legitimacy to OPIC's claim determination process.[109] If OPIC were to ignore such rules, then investors are more likely to not trust OPIC's process and may therefore seek PRI coverage from other providers. It will also most definitely make OPIC's determinations more vulnerable to attack before arbitral tribunals established pursuant to OPIC contracts. Finally, following prior decisions is efficient – investors can cite those decisions in their submissions, and OPIC can rely on them, without having to re-invent the wheel.[110]

While the practice of citing judicial decisions on relevant points of law is non-controversial, the practice of treating those decisions as authoritative determinations and

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US, Award No 586-A27-PT (5 June 1998) *in Mid-American Energy Holdings Co*, Memorandum of Determinations, Indonesia (OPIC) (1999).

104 *CMS Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005); *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (2007) at para 335-7[hereinafter, *Enron(merits)*].

105 *See, e.g.*, *Texaco Overseas Petroleum Company v. The Government of the Libyan Arab Republic*, 1978 ILM 1 and *Sapphire/Iran Award*, 1963 ILR 136 in *Citibank, NA*, Memorandum of determinations (Claim 2) Sudan (OPIC) (2001).

106 OPIC Memorandum of Determination, Expropriation Claim of Ponderosa Assets, L.P. – Argentina – Contract of Insurance No. D733; *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, Award (2007)*.

107 *Id.*

108 *Id.*

109 *See Palmeter et al, The WTO Legal System, supra* note 96, at 402 (making the same argument in respect of WTO rulings).

110 *Id.*

therefore *following* them uncritically cannot easily be justified. In case of OPIC, it is not rare that investors who have submitted a claim under their insurance policy are also simultaneously seeking recovery through other means, such as arbitration provided under their investment contracts or BITs. That is precisely what happened in case of Enron and Ponderosa Assets, who submitted a claim at OPIC and initiated ICSID arbitration under the US-Argentina BIT within a period of one year.[111] The facts giving rise to the two claims were the same, in both cases investors alleged expropriation, and, while expropriation is defined differently under the BIT and the OPIC contract, the same principles of international law applied in both instances. Moreover, in the three years during which OPIC deliberated over Ponderosa's claim, many other similar cases against Argentina were registered with ICSID, with one such case – *CMS v. Argentina* – producing an award on the merits just three weeks before the OPIC determination was published.[112]

Such parallel proceedings raise the possibility of cross-citation: OPIC citing ICSID awards and ICSID citing OPIC determination. It also increases expectations of investors – perhaps legitimately – for similar treatment by both forums. Yet, in practice, ICSID tribunals and OPIC have been relatively oblivious of each other, with any overlap between the two arising more as a matter of chance than a concerted effort on part of either forum to follow the other's lead. In case of Enron/Ponderosa claims, for example, both OPIC and ICSID tribunals ruled in favour of the investors; however, the manner in which they reached that conclusion differs in material ways. Crucially, the ICSID tribunal found that the Emergency Act passed by the Government of Argentina was not expropriatory because Enron/Ponderosa continued

111 The ICSID claim was registered on April 11, 2001 and the final award was issued on May 22, 2007; whereas, the OPIC claim was filed on August 12, 2002 and the determination was issued on August 2, 2005.

112 *CMS Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005).

to maintain their control over TGS.[113] The tribunal did however find that the Act violated two provisions of the BIT. First, the Act denied Enron/Ponderosa "fair and equitable treatment" by dismantling the 'stable legal framework' that originally induced the investors.[114] Second, the removal of the tariff provisions also violated the BIT's so-called "umbrella clause", which obliges Argentina to "observe any obligation it may have entered into with regard to the investments".[115] By contrast, OPIC found that the Emergency Act was expropriatory because it had the effect of repudiating a contractual commitment for non-commercial reasons, which deprived the investor of its fundamental rights in the investment and did not compensate the investor for its loss.[116]

Despite the difference in analysis, there was some overlap too. First, OPIC cited jurisdictional rulings issued by three ICSID tribunals – *Ponderosa*, *CMS* and *Azurix* – in support of its decision to treat TGS as a foreign party.[117] Notably, OPIC did not cite *CMS (Merits)* award, which was available in the public domain by the time OPIC published its determination. In contrast, none of the ICSID tribunals established under the US-Argentina BIT have ever relied on OPIC's *Ponderosa* determination, despite investors seeking to persuade the tribunals to place such reliance. In *Ponderosa v. Argentina*, for example, the tribunal noted[118]:

> The Tribunal must also point out that although the OPIC "Memorandum of Determinations" referred to above reaches a different conclusion on this matter, it responds to a different kind of procedure and context that cannot influence or be taken into account in this arbitration.

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113 *Enron (Merits), supra* note 104 at paras. 245-6.

114 *Id.*, para. 267.

115 *Id.*, paras. 269-77.

116 OPIC Memorandum of Determination, Expropriation Claim of Ponderosa Assets, L.P. – Argentina – Contract of Insurance No. D733.

117 *Id.* at p.7.

118 *Enron (Merits), supra* note 104 at para. 247.

Similarly, in *National Grid v. Argentina*, an UNCITRAL tribunal noted that[119]:

> [T]he Tribunal considers that the determination of OPIC in the Ponderosa case is of limited value as a precedent for the reasons adduced by the Respondent, namely, that it is a decision of an organ of a government, not one arrived at by an independent tribunal after hearing the parties.

The second area of overlap between the two regimes emerged in the context of OPIC's discussion, in dicta, regarding whether Argentina was responsible for denial of justice. OPIC acknowledged that by agreeing to submit the claim to ICSID, GOA had provided a forum for dispute resolution, though Argentina's jurisdictional challenges and delay tactics did, to some extent, undermine the effectiveness of that forum. OPIC also wrongly assumed that its own determination of contractual repudiation meant that Argentina was responsible for denial of justice until it paid the final award issued by the ICSID Tribunal.

Aside from decisions of international courts and investment treaty tribunals, OPIC has on a few occasions cited decisions of national courts as well. Some of these citations have been to decisions of local courts in the host State; such citations always form part of OPIC's narration of facts or explanation of the procedural history of the claim. In other words, OPIC has not relied on decisions of foreign courts to interpret the OPIC contract. However, the same cannot be said for citations to decisions of U.S. courts. Because the law applicable to the OPIC contract is usually the law of the District of Columbia,[120] OPIC relies on local decisions (applying D.C. law) to resolve questions regarding its own powers and authority. For example, in response to a request by the insured for punitive damages, OPIC reviewed U.S. case law to determine that such damages cannot be recovered from an agency of the federal government.[121] So far, however, OPIC has not relied on decisions of U.S. courts on takings – such as decisions

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119 *National Grid plc v. Argentina*, UNCITRAL, (2006) at para. 144.

120 Some of the new OPIC contracts, however, are governed by New York law.

121 Berckman Instruments, Inc., Memorandum of determination El Salvador (OPIC) (1988)..

of the U.S. Supreme Court on the fifth amendment of the U.S. constitution – to interpret the expropriation coverage under the OPIC contract.

4.4. Scholarly works

The "teachings of the most highly qualified publicists of the various nations" are treated in Article 38(1)(d) of the ICJ Statute as subsidiary means for the determination of rules of international law. Such writings include treatises and other writings of authors of standing; resolutions of scholarly bodies such as the Institute of International Law (Institut de droit international); draft texts and reports of the International Law Commission, and systematic scholarly presentations of international law such as the Restatement on Foreign Relations.[122] Another important subsidiary means for the determination of international law is resolutions of international organizations, particularly the U.N. General Assembly. While not being a source of law by themselves, they do provide evidence for the existence of (or lack thereof) principles of international law. Their evidentiary value, however, differs; for example, resolutions of universal international organizations, adopted with little or no dissent, have greater evidentiary value.[123]

OPIC also often cites scholarly works in its determinations, including writings of established international law scholars,[124] reports of scholarly bodies and commissions, such as the Restatements, ILC's Draft Articles on State Responsibility and UNIDROIT Principles on

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122 *See Restatement*, § 103, Rep. Note 1.

123 See Military and Paramilitary Activities in and against Nicaragua (*Nicaragua v. United States of America*) (ICJ, 1986); *See* B. Sloan, GENERAL ASSEMBLY RESOLUTIONS IN OUR CHANGING WORLD (1991); Oscar Schachter, *United Nations Law*, 99 AJIL 1994.

124 See, e.g., Sohn and Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 Am. J. Int'l L. 545 (1961) in *Mid-American Energy (Indonesia, 1999)*; George C. Christie, *What Constitutes a Taking Under International Law?*, 28 Brit. Y.B. Int'l L. 307 in *Ponderosa Assets LP (Argentina, 2005)*.

Private International law.[125] While there is nothing controversial about citing such sources – and in fact most tribunals do regularly cite them – OPIC's absolute reliance on the Restatements as the authoritative statement on international law raises some concerns that were discussed previously.[126]

5. Conclusion

All insurance schemes are based on the assumption that the insurer will be able to recover some, if not all, of the compensation it has to pay out to the insured. Insurers strive to achieve that objective by including assignment provisions in their policies, which require the insured, once it has been indemnified, to assign all claims and remedies against the host State to the insurer. The insurer then tries to enforce these claims against the host State via subrogation provisions contained either in investment treaties or, in the case of OPIC, in Incentive Agreements.

However, having subrogation rights in treaties by itself is not sufficient. Insurers need to actively design their policies and claim determination process in a way that makes these subrogation rights useful. In particular, they need to ensure alignment between the protections they make available to investor under their policies and protections that are available to investors under investment treaties (or, as in the case of OPIC, under international law generally). The failure to establish such alignment could expose the insurer to the risk of inconsistent decisions, which in turn would affect the insurer's recovery prospects.

This chapter explained that most insurers seem to be alive to this risk. Both OPIC and MIGA refer to international law in their provisions on expropriation. That is, to establish expropriation under their policies, the investor must show that host State's actions have

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125 *See, e.g., Ponderosa Assets* (Argentina, 2005), at 937, n. 22, citing UNIDROIT Principles, Art. 2.1 (1994). On the ILC Draft Article on State Responsibility and the Restatement, *see* earlier section above.

126 *See supra* s. 4.2.

breached international law. By doing so, the insurer hopes that when, as a subrogee, it brings a claim against the host State under an investment treaty (or, in case of OPIC, when the claim is brought by the U.S. government under the Incentive Agreement), the international tribunal, which is also applying international law, will reach the same conclusion. Reference to international is therefore a form of security for insurers.

However, the value of this security depends largely on how the insurer, when determining a certain claim, applies international law. That, in turn, depends largely on the sources of international law that are relied upon. This chapter demonstrated that OPIC (the only insurer for which a body of internal jurisprudence is available) relies mostly on the U.S. Restatement of Foreign Relations, a source on which international tribunals rarely, if ever, rely. Excessive reliance on the Restatement makes OPIC hostage to the Restatement's fallacies. As noted above, if, in comparison to customary international law, the Restatement is over-friendly to investors then OPIC might find itself in the undesirable situation of having paid out to the investor, but being unable to recover that sum by recourse to an international tribunal. The opposite scenario – i.e. if the Restatement is less friendly to investors as compared customary international law – is not ideal either because the investors might feel that buying an OPIC policy is not a good commercial bargain and that may affect the demand for OPIC's policies. In fact, at least in one case – *CMS v Argentina* – OPIC and treaty tribunal reached different conclusions on whether an indirect expropriation had taken place; however, OPIC was 'saved' by a separate finding by the tribunal that Argentina has breached the fair and equitable treatment clause of the relevant treaty.

It is therefore important for insurers, be it OPIC or any other State's insurer, that there is as much alignment as possible between, on the one hand, its policies and claim determination process and, on the other hand, international law which will govern the claim that be brought to arbitration between the insurer, acting as a subrogee, and the host State. As such, the relevance of international law to the workings of the insurers cannot be doubted.

However, it is important to remember that agencies like OPIC are instrumentalities of the State. In almost all States, export credit agencies that extend PRI policies are controlled and funded by the national governments. Be that as it may, if OPIC or an ECA issues a ruling in respect of a claim where it also makes a determination on an issue of international law (as it almost always will, given that, to prevail, investors have to show a breach of international law), arguably these agencies are participating in the process of creating international law. If that is indeed the case then several serious consequences could follow, including the possibility that these determinations may have the effect of binding the government of the home state in its dealings with investors from other countries. The chapter that follows considers the law-creation role that these agencies perform and the consequences that flow from it.

CHAPTER 5

ROLE OF INTERNATIONAL LAW IN DETERMINATIONS ISSUED BY POLITICAL RISK INSURANCE PROVIDERS

1. Introduction

Chapter 3 explained the concept of subrogation and its relevance to the various stakeholders: investors, host States and insurers. As far as the insurers are concerned, subrogation rights are crucial. Unlike investors, insurers do not make any investment in the territory of the host

State. Therefore, by themselves, they do not have any standing under an investment treaty. They only have standing as subrogees.[1]

Next, Chapter 4 explained that, whilst subrogation rights are necessary, they are not sufficient to protect insurers. It is equally vital that insurers actively design their insurance policies and claim determination processes in ways that make it possible for them to recover compensation in treaty arbitrations. The most obvious way to do so – and one that certain insurers like OPIC already do – is to refer to international law in insurance policies. That way, because the insurer and the international tribunal would be evaluating the host State's actions against the same legal standards, it is more likely that they will reach the same conclusion (though, of course, much will depend on how the applicable international law is interpreted and applied in practice).[2]

It follows from Chapters 3 and 4 that international law creates rights and remedies that are important to insurers. But that is only one side of the coin: the practice of State sponsored insurers can be relevant to the interpretation of investment treaties and, in certain circumstances, contribute to the development of international law.

In case of investment treaties, whilst State parties continue to maintain an interest in the interpretation and application of these treaties, it is the tribunals who effectively perform that role.[3] The interpretive powers of tribunals are, however, very wide – primarily because the guarantees contained in the treaties are so broad. As a result, tribunals often give interpretations which appear to go beyond the ordinary meaning of the treaty - when such interpretations favour investors (as they sometimes do), State parties criticize tribunals for being over investor-friendly. . The disconnect between tribunals and State parties, in turn,

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1 *See supra* Ch. 3, s.1.

2 See *supra* Ch. 4, s. 2.3.

3 *See,* Anthea Roberts, *Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States*, 104 Am. J. Int'l. L. 179 (2010) [hereinafter, *Roberts, Power and Persuasion*].

raises questions about the legitimacy of the investment treaty regime.[4] Those questions have become even more urgent in recent years, with countries deciding to terminate their treaties prematurely (as in the case of Ecuador, Bolivia, South Africa and Indonesia), denouncing international institutional mechanisms (such as the ICSID Convention), placing a halt on negotiations of future treaties (e.g., South Africa) and, most commonly, negotiating new treaties that are more prescriptive and less protective of investors' rights.[5]

But there are other ways to address this disconnect. In particular, investment treaties are not static. They should be interpreted in accordance with the effect that the State parties have given, or agreed to give, to the provisions of the treaty, well after the treaty has been concluded. Indeed, that is what is required under Article 31(3) of the Vienna Convention on the Law of Treaties ("VCLT"), which requires that the tribunals take into account the treaty parties' subsequent agreements and practice.[6]

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[4] *See, e.g.*, Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005) discussing problems of legitimacy through inconsistent awards); Asha Kaushal, *Revising History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime*, 50 HARV. INT'L L. J. 491, 510 (2009) (arguing ITA awards are "unpredictable" and "extremely generous to foreign corporations"); Katia Yannaca-Small, *Improving the System of Investor-State Dispute Settlement: An Overview* 11 (Org. for Econ. Co-operation & Dev., Working Paper No. 2006/1, 2006) (discussing problems deriving from inconsistency).

[5] *See e.g.*, News Release, Int'l Ctr. for Settlement of Inv. Disputes, Bolivia Submits a Notice Under Article 71 of the ICSID Convention (May 16, 2007), available at http://icsid.worldbank.org/ICSID/StaticFiles/Announcement3.html; News Release, Int'l Ctr. for Settlement of Inv. Disputes, Ecuador's Notification under Article 25(4) of the ICSID Convention (Dec. 5, 2007), available at http://icsid.worldbank.org/ICSID/StaticFiles/Announcement9.html; see generally, Anne van Aaken, *International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis*, 12 J. Int'l Econ. L. 507, 533 & nn.113-14 (2009); Asha Kaushal, *Revisiting History: How the Pas Matters for the Present Backlash Against the Foreign Investment Regime*, 50 Harv. Int'l L. J. 491, 493 (2009).

[6] *See generally*, I. Sinclair, THE VIENNA CONVENTION ON THE LAW OF TREATIES 130-138 (Manchester, Manchester University Press, 1984); Georg Nolte, International Law Commission, *First Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/660, (2013) [hereinafter, *First ILC Report*]; Georg Nolte, International Law Commission, *Second Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/671 (2014) [hereinafter, *Second ILC Report*]; *Roberts, Power and Persuasion, supra* note 3.

As explained below, one of the chief problems with relying on subsequent practice and agreement is that there is little evidence of it. As far as agreements on interpretation are concerned, some treaties – such as NAFTA – contain mechanisms that allow State parties to issue binding interpretive statements.[7] Where no such mechanisms exist, State parties can agree on interpretations on an ad-hoc basis. However, this is rarely done. Indeed, even under NAFTA, only on one occasion have State parties agreed to issue an interpretive statement and there too, as discussed below, the tribunals have had different reactions to the effect that the statement should be given.[8]

Aside from agreements, it is also possible for States to evidence what they understand the treaty clauses to mean through their practice. Commentators have noted that such practice could include pleadings submitted by parties, interventions made by non-disputing parties, statements made by treaty parties, clarifications provided by the parties in their model BITs and parties' internal practice (e.g. decisions of local courts).[9] However, as discussed below, all of these examples of State practice have their own deficiencies. For example, pleadings submitted by parties are likely to be drafted from the perspective of avoiding liability and may not, therefore, contain the State's general views on interpretation of a certain clause. Interventions by non-State parties are likely to be more objective than pleadings, but they are often criticised for introducing diplomatic protection through the backdoor (especially where home States are intervening). Statements made in, for example, the State's annual yearbook of international law, could be useful, but such statements are rarely made. In any event, a statement made by one State alone is not sufficient to create an agreement of interpretation –

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7 NAFTA, articles 1131(2), 2001(1) & (2)(c). *See infra* s. 3.1.

8 Notes of Interpretation of Certain Chapter Eleven Provisions (Free Trade Commission, July 31, 2001), available at http://www.international.gc.ca, Foreign Affairs and International Trade Canada website.

9 *See generally*, *First ILC Report*, *supra* note 6, at 46 ; *Roberts, Power and Persuasion*, *supra* note 3, at 203; *see infra* s. 3.1.

other treaty parties need to agree to it or acquiesce in it (by, for example, not reacting to a publicly made statement).[10]

This chapter demonstrates how the practice of State sponsored political risk insurers could be a potentially important interpretive source. Specifically, section 4 below explains that the acts of public insurers are attributable to the State because they are State-owned entities who are exercising governmental authority and/or acting under the direction and control of the State. Moreover, insurers continuously engage with international law in various ways. First, at the time of drafting their insurance policies, many insurers define concepts such as "expropriation" in the same way as they are defined in the BITs signed by the insurers' home States. Secondly, to make a successful claim under the policy, insurers typically require investors to show a breach of international law. Thirdly, as explained below, insurers often use their political clout to 'advocate' on behalf of the investors even before the government of the host State has taken any adverse steps. At the time of conducting such advocacy, which includes sending letters, meeting with ministers and, in some cases, threatening sanctions, insurers would remind the host State of its obligations under international law, including obligations under any investment treaties. Fourthly, the insurer would use its leverage to extract a favourable settlement from the host State where the investor has suffered losses. Finally, when everything else fails, the insurer has the right to bring a claim against the host State under either any specially negotiated agreements (as in the case of OPIC) or investment treaties.[11]

For these reasons, and as explained in detail below, the practice of State sponsored insurers can constitute "subsequent practice" of that State, which when combined with the acts of the host State where the insured has made its investment, can give rise to an "agreement

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10 *Id.*

11 *Id.*

regarding interpretation" of any investment treaty between the home State of the insurer and the host State.[12]

This Chapter proceeds as follows. Section 2 sets out the relevant rules contained in the VCLT. In particular, it explains the difference between subsequent agreements and subsequent practice, on the one hand, and between subsequent practice and international custom, on the other hand. Section 3 considers how subsequent agreements and subsequent practice have been applied by treaty tribunals. It examines different forms of evidence that tribunals have considered, as well as the perceived or actual shortcoming with those forms of evidence. Section 4 takes up the challenge of showing how practice of political risk insurers can be a useful interpretive source. To do so, it considers the various ways in which insurers engage with the international law, as well as with the government of the host States in which the investments have been made. The analysis contained in Section 4 then forms the basis for the next chapter, which provides an illustrative list of examples from OPIC's jurisprudence and practice.

2. Interpretation of treaties

Articles 31-33 of the VCLT contain customary international rules on interpretation of treaties.[13] According to Article 31, treaties are to be interpreted "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty".[14] In addition, courts should

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12 Article 31(3)(b) of the *VCLT*.

13 *See*, e.g., *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction, 29 November 2004, para. 75 ("The Tribunal shall proceed to the interpretation of this Article in conformity with Articles 31 to 33 of the Vienna Convention on the Law of Treaties which reflect customary international law"); *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005 (noting that "Arts. 31 et seq. of the Vienna Convention on the Law of Treaties . . . reflect the customary international law concerning treaty interpretation").

14 *VCLT*, art. 31(1).

construe provisions in a manner that honors the treaty's "object and purpose",[15] and a treaty's terms are to be understood "in their context".[16]

However, the drafters of VCLT recognised that strict adherence to a treaty provision's ordinary meaning will occasionally lead to unreasonable results.[17] That is why several caveats were added to Article 31's "ordinary meaning" presumption. Of these, two caveats are particularly relevant to the analysis presented in this chapter. First, courts may deviate from "ordinary meaning" when treaty parties conclude a subsequent agreement that otherwise elucidates or reconfigures "the interpretation of the treaty or the application of its provisions".[18] Secondly, interpreters may consider parties' "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation".[19]

That said, investor-State tribunals rarely apply these rules of interpretation in a systematic manner, often relying on only a limited number of elements set out in Article 31. That has been confirmed by a study carried out by J. Romesh Weeramantry. That study found that, of the 258 investment treaty awards included in the sample, 53 per cent (i.e. 136 out of 258) referred to Article 31(1), 19 per cent (i.e. 49 out of 258) referred to Article 31(2), 5 per cent (i.e. 12 out of 258) referred to Article 31(3) and 1 per cent (i.e. 2 out of 258) referred to Article 31(4).[20]

2.1. Difference between "subsequent agreements" and "subsequent practice"

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15 *Id.*

16 *Id.*

17 *See* Evan Criddle, *The Vienna Convention on the Law of Treaties in U.S. Treaty Interpretation*, 44 Va. J. Int'l L. 431, 440 (2004) (discussing the negotiation history of VCLT).

18 *VCLT*, art. 31(3)(a).

19 *Id.*, art. 31(3)(b).

20 J. Romesh Weeramantry, TREATY INTERPRETATION IN INVESTMENT ARBITRATION (OUP: Oxford, 2012), p. 40.

At the outset, it is important to distinguish between, on the one hand, "subsequent agreement between the parties regarding the interpretation of the treaty" and, on the other hand, "subsequent practice . . . which establishes the agreement of the parties". "Subsequent agreement" has been described as representing "an authentic interpretation by the parties which must be read into the treaty for the purposes of its interpretation", whereas "subsequent practice" has been defined as constituting "objective evidence of the understanding of the parties as to the meaning of the treaty".[21]

That said, international tribunals often conflate the two concepts and do not attempt to distinguish between them. For example, the ICJ has used terms such as "subsequent attitudes"[22] and "subsequent positions"[23] to refer to both Articles 31(3)(a) and 31(3)(b). The *CME v Czech Republic* tribunal used the phrase "common position" between the host State (Czech Republic) and the home State of the investor (Netherlands) to confirm its interpretation of the treaty, without explaining whether the reference was to 'subsequent agreement' or 'subsequent practice'.[24]

One exception in this regard is *CCFT v United States* case where the NAFTA tribunal tried (albeit in an unconvincing manner) to distinguish between the two concepts.[25] There, the United States relied on different types of acts of the three NAFTA parties, including statements made by the executive branch of the respective governments at the time of ratification of NAFTA as well as submissions made by the governments in other NAFTA arbitrations. Those

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21 *See* Georg Nolte, International Law Commission, *First Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/660, p. 29, para. 70 (2013) (citing Yearbook of International Law Commission (1966), vol. II, p. 221, para. 14).

22 *Case Concerning the Territorial Dispute (Libyan Arab Jamahiriya/Chad)* [1994], I.C.J. Reports 1994, p. 34, paras 66 *et seq.*

23 *Case Concerning Sovereignty over Palau Ligitan and Palau Sipadan (Indonesia v Malaysia)* [2002], I.C.J. Reports 2002, p. 656, para. 61.

24 *CME Czech Republic B.V. v. Czech Republic*, Final Award, UNCITRAL, (2003) at para. 437.

25 *Canadian Cattlemen for Fair Trade (CCFT) v United States*, Jurisdiction, UNCITRAL (28 Jan. 2008).

acts, when taken together, the Unites States argued, established "the NAFTA Parties' *concordant, common and consistent* State practice [in relation to] . . . interpretation of Chapter Eleven" of NAFTA.[26]

In response to United States' submissions, the tribunal considered whether there was a "subsequent agreement" and, if not, whether there was sufficient "subsequent practice" between the parties to establish an agreement on interpretation. As for subsequent agreement, the tribunal concluded that there was none. It noted that NAFTA permits State parties to issue binding statements through the Free Trade Commission ("FTC") and that no such interpretation had been issued in this instance.[27] Nevertheless, the tribunal (rightly) also noted that formal process of issuing interpretations is not the only way in which a subsequent agreement might be reached. Instead, subsequent agreement could be evidenced by "other means" as well.[28] Unfortunately, however, the tribunal did not explain what such "other means" might be and simply concluded that whilst "[a]ll of this is certainly suggestive of something approaching an agreement, . . . to the Tribunal, [it] does not rise to the level of a "subsequent agreement" by the NAFTA Parties".[29]

Next, the tribunal considered whether the very same evidence could constitute relevant subsequent practice. It concluded "there is evidence of a sequence of facts and acts that amounts to a practice that is concordant, common, and consistent. The Tribunal is of the view that this is "subsequent practice" within the meaning of Article 31(3) (c)".[30]

The above reasoning suggests that there are at least two important differences in the way tribunals approach subsequent agreements, as compared to subsequent practice. First,

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26 *Id.* at para. 177.

27 *Id.* at paras 186-187.

28 *Id.* at para. 186.

29 *Id.* at para. 187.

30 *Id.* at para. 189.

generally speaking, subsequent agreements are likely to be established by formal means only; although the *CCFT* tribunal noted that FTC type interpretations are not necessary, it struggled to identify other ways by which such agreements might get established. Subsequent practice, on other hand, could comprise of a variety of acts by State parties, all of which could be potentially relevant.

Secondly, because subsequent agreements are likely to be established by formal interpretations issued by parties, where such agreements exist, they should be relatively straightforward to find and apply. That, however, would not be the case with subsequent practice. In addition to identifying the relevant acts that could comprise subsequent practice, tribunals have to also determine whether that practice manifests an "agreement" of the parties regarding the interpretation of the treaty. To do so, tribunals would have to necessarily determine whether there is a common position that can be identified from the parties' subsequent practice; if there is no common position, the practice is largely irrelevant to the interpretation of the treaty.

3. Limited reliance on "subsequent agreements" and "subsequent practice'" by investment treaty Tribunals

International courts and tribunals frequently rely on subsequent agreements and practice in treaty interpretation. This is true for the ICJ[31] as well as its predecessor, the Permanent Court of International Justice ("PCIJ").[32] Other international tribunals, including the Iran-US Claims Tribunal, the International Tribunal for the Law of the Sea, the European Court of Human Rights, the International Tribunal for the Former Yugoslavia and the WTO Panels and

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[31] *See, e.g.*, *Case concerning the Temple of Preah Vihear*, (*Cambodia v. Thailand*) merits [1962] I.C.J. Rep. 6 at pp. 33-34; for additional citations, see *First ILC Report*, *supra* note 6, n. 2.

[32] *See, e.g.*, *Competence of the ILO in regard to International Regulation of the Conditions of the Labour of Persons Employed in Agriculture*, Advisory Opinion of 12 August 1922, PCIJ Series B No. 2, pp. 38-40; for additional citations see *First ILC Report*, *supra* note 6, n. 3.

Appellate Body, have similarly relied on these interpretive sources in the past.[33] However, generally speaking, investment treaty tribunals have not made much use of subsequent agreements and practice when interpreting BITs. [34]

3.1. Subsequent agreements

As far as agreements on interpretation are concerned, some investment treaties, albeit not many, contain specific mechanisms which allow State parties to the treaty to issue binding interpretations. The best known example of this is NAFTA, which provides that a body comprising cabinet-level representatives of the State parties – the FTC – has responsibility for resolving "disputes that may arise regarding [the treaty's] interpretation or application" and that its interpretations are binding on NAFTA tribunals.[35] The FTC has used this power only once: in July 2001, it issued an interpretation on two matters: (i) confidentiality and public access to documents; and (ii) minimum standards of treatment under article 1105 of NAFTA.[36] The latter interpretation, which had been prompted by several arbitral awards that expansively interpreted Article 1105, attempted to align Article 1105 more closely to customary international law standards. That, however, generated significant debate amongst scholars[37]

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33 *See* citations contained in nn. 4-9 of the *First ILC Report*, *supra* note 6.

34 *See generally*, *Roberts*, *Power and Persuasion*, *supr-a* note 3; *See* Ole Kristian Fauchald, *The Legal Reasoning of ICSID Tribunals: An Empirical Analysis*, 19 Eur. J. Int'l L. 301, 328-33, 335, 351 (2008) (a study of ICSID awards showing that, whilst 94 percent and 74 percent relied on case law and academic authorities, respectively, only a handful relied on subsequent practice and agreements by treaty parties).

35 *NAFTA*, articles 1131(2), 2001(1) & (2)(c). Aside from NAFTA, similar or identical mechanisms have been introduced by the NAFTA parties in numerous instruments entered into with third States. For examples, see Gabrielle Kaufmann Kohler, *Interpretive Powers of the Free Trade Commission and the Rule of Law*, in FIFTEEN YEARS OF NAFTA CHAPTER 11 ARBITRATION (2011).

36 Notes of Interpretation of Certain Chapter Eleven Provisions (Free Trade Commission, July 31, 2001), available at http://www.international.gc.ca, Foreign Affairs and International Trade Canada website.

37 *See generally*, Gabrielle Kaufmann Kohler, *Interpretive Powers of the Free Trade Commission and the Rule of Law*, in FIFTEEN YEARS OF NAFTA CHAPTER 11 ARBITRATION (2011); Charles H. Brower, II, *Why the FTC Notes of Interpretation Constitute a Partial Amendment of NAFTA Article 1105*, 46 VA. J. INT'L L. 347 (2006); Charles H. Brower, II, *Structure, Legitimacy, and NAFTA's Investment Chapter*, 36 VAND. J. TRANSNAT'L L. 37 (2003); Mark Clodfelter, *U.S. State Department Participation in International Economic Dispute Resolution*, 42 S. TEX. L. REV. 1273

and tribunals. Certain tribunals, like the *Pope & Talbot* tribunal, described FTC interpretations as an illegitimate attempt to amend the treaty and interfere with an on-going case.[38] On the other hand, tribunals like the *ADF Group* tribunal had no objection to accepting the interpretation on the basis that "[n]o more authentic and authoritative source of instruction on what the Parties intended to convey in a particular provision of NAFTA, is possible".[39]

Whilst NAFTA-type formal mechanism for interpretative agreements are not that common – and, even where they exist, they are rarely used – there is no reason why such mechanisms are necessary for State parties to reach subsequent agreements on interpretation. For example, in *Aguas del Tunari v. Bolivia*, an arbitration under the Bolivia-Netherlands BIT, Bolivia relied on certain statements made by the Dutch Government in the Dutch Parliament as establishing a 'subsequent agreement' or 'subsequent practice' on interpretation of the BIT. Specifically, Bolivia argued that: "the statements of the Dutch Government result in the unprecedented situation where both State Parties to the BIT agree that the Tribunal does not possess jurisdiction over the dispute before it".[40] Indeed, Bolivia's counsel noted that: "[t]his is the only ICSID case that we know of in which both state parties to the Treaty that's being invoked by the Claimant are on record as saying that that Treaty does not apply to this case".[41] However, the tribunal rejected Bolivia's argument. According to the tribunal, the convergence between Bolivia's position in the arbitration and the views expressed by the Netherlands

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(2001); Charles H. Brower, II, *Investor-State Disputes Under NAFTA: A Tale of Fear and Equilibrium*, 29 PEPP. L. REV. 43 (2001); Charles H. Brower, II, *Investor-State Disputes Under NAFTA: The Empire Strikes Back*, 40 COLUM. J. TRANSNAT'L L. 43 (2001); Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L L. 365 (2003).

38 *Pope & Talbot Inc. v. Canada, Damages*, para. 47 (NAFTA Ch. 11 Arb. Trib. May 31, 2002), 41 ILM 1347 (2002) (holding that, "were the Tribunal required to make a determination whether the Commission's action is an interpretation or an amendment, it would choose the latter. However, for the reasons discussed below, this determination is not required.").

39 *ADF Group Inc. v. United States*, ICSID No. ARB(AF)/00/1, para. 177 (NAFTA Ch. 11 Arb. Trib. Jan. 9, 2003), 18 ICSID REV. 195 (2003)..

40 *Aguas del Tunari v. Bolivia*, Respondent's Objections to Jurisdiction, ICSID No. ARB/02/3, para. 249 (Oct. 21, 2005), 20 ICSID Rev. 450 (2005)..

41 *Id.*

government in parliamentary statements relating to the same arbitration did not amount to a subsequent agreement on interpretation because "[t]he coincidence of several statements does not make them a joint statement" and "there was no intent that these statements be regarded as an agreement".[42]

Having rejected Bolivia's argument in respect of Article 31(3)(a), the *Aguas* tribunal next considered whether the same statements could count as subsequent practice on interpretation, in accordance with article 31(3)(b). The tribunal found that there were inconsistencies in the statements of Dutch Government on which Bolivia sought to rely. Accordingly, it wrote a letter to the Dutch Government – a non-disputing party – requesting it to clarify whether those statements "reflect[ed] an interpretative position of general application held by the Government of the Netherlands" and, if so, "provide the Tribunal with information (of the type suggested by Articles 31 and 32 of the Vienna Convention on the Law of Treaties as being possibly relevant) upon which that general interpretative position is based".[43] The Government's response, however, failed to provide the tribunal with the type of information it said it needed to conclude that there was an agreement between the parties on interpretation. Accordingly, it placed no reliance on the Dutch Government's response.[44]

Broadly speaking, there appear to be two principal objections to the use of interpretive agreements. First, it has been suggested that "a mechanism whereby a party to a dispute is able to influence the outcome of judicial proceedings, by issuing an official interpretation to the detriment of the other party, is incompatible with the principles of a fair procedure and is hence undesirable".[45] That objection, however, seems misplaced given that to issue an

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42 *Id.* at para. 251.

43 *Id.* at para. 258.

44 Id. at para. 260.

45 *Roberts, Power and Persuasion*, *supra* note 3, at 217 (citing Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 34-35 (2008)).

interpretation all State parties to the treaty, including the home State of the investor, need to be in agreement.

The second objection raised against the use of interpretations is that it "may reduce the transparency of the treaties, in the sense that investors cannot trust that the treaty constitutes the final regulatory framework".[46] Again, this objection appears unmeritorious, given that treaty standards are very broad and investors can never accurately predict how a certain standard would be interpreted by the tribunal. If anything, interpretive agreements reached between State parties are likely to increase the transparency of investment treaty arbitration. Because such agreements are binding on tribunals, they may reduce tribunals' interpretive discretion and, thus, increase consistency in decision making.

3.2. Subsequent practice

Aside from subsequent agreements on interpretation, article 31(3) also requires interpreters (including tribunals) to take account of subsequent practice of the parties to the treaty. Specifically, Article 31(3)(b) states that tribunals "shall . . . take[] into account, together with the context: (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation".

Anthea Roberts has identified certain forms of subsequent practice that investment treaty tribunals can (and should) use.[47] First, "the most obvious form of subsequent practice" is the pleadings of the respondent State, where that pleading contains the State's general submissions about treaty interpretation and is supported by other State parties.[48] The latter requirement – that the position taken by the respondent State is supported by other States – is

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46 *Roberts, Power and Persuasion*, *supra* note 3, at 217 (citing Ole Kristian Fauchald, *The Legal Reasoning of ICSID Tribunals: An Empirical Analysis*, 19 Eur. J. Int'l L. 301, 332 (2008)).

47 *See Roberts, Power and Persuasion*, *supra* note 3, at 217 -8.

48 *Id.*

necessary in order to establish "agreement of the parties regarding [the treaty's] interpretation". Yet, most tribunals do not rely upon such pleadings. In fact, tribunals have expressly rejected the relevance of such pleadings on various grounds, including that an "argument made by a party in the context of an arbitration [does not] reflect [state] practice establishing agreement between the parties to a treaty"[49] and that they would "reintroduce diplomatic protection by the backdoor".[50] Similarly, commentators have raised doubts about the use of pleadings as a source of subsequent practice on the basis that they are "likely to be perceived as self-serving and as determined by the desire to influence the tribunal's decision in favour of the state offering the interpretation" [51], or that they are likely to contain "expedient interpretations to avoid liability in particular cases rather than considered interpretations that they would wish to have general application".[52]

That said, it seems odd to completely disregard pleadings as a potential source for subsequent practice. The objections set out above go primarily to the weight to be given to a particular pleading; they do not, however, make pleadings irrelevant. For example, a pleading that sets out the State's general view on a certain matter should be given more weight than one which addresses a narrow point in dispute between the parties (the more general the submission, the less likely it is that the submission simply represents a position that the State has adopted to avoid liability in that arbitration). Similarly, a pleading that is supported by

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[49] *Gas Natural SDG S.A. v. Argentina*, ICSID No. ARB/03/10, Jurisdiction (2005) at para. 47 n.12.

[50] *Roberts, Power and Persuasion*, *supra* note 5, at 218 (citing *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Jurisdiction (2004) at para 48: "[W]hat the State of nationality of the investor might argue in a given case to which it is a party [and to which the specific investor is not a party] cannot be held against the rights of the [specific] investor in a separate case to which the [specific] investor is a party. This is precisely the merit of the ICSID Convention in that it overcame the deficiencies of diplomatic protection where the investor was subject to whatever political or legal determination the State of nationality would make in respect of its claim.).

[51] Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 34-35 (2008).

[52] *Roberts, Power and Persuasion*, *supra* note 3, at 218 (citing Charles H. Brower II, Structure, *Legitimacy, and NAFTA's Investment Chapter*, 36 Vand. J. Transnat'l L. 37, 51-57 (2003)).

other forms of State practice should be given more weight.[53] For example, if the position set out in the pleading is consistent with views expressed by the State in earlier disputes or statements issued by government officials, then that pleading should be considered more seriously. By contrast, if the position is contradicted by prior State practice, then the pleading should be given lesser weight.

The second form of subsequent practice identified by Anthea Roberts is "[i]nterventions by non-disputing parties".[54] Of course, the universe of potential non-disputing parties is broad and could include, among others, States who are not parties to the treaty, as well as supra-national organisations (like the European Commission), international organisations and NGOs. But because Article 31(3)(b) focusses on "subsequent practice . . . which establishes the agreement of the parties" (emphasis added), it must be that only interventions made by other treaty parties count. In case of a bilateral investment treaty, this would mean the home State of the investor, whereas in case of a multilateral investment treaty (like NAFTA or ECT), this could mean any of State parties not directly involved in the arbitration.

In this regard, NAFTA again offers an interesting example. In addition to the joint interpretation mechanism mentioned above, NAFTA also allows non-disputing parties to make the so-called Article 1128 submission "on a question of interpretation" of the NAFTA. Whilst many Article 1128 submissions have been made by various NAFTA parties,[55] there has been only one joint interpretation so far (as noted above, that interpretation concerned the scope of article 1105 of NAFTA). That said, NAFTA tribunals have differed over the weight

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53 *Roberts, Power and Persuasion*, *supra* note 3, at n. 185.

54 *Roberts, Power and Persuasion*, *supra* note 3, at 219.

55 *See, e.g.*, *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada*, ICSID Case No. ARB(AF)/07/4 (2007) (four Article 1128 submissions made); *Methanex Corporation v. United States of America*, UNCITRAL (2005) (eight Article 1128 submissions made); and *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL (2001) (over a dozen Article 1128 submissions made).

that Article 1128 pleadings should be given. For example, in *ADF v United States*, the tribunal took account of the Article 1128 submissions made by Canada and Mexico, which broadly supported the interpretation advanced by the United States.[56] On the other hand, the *Pope & Talbot v Canada* tribunal noted that the position advanced by Canada was consistent with the Article 1128 submissions made by the United States and Mexico; yet, it found that position unconvincing.[57]

Even in case of treaties that do not expressly provide for interventions by non-disputing parties, it is possible for such parties to intervene (with the permission of the tribunal). For example, as noted above, in *Aguas del Tunari v. Bolivia*, the tribunal requested the Dutch government to clarify its views on the interpretation of a provision of the Netherlands – Bolivia BIT. On the other hand, in *SGS Société Générale de Surveillance v. Pakistan*, a dispute under the Switzerland-Pakistan BIT, the Swiss Government complained that its views on the umbrella clause were not taken into account by the tribunal:

> "[T]he Swiss authorities are wondering why the Tribunal has not found it necessary to enquire about their view on the meaning of Article 11 [the umbrella clause] in spite of the fact that the Tribunal attributed considerable importance to the intent of the Contracting Parties in drafting this Article and indeed put this question to one of the Contracting Parties (Pakistan) . . . [T]he Swiss authorities are alarmed about the very narrow interpretation given to the meaning of Article 11 by the Tribunal, which not only runs counter to the intention of Switzerland when concluding the Treaty but is quite evidently neither supported by the meaning of similar articles in BITs concluded by other countries nor by academic comments on such provisions". [58]

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[56] *ADF Group Inc. v. United States*, ICSID No. ARB(AF)/00/1, para. 177 (NAFTA Ch. 11 Arb. Trib. Jan. 9, 2003), 18 ICSID REV. 195 (2003), para. 179.

[57] *Pope & Talbot Inc. v. Canada*, *supra* note 55, Merits of Phase 2, para. 79 (Apr. 10, 2001).

[58] Note on the Interpretation of Article 11 of the Bilateral Investment Treaty between Switzerland and Pakistan in the light of the Decision of the Tribunal on Objections to Jurisdiction of ICSID in *Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Objection to Jurisdiction (2003) attached to the Letter of the Swiss Secretariat for Economic Affairs to the ICSID Deputy-Secretary General dated October 1, 2003, published in 19 Mealey's: Int'l Arb. Rep. E 3 (Feb. 2004).

In some respects, there should be fewer objections to the use of pleadings submitted by non-disputing parties. Unlike party pleadings, which are (correctly) criticized for being motivated by the desire to avoid future liability, pleadings of non-disputing parties are likely to contain a State's general views on interpretation of that treaty. That said, there is a risk that intervention by the home State of the investor may be viewed as that State exercising its right to diplomatic protection (something that is generally regarded as being impermissible in investment treaty law[59]). Indeed, that was a concern to which the tribunal in the *Aguas del Tunari v. Bolivia* case was alive. In its request the tribunal referred to article 27 of the ICSID Convention, which prohibits diplomatic protection by home State. Accordingly, the tribunal framed its request narrowly; it noted that[60]:

> Given further the above quoted Article 27 of the ICSID Convention and the fact that the Netherlands is not a party to this arbitration, the Tribunal is also of the view that such questions must be specific and narrowly tailored, aimed at obtaining information supporting interpretative positions of general application rather than ones related to a specific case. It is the opinion of the Tribunal that it possesses the authority to seek this information under Rule 34 of the ICSID Arbitration Rules.

Aside from pleadings and interventions from non-disputing parties, there are other forms of subsequent practice that tribunals can (and have) considered in the past. For example, States can make statements clarifying their understanding of a treaty clause and then make such statements available publicly, on a website or the international law digest.[61] Of course such statements by themselves would not establish an "agreement on interpretation", but at least it would give the other treaty party the opportunity to consider the statement and respond.

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59 *See, e.g.*, ICSID Convention, Art. 27(1).

60 *Aguas del Tunari v. Bolivia*, Respondent's Objections to Jurisdiction, ICSID No. ARB/02/3 (2005) at para 258.

61 *See Roberts, Power and Persuasion*, *supra* note 3, at 221.

Similarly, a State could issue clarification and explanatory notes along with its model BIT, which set out that State's views on interpretation of treaty clauses.[62]

The main objection against using statements or model BITs as an interpretive tool is the possibility of abuse by the State. Where the statement is made around the same time as when the BIT was concluded, or where the BIT is based on the model, treaty tribunals are unlikely to have any objection in using the statements and model texts to inform their understanding of the treaty provisions (although, in such cases, the statements and model texts are more likely to be used as a means to establish the original intentions of the parties, as opposed to "subsequent practice" under Article 31(3)[63]). On the other hand, where the statements are made at a later point, tribunals have, generally speaking, refused to consider the interpretations, even when they are shared by both treaty parties, on the basis that those interpretations do not reflect the original intentions of the parties. For example, in *Enron v Argentina*, expert legal evidence submitted on behalf of Argentina showed that there was convergence between Argentina's position, and the views expressed by the United States in its official statements, on interpretation of the non-precluded measures clause in the Argentina-United States BIT.[64] However, the tribunal rejected Argentina's proposed interpretation on

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62 *Id.* Most capital-exporting countries have their own model investment agreements. Moreover, many States have also revised their model agreements. The United States, for instance, presented a new model BIT in 2012, which replaced the 2004 model. The 2004 model had replaced the 1992 model previously.

63 *See, e.g.*, *Pan Am. Energy LLC v. Argentina*, ICSID No. ARB/03/13, Preliminary Objections, (2006) at para. 108 (citing 2004 U.S. Model BIT to interpret the umbrella clause in the U.S.-Argentina BIT); *CMS Gas Transmission Co. v. Argentina*, ICSID No. ARB/01/08 (2005) at para 368, (citing 2004 U.S. Model BIT to interpret the emergency provisions in the U.S.-Argentina BIT); *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Jurisdiction (2004) at para 46(citing 2004 U.S. Model BIT in relation of definition of the term "investor" in the U.S.-Argentina BIT); *El Paso Energy Int'l Co. v. Argentina*, ICSID No. ARB/03/15, Jurisdiction (2006) at para 80 (citing 2004 U.S. Model BIT to interpret the umbrella clause in the U.S.-Argentina BIT). *But see A.G. v. Argentina*, ICSID No. ARB/02/8, Jurisdiction (2004) at para 106 (rejecting that the German model BIT is relevant to understanding the terms of the Argentina-Model BIT).

64 *See, e.g.*, *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (2007) at para 335-7.

the basis that "[w]hat is relevant is the intention the parties had in signing the Treaty".[65] The tribunal went on to note that even if Argentina's proposed "interpretation were shared today by both parties to the Treaty, it would still not result in a change of its terms".[66] In the tribunal's view that would count as an amendment to the terms of the treaty, which whilst the States are free to agree to, "would not affect rights acquired under the Treaty by investors or other beneficiaries".[67] In *Sempra v Argentina*, the tribunal made very similar findings.[68]

It seems evident that the tribunals' rejection of the subsequent statements made by parties is motivated by the concern that State parties should not be able to issue opportunistic statements that favour the positions that they have adopted in on-going arbitration, or will adopt in expected arbitrations. Nevertheless, the focus on parties' original intentions is incorrect as it ignores the continuing relevance of "subsequent practice", which, as noted above, treaty tribunals *must* take into account when interpreting treaties.

Finally, internal practice of States can also provide evidence of "subsequent practice".[69] Internal practice can be manifested in various forms, including decisions of domestic courts[70] or statements made by the various branches of the government at the time of ratification of a treaty.[71] However, internal practice of one State does not establish an

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65 *Id.* at para. 337.

66 *Id.*

67 *Id.*

68 *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award, para. 386 (28 Sept. 2007).

69 See *Roberts, Power and Persuasion*, *supra* note 3, at 222.

70 *See, e.g., Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, ancillary claim (2004) at paras. 38-39 (referring to a decision of the U.S. Supreme Court on direct and indirect ownership that it found inconsistent with the position taken by Argentina in that case and by the United States in other cases, which demonstrated a lack of agreement on interpretation. *See Dole Food Co. v. Patrickson* 538 U.S. 468 (2003).

71 *Generation Ukraine Inc. v. Ukraine*, ICSID No. ARB/00/9 (2003) paras. 15.4-15.7 (referring to a letter sent by the U.S. Department of State to the President of the United States at the time of the ratification of U.S.-Ukraine BIT); *Feldman v. Mexico*, ICSID No. ARB(AF)/99/1(2002) at para 181 (referring to a U.S. Statement of Administrative Action submitted in relation to NAFTA).

"agreement on interpretation"; for that, there needs to be consistency in the internal practice of both State parties. In the investment treaty context, it is rare to find such agreement evidenced by internal practice. However, there are some exceptions. For example, in the *Baywater Irrigation District v Mexico* case, the tribunal noted that the interpretation advanced by Mexico in respect of definition of "investor" and "investment" under NAFTA was consistent with the internal practice of the State parties to NAFTA[72]:

> "The interpretation adopted here is supported by the fact that it is the interpretation publicly adopted by the NAFTA Parties themselves prior to this litigation. The Tribunal notes the terms of the United States Statement of Administrative Action submitted to Congress in connection with the conclusion of the NAFTA, the report on NAFTA prepared prior to the approval of the NAFTA by the Mexican Senate, and the Canadian Statement on Implementation of the NAFTA".

Similarly, in *ADF Group v United States*, the tribunal noted that the domestic content and performance requirements in governmental procurement that were at issue in that case were consistent across all NAFTA State parties. This, the tribunal considered, suggested that the requirements were not prohibited in these States and were, therefore, contrary to the investor's submission, unlikely to unfair or inequitable.[73]

That said, neither the *Baywater Irrigation* tribunal, nor the *ADF Group* tribunal referred to Article 31(3)(b) when analysing the internal State practice of the treaty parties. That is very different to how other international courts/tribunals have approached the question of interpretation of treaties in light of subsequent State practice. For example, the European Court of Human Rights ("ECtHR") often considers internal practice of the various parties to the European Convention of Human Rights ("ECHR") when interpreting its provisions.[74]

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72 *Bayview Irrigation District et al. v. United Mexican States*, ICSID Case No. ARB(AF)/05/1 (2007) at para 106 (internal footnotes removed).

73 *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (AF)/00/1 (2003) at para 188.

74 *See Roberts, Power and Persuasion*, *supra* note 3, at 204 (identifying such seminal cases as *Tyrer v United Kingdom* (where the ECtHR concluded that judicial corporal punishment of juveniles amounted to degrading punishment partly on the basis that it was prohibited in majority of the other treaty parties) and *Bankovic v Belgium*, [2001] ECHR 890 (where the ECHR undertook a comparative

Similarly, the WTO Dispute Settlement Body often relies on subsequent practice of treaty parties to interpret terms of WTO instruments, including the GATT.[75]

4. Acts of political risk insurance providers as a form of state practice

This section describes how decisions of PRI providers can be an important source of State practice, which can constitute "subsequent practice" within the meaning of Article 31(3)(b) of the VCLT and, in certain circumstances, can also lead to the formation of custom. But before turning to that analysis, it is helpful to identify certain matters that emerge from the analysis set out above.

4.1. Introduction

First, in terms of doctrine, as noted above, whilst international tribunals do not always distinguish between "subsequent agreements" (Article 31(3)(a)) and "subsequent practice" (Article 31(3)(b)), there is a clear distinction between the two concepts. The former is formalistic, whereas the latter is more fluid and can encompass all types of unilateral acts, which, when combined with acts of the other parties to the treaty, can give rise to agreements on interpretation. As such, the concept of "subsequent practice" is more useful to studying decisions of political risk insurers. Going forward, therefore, "subsequent agreements" will not be discussed.

Secondly, and again as explained above, the same State practice that is relevant to interpretation of a treaty under Article 31(3)(b) of the VCLT can also be relevant to the formation of custom. The key difference is that, whilst Article 31(3)(b) requires consistency in practice of only parties to a treaty (which, in case of a BIT, would mean only two States),

review of internal practice before concluding that the extraterritorial bombing by NATO did not fall within the jurisdiction of the ECHR)).

[75] See Alexander M. Feldman, *Evolving Treaty Obligations: A Proposal for Analyzing Subsequent Practice Derived from WTO Dispute Settlement*, 41 N.Y.U. J. Int'l L. & Pol. 655 (2009).

international custom requires that practice to be followed consistently by many more States. The threshold for the formation of custom is, therefore, much higher. That said, as discussed below and in Chapter 7, it is not inconceivable that, under certain circumstances, activities of political risk insurers would lead to the formation of custom.

Thirdly, as far as the jurisprudence of treaty tribunals is concerned, so far tribunals have placed limited reliance on State practice in interpreting investment treaties. As explained above, the main sources of State practice that the tribunals have used so far, or that academics have identified, are pleadings of respondent States, interventions by non-disputing parties, statements issued by executive branches of the government, model BITs and the commentary accompanying them, and internal practice of States. However, as explained above, all these sources, however, have shortcomings, which is why tribunals have been reluctant to use these sources.

That said, and this is the fourth observation, despite the difficulties associated with the various sources identified above, it is still worth trying to find new sources of State practice that tribunals can credibly take into account when interpreting treaties. That is because of several reasons.[76] First, at present, investor-State jurisprudence is built largely on prior decisions of international tribunals, with very little attention paid to State practice. That, in turn, has the effect of creating a disconnect between tribunals and State parties, leading to questions being raised about the legitimacy of the investment treaty regime and, ultimately, causing significant backlash, in the form of premature termination of BITs, denunciation of international institutional mechanisms, halt on the negotiations of new treaties and, most commonly, negotiation of new treaties that are more prescriptive and less protective of

[76] *See generally*, Roberts, *Power and Persuasion*, *supra* note 3.

investors' rights.[77] If the views of the States were taken more seriously, arguably some of the backlash can be avoided.

The second advantage of taking State practice into account is that, by doing so, tribunals would be conforming more closely with the orthodox notion that States create international law, whilst tribunals only apply and interpret it.[78] The problem with the current jurisprudence is that, as others have pointed out, tribunals have elevated prior decisions – which are, at best, "subsidiary means for the determination of rules of law" – into a source of international law.[79]

The third advantage of taking State practice into account is that treaty standards tend to be broad and vague (e.g. the obligation to treat an investment in a 'fair and equitable' manner). Any guidance from State practice that assists in the interpretation of such clauses should be encouraged.

Against the backdrop of these observations, the next section of this chapter explains how tribunals may consider decisions of political risk insurers when interpreting treaties.

4.2. State practice

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[77] See, e.g., Gilbert Gagné and Jean-Frédéric Morin, *The Evolving American Policy on Investment Protection: Evidence from Recent FTAs and the 2004 Model BIT*, 9 J Intl Econ L 357, 363 (2006); Stephen Schwebel, *The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law*, 3 Transnat'l Disp Mgmt 1, 3-7 (Apr 2006); Mark Kantor, *The New Draft Model U.S. BIT: Noteworthy Developments*, 21 J Intl Arb 383, 385 (2004).

[78] *See, e.g.,* James Crawford, BROWNLIE'S PRINCIPLES OF PUBLIC INTERNATIONAL LAW 24-28 (OUP: 2008) ("[s]ince the Law of Nations is based on the common consent of individual States, and not of individual human beings, States solely and exclusively are the subjects of International Law" (internal footnoted removed)).

[79] On use of precedent in investment treaty law, see generally Catherine Kessedjian, *To Give or Not to Give Precedential Value to Investment Arbitration Awards?* in THE FUTURE OF INVESTMENT ARBITRATION 43 (Catherine A. Rogers & Roger P. Alford eds., 2009); Christoph Schreuer & Matthew Weiniger, *A Doctrine of Precedent?* in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 1188, 1189-91 (Peter Muchlinski, Federico Ortino, & Christoph Schreuer eds., 2008).

Acts of political risk insurers will constitute State practice only if the insurers can be regarded as part of the State. It is imperative, therefore, that any analysis in this area should begin with a description of an insurer's status under international law.

4.2.1. Attribution

PRI is provided by both entities State-owned entities – such as OPIC in the United States or export credit agencies in most countries – or by private companies. Except in very limited cirucmstances, acts of private insurers would not constitute State practice (e.g. acts which have been "acknowledged and adopted by the state as its own"). Acts of public insurers, however, are different.

In its 2001 Articles on State Responsibility for internationally wrongful acts, the International Law Commission has adopted rules on attribution of conduct to a State ("ILC Articles").[80] Those rules are not directly applicable to the identification of relevant interpretive practice; the range of possible wrongful acts by a State is necessarily much wider than those which are "in application of" a treaty.[81] Nevertheless, the rules of attribution can be a useful starting point in the present context.

Under the ILC Articles, the conduct of public insurers would be attributable to a State on one or the other of the following grounds:

- they are organs of the State within the meaning of Article 4 of the ILC Articles;
- they are entities exercising governmental authority within the meaning of Article 5 of the ILC Articles;

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[80] The International Law Commission Articles on State Responsibility, Introduction, Text and Commentaries, James Crawford, 2002 [hereinafter, *ILC Articles*]. For an authoritative treatment of certain topics in the law of international responsibility, *see generally*, James Crawford, ALAIN PELLET AND SIMON OLLESON, THE LAW OF INTERNATIONAL RESPONSIBILITY (OUP, 2010).

[81] See *First ILC Report*, *supra* note 6, at 46.

- they act under the control and direction of the State within the meaning of Article 8 of the ILC Articles.

These Articles, together, set out the "structural, functional and control tests" of determining whether the conduct of an entity is attributable to the State.[82]

As far as Article 4 is concerned, "the reference to a 'State organ' covers all the individual or collective entities which make up the organization of the State and act on its behalf".[83] Moreover, once an entity has been established as a State organ, the presumption is that all of its acts are attributable to the State.[84] However, it is unlikely that public insurers can be considered State organs. They almost always have a separate legal personality under local law and are considered as separate and distinct from the State. For example, as noted in chapter 1, OPIC's enabling statute describes it as a "Corporation"[85] and adorns it with many features that would be found in private businesses, including oversight of a Board of Directors,[86] requirement to publish profit and loss statements and balance sheets annually,[87] and instruction to operate on a "self-sustaining" basis.[88] For these reasons, OPIC is unlikely to qualify as an organ of the United States.

However, even if OPIC is not a State organ under ILC Article 4, its actions could still be attributable to the United States under ILC Article 5 if: (i) it "is empowered by the law of that State to exercise elements of the governmental authority"; and (ii) it "is acting in that

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82 *EDF (Services) Limited v. Romania*, Award, ICSID Case No. ARB/05/13 (2009) at para 187 [hereinafter, *EDF Award*].

83 *ILC Articles*, *supra* note 80, p. 94.

84 *EDF Award*, *supra* note 82, para. 188 (citing the expert opinion of Professor Christopher Greenwood).

85 The Foreign Assistance Act, Pub. L. 87-195, 75 Stat., 22 U.S.C. § 2151 (1969).

86 *Id.* at s. 2193.

87 *Id.* at s. 2199(c)(2).

88 *Id.* at s. 2191(a).

capacity in the particular instance".[89] As for (i), OPIC is clearly empowered by U.S. federal law to exercise governmental authority. In fact, its enabling statute clearly states that OPIC "shall be an agency of the United States under the policy guidance of the Secretary of State".[90] Moreover, the U.S. government regularly negotiates bilateral treaties with other countries on OPIC's behalf,[91] and OPIC regularly commits the "full faith and credit" of the U.S. government in support of the projects it approves.[92] As for (ii), because the practice of issuing insurance policies, making claim determinations, paying insurance claims and recovering those sums from the home States are part of OPIC's pursuit of its government authorised mandate, all of those acts are attributable to the United States under ILC Article 5.

Alternatively, those acts may be attributable to the United States under ILC Article 8 if they have been carried out on the "instruction of, or under the direction or control of" the U.S. government. As noted in the commentary to ILC Article 8, mere State ownership of a corporate entity is not sufficient; what is needed is evidence "that the corporation was exercising public powers, or that the State was using its ownership interest in or control of a corporation specifically in order to achieve a particular result".[93] In case of OPIC, it is clear that the U.S. government is using its control over the entity to achieve "a particular result": to increase U.S. investment flows to other countries. In fact, according to its enabling statute, OPIC is "to mobilise and facilitate the participation of the United States private capital and skills in the economic and social development of less developed countries and areas".[94]

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89 *ILC Articles*, *supra* note 80 at art. 5.

90 *Id.* at 2191.

91 *See* M. Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation,* 36 Virg. J. Int'l L. 511, 518 (1995).

92 General provisions relating to insurance, guaranty, financing, and reinsurance programs, 22 USC §2197(c).

93 *ILC Articles*, *supra* note 80, pp. 112-113.

94 Congressional statement of purpose; creation and functions of Corporations, 22 USC s. 2191.

Therefore, for reasons set out above, acts of public insurers like OPIC can be attributed to their respective States under both ILC Articles 5 and 8.

4.2.2. Practice "in the application" and "regarding the interpretation" of investment treaties

Subsequent practice under Article 31(3)(b) must be in the "application of the treaty" and it must lead to the establishment of an agreement "regarding its [the treaty's] interpretation". It is difficult to conceive of conduct "in the application of the treaty" which does not require the State party to take a position "regarding the interpretation" of the treaty.[95] At the same time, conduct, which takes place regardless of the treaty obligation, may not be "in the application of the treaty" or "regarding its interpretation".[96] Such conduct may include voluntary practices that are not motivated by treaty obligations, or practices that are completely motivated by non-treaty related considerations. A well-known example is the *Certain Expenses* case, where Judge Fitzmaurice noted that the continued payment of membership contributions by State parties does not mean that they "necessarily admit in all cases a positive legal obligation to do so".[97] That said, it is not always easy to distinguish practice that is in application of the treaty from that which is not. Ultimately, this is likely to be a question of the interpretive weight to be given to a certain practice – the more closely it is related to the treaty or the more specific it is, the more interpretive weight that practice deserves.[98]

In particular, as noted in Chapter 1, under certain national schemes, such as NEXI in Germany, one of the pre-conditions for obtaining PRI is that the investment should be made

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95 *Second ILC Report*, *supra* note 6 at para 5.

96 *Id.* at para. 6.

97 *Certain Expenses of the United Nations, Advisory Opinion*, 1962 I.C.J. Reports 51, at p. 201 (*Separate Opinion of Judge Fitzmaurice*).

98 *Second ILC Report*, *supra* note 6, p. 6, para. 10.

in a State with whom the home State of the investor has signed a bilateral investment treaty. In these countries, investment treaties are viewed as the primary means of protecting investments; insurance schemes are viewed as subsidiary means of protection.

Further, at the time of drafting the insurance policy, insurers appear to be conscious of treaty protections. In particular, many insurers require that, to have a claim under the policy, the insured must show that the government measure constituted a breach of international law. As explained in Chapter 3, one of the conditions that had to be proven to make a claim for expropriation under the earlier version of OPIC's and MIGA's standard form contracts was that the host State had breached international law.

Next, at the claim determination stage, if the insurance policy requires the insured to show breach of international law, then necessarily the insurer has to make a determination as to whether the government measure did in fact fall foul of international law. Whether there has been a breach of international law can be evidenced in many different ways, including by showing that there has been a breach of an investment treaty. For example, as noted in Chapter 5, in the *Marine Shipping* case, the insured – Marine Shipping Corporation ("MSC") – claimed that certain taxes charged by the Egyptian port authority were significantly higher than the amount that would have been charged to an Egyptian company, and therefore such discriminatory treatment violated the US-Egypt BIT, and by extension, the OPIC contract.[99] In its determination, OPIC did not question the logic behind MSC's submission that a violation of a US-Egypt BIT could trigger a violation of the OPIC contract. However, it found that even if the disparate fee allegations were factually correct, such treatment would not constitute a

[99] OPIC, Memorandum of Determination, *Confiscation Claim of Marine Shipping Corporation Contract of Insurance No. CO15* (2 July 2009).

treaty violation because of certain exceptions contained in the 'national treatment' clause of the BIT.[100] OPIC has similarly referred to U.S. BITs in several other determinations.[101]

Finally, at the recovery stage – i.e. after the insurer has paid out under a policy and is seeking to recover that sum from the host State – investment treaties are particularly relevant. As explained in Chapter 4, public insurers may be able to rely on the subrogation clauses in investment treaties to bring claims against host States. To that end, it helps if there is an alignment between protections available to an investor under insurance policies and protections that are available to investors under investment treaties. The failure to establish such alignment could expose the insurer to the risk of inconsistent decisions, which in turn would affect the insurer's recovery prospects.

In light of the above, it is not inconceivable that practice of State owned political risk insures in relation to matters that are also covered under investment treaties – such as 'expropriation' or 'currency convertibility' – qualify as relevant 'subsequent practice' for the purposes of article 31(3)(b).

4.2.3. Frequency of subsequent practice

100 *Id.* at 7.

101 Of the other cases in which OPIC has cited BITs, only *Alliant Techsystems, Inc.*, Memorandum of Determination Belarus (OPIC) (1997) contains any substantive discussion regarding the BIT. In that case, OPIC found that the actions of the Government of Belarus violated both customary international law and the U.S. – Belarus BIT. Even though the BIT had not entered into force at the time of the determination (and, in fact, has not entered into force to date), OPIC still found that governmental interference with the local investment was contrary to the treaty's "object and purpose" of creating a "stable framework of investment". Other cases in which OPIC has cited BITs are *Poderosa Assets – Argentina* (2003) (U.S. – Argentina BIT); *Sears, Roebuck & Co. – Nicaragua* (1980) (U.S. – Nicaragua BIT) and *Ralston Purina – Nicaragua* (1980) (U.S. – Nicaragua BIT).

The next logical question to consider is whether subsequent practice under Article 31(3)(b) requires a single act or a series of consistent acts. In this regard, the WTO Appellate Body stated in the *Japan – Alcoholic Beverages II* case that[102]:

> Subsequent practice in interpreting a treaty has been recognised as a 'common, concordant and consistent' sequence of acts or pronouncements, which is sufficient to establish a discernible pattern implying the agreement of the parties regarding its interpretation.

The WTO Appellate Body's approach has been described as setting a "high threshold".[103] It is also at odds with the jurisprudence of the ICJ and other international tribunals, who have applied Article 31(3)(b) more flexibly, including in circumstances where there was no discernible pattern to the subsequent State practice.[104] Indeed, the phrase "common, concordant and consistent", which the WTO Appellate Body borrowed from Sir Ian Sinclair's treatise on the VCLT, had been used in the latter publication not as a form of pre-condition for the use of subsequent practice. Instead, Sinclair has said that "*the value* of subsequent practice will naturally depend on the extent to which it is common, concordant and consistent".[105] Therefore, in the same way as the interpretive value of State practice depends on its specificity (as discussed above, the more specific and closely related it is to a treaty, the more weight will be given to it in the interpretation of that treaty), the interpretive value of State practice also depends on how frequent and consistent it is (greater frequency and consistency would mean that it is of greater value as a means of interpretation).[106]

The practice of political risk insurers may, at times, demonstrate a consistent sequence of acts, such as where the insurer interprets the policies' clauses on expropriation or currency

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102 WTO, Appellate Body Report, *Japan – Alcoholic Beverages II*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, sec. E, pp. 12-13 (4 Oct. 1996).

103 *Second ILC Report*, *supra* note 6, p. 21, para. 45.

104 *Id.* at pp. 21-22.

105 I. Sinclair, THE VIENNA CONVENTION ON THE LAW OF TREATIES 137 (Manchester, Manchester University Press, 1984) (emphasis added) (cited in *Second ILC Report*, *supra* note 6, pp. 22-23).

106 *See also Second ILC Report*, *supra* note 6, p. 23.

convertibility in the same way again and again. At other times, however, there may be no consistency (where, for example, an insurer issues conflicting determinations in relation to the same provisions in its policies) or there may only be single act to consider. Irrespective of the specific circumstances, based on the above, all such acts are relevant to the identification of 'subsequent practice' for the purposes of Article 31(3)(b), although they may vary significantly in their interpretive value.

4.2.4. Agreement of the parties regarding the interpretation of the treaty

The final element of Article 31(3)(b) is the existence of an "agreement" between the parties "regarding interpretation" of the treaty. An agreement is necessary for subsequent State practice to have any interpretive value. The lack of an agreement is in fact one of the main reasons why investment treaty tribunals have ignored various forms of State practice that would have otherwise qualified for the purposes of Article 31(3)(b). As noted above, statements made by a government regarding provisions in a BIT, model BITs and explanatory notes, as well as States' internal practice (such as decisions of local courts) are all forms of "subsequent practice" which can inform the interpretation of a treaty. However, they rarely do. That is because there is seldom any evidence available to show that the other State party agrees with that practice, or there is some form of commonality in the parties' positions.

The practice of political risk insurers is also unilateral: the acts of insurers are only attributable to the States who control them, and not to anyone else. At the indemnification and recovery phase, however, there is some interaction between the insurers and other States; that interaction can, in certain circumstances, lead to the establishment of an agreement regarding interpretation of the treaty. This interaction occurs in three ways primarily.

First, public insurers (like OPIC) may try to influence the course of political events in order to reduce the frequency of claims.[107] As explained in Chapter 2, unlike private insurers who like to keep their involvement in an investment project confidential, public insurers (like OPIC) deliberately inform the host government of the existence of its political risk insurance contracts. Moreover, the U.S. government, on behalf of OPIC, signs bilateral incentive agreements with the host government. As a result, the host government is often aware that, should it take steps that adversely affect an investment insured by OPIC, the U.S. government will pursue remedies available to it. This threat "tends to inhibit government action".[108] Indeed, in his comments to the House Foreign Affairs Committee, OPIC's General Counsel noted that[109]:

> The existence of OPIC's expropriation insurance is undoubtedly a deterrent to nationalization without compensation. In several cases in the last year and a half, governments have failed to follow through on announced plans to nationalize OPIC-insured investment because we were able to bring to the attention of the governments concerned the fact of OPIC's involvement. We also pointed out that OPIC would be subrogated to the rights of an expropriated investor. We further noted the economic problems of operating the enterprises on a profitable basis, and the difficulties of providing prompt and adequate compensation. Unfortunately, we are unable to discuss these particular cases publicly.

There are many examples of OPIC using its negotiation leverage to prevent the investor from suffering any loss. As explained in the next chapter, perhaps the most notable instance of OPIC's involvement in this respect relates to nationalisation claims arising from Chile.[110]

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107 *See* Maura Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation*, 36 Virg. J. Int'l. L. 511, 554 (1996) [hereinafter, *Efficient Foreign Aid*].

108 *Id.*

109 Foreign Affairs Division, Cong. Research Service, Library of Congress, House Comm. on Foreign Affairs, 93d Cong., 1st Sess., The Overseas Private Investment Corporation: A Critical Analysis 96 (Comm. Print 1973) (cited in *Efficient Foreign Aid*, *supra* note 107, at 555).

110 *Chile Copper Co. (Exotica)*, Contract No. 5850, Memorandum of Claim Determination (OPIC) (1972).

Secondly, if OPIC is unsuccessful in averting the claim altogether, it often uses its influence to reduce the value of the claim. As explained in Chapter 2, after the investor submits the claim, OPIC typically investigates it and attempts to facilitate a settlement between the investor and the host State. Because of the "full faith and credit" backing of the U.S. government, OPIC has been very successful in negotiating such settlements. According to the agency's own statement:[111]

> "Since 1971, OPIC has made 290 insurance claims settlements totalling $969.8 million. . . . OPIC cash recoveries on claims total $447.1 million (without regard to reinsurance reimbursements). Additional recoveries in the form of receivables ($219 million) and recoveries on OPIC guaranteed obligations ($226 million) bring OPIC's total recoveries to $892.1 million, or 92% of total cash settlements".

Again, there are many examples of OPIC using its influence to extract a favourable settlement from the host State. As explained in the next chapter, the most striking example in this regard is OPIC's involvement in respect of Indonesia.

Finally, if a settlement is not possible then OPIC either pays the insured or denies the claim. In the latter case, the investor can seek a formal review of the insurer's determination by invoking the dispute resolution clause in the policy (which usually provides for arbitration). Once OPIC has paid the investor – either on its own or after being forced to do so by an arbitral tribunal – OPIC is subrogated to the investor's rights in the investment. OPIC may then assert those rights against the host government under the bilateral incentive agreements. There is only one instance on which OPIC is known to have done so – when it initiated arbitration against India. That arbitration will be discussed in detail in the next chapter.

5. Conclusion

The previous chapters explained how international law creates rights and remedies that are important to insurers. This chapter explains how the practice of State sponsored insurers could

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111 OPIC, *Insurance Claims Experience To Date: OPIC and its Predecessor Agency* (Sep 30, 2010) (on file with the author).

be relevant to the interpretation of investment treaties and, in certain circumstances, even contribute to the creation of customary international law.

Subsequent practice is an important interpretive tool, which has been largely ignored by treaty tribunals. That has been the case partly because there is little evidence of subsequent practice and, when there is, it is usually deficient in several respects. The practice of State sponsored political risk insurers, however, can be a compelling interpretive source. This chapter explained why, as a matter of doctrine, that practice is relevant. Specifically, the acts of public insurers are attributable to the State because they are State-owned entities who are exercising governmental authority and/or acting under the direction and control of the State. Moreover, insurers continuously engage with international law in various ways, including at the time they draft the insurance policies, when they 'advocate' on behalf of the investors before the government of the host State, at the time of negotiating a settlement between the host State and the investor, and when they exercise their subrogation rights to bring a claim against the host State.

For these reasons, the practice of State sponsored insurers can constitute "subsequent practice" of that State, which when combined with the acts of the host State, can give rise to an "agreement regarding interpretation" of any investment treaty between the home State of the insurer and the host State.

Having discussed the analytical framework, the next chapter provides an illustrative list of examples from OPIC's jurisprudence and practice. Those examples show how, in practice, tribunals can use insurers' practice to interpret investment treaties.

PART C

ILLUSTRATIONS AND SPECIFIC EXAMPLES

CHAPTER 6: ILLUSTRATIVE OPIC DETERMINATIONS AND PRACTICE

1. Introduction

In the previous chapter, it was explained that the practice of State sponsored insurers could be relevant to the interpretation of investment treaties and, in certain circumstances, even contribute to customary international law.[1] Specifically, it was argued that the acts of public insurers are attributable to the State because they are

[1] *See*, Chapter 5, s. 5.

either "de-facto" organs of the State, or State-owned entities acting under the direction and control of the State.[2] Furthermore, insurers continuously engage with international law in various ways, including at the time they draft the insurance policies, when they issue determinations grounded in international law, when they 'advocate' on behalf of the investors before the government of the host State, at the time of negotiating a settlement between the host State and the investor, and when they exercise their subrogation rights to bring a claim against the host State. For these reasons, the practice of State sponsored insurers can constitute "subsequent practice" of that State.[3]

But practice of States that own and control the insurers is only one side of the coin. To establish an "agreement regarding interpretation" of any investment treaty between the home State of the insurer and the host State for the purposes of Article 31(3)(b) of the Vienna Convention on the Law of Treaties ("VCLT"), more is needed.[4] Specifically, the practice of the host State must evidence an agreement between the parties. Broadly speaking, the host State could respond to an adverse determination made by the insurer of the home state in the following three ways.

First, the host State immediately agrees to pay the subrogated insurer out of a sense of legal obligation. That would be the strongest indication of an agreement

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2 *See*, Chapter 5, s. 4.2.1.

3 *See*, Chapter 5, s.3.2.

4 On article 31(3)(b) of the *VCLT*, *See, generally*, I. Sinclair, THE VIENNA CONVENTION ON THE LAW OF TREATIES 130-138 (Manchester, Manchester University Press, 1984); Anthea Roberts, *Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States*, 104 Am. J. Int'l. L. 179 (2010); Georg Nolte, International Law Commission, *First Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/660, (2013); Georg Nolte, International Law Commission, *Second Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/671 (2014).

between the States regarding interpretation of the treaty.[5] Secondly, the host State might initially resist payment but, in the light of pressure exerted by the insurer's home State, agree to reimburse the insurer. The pressure exerted on the home State could be both political (e.g. threat of economic sanctions), as well as legal (e.g. threat of an international claim). Founding an agreement on interpretation in such circumstances would be less straightforward as it can be validly argued that the host State's decision to pay was, ultimately, a political act, which was not based on the law. Even then, and as explained further below, it would be odd to completely brand host State's actions as lacking any interpretive value. Indeed, majority of the interaction between States – which is routinely taken into account by international tribunals – occurs under similar circumstances.[6]

Finally, the host State might successfully resist payment, leading the insurer to write off the loss. In such circumstances, quite clearly, there is no agreement. If anything, it is the opposite: the host State's resistance may be considered as evidencing a disagreement between the parties on interpretation. Another situation in which the same interpretive result would be reached is where the host State agrees to pay, but at the time of making the payment, it makes it clear that it disagrees with the position of the insurer and accepts no liability under international law.[7]

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5 *See generally*, Mark A. Chinen, *Game Theory and Customary International Law: A Response to Professors Goldsmith and Posner*, 23 Mich. J. Int'l L. 143, 178 (2001); Curtis A. Bradley, Mitu Gulati, *Withdrawing from International Custom*, 120 Yale L.J. 202 (2010).

6 *See, e.g.*, Jack L. Goldsmith & Eric A. Posner, *A Theory of Customary International Law*, 66 U. Chi. L. Rev. 1113 (1999); Jack L. Goldsmith & Eric A. Posner, *Understanding the Resemblance Between Modern and Traditional Customary International Law*, 40 Va. J. Int'l L. 639 (2000) (arguing that states do not comply with customary international law out of a sense of legal obligation--they act out of their rational self-interest and coercion in their interactions with other states).

7 *See*, *infra* s. 2.3.

In order to illustrate these different responses, this chapter analyses two major, and relatively recent, OPIC determinations: the *Mid-American Holding Determination*[8] and the *BoA Determination*.[9] In both cases, the host States – Indonesia and India respectively – agreed to pay OPIC. However, the circumstances under which payments were made starkly different. That, in turn, has an impact on the interpretive value of the parties' actions, as explained below.

These determinations also present an opportunity to highlight the potential impact of of OPIC's jurisprudence on general international law. Specifically, the determinations reveal two characteristics of OPIC's jurisprudence. First, in some respects, OPIC's determinations apply general international law, albeit often by relying specifically on U.S. centric sources. In the process, OPIC reinforces established principles of international law. For example, OPIC's treatment of the rules of attribution in the determinations discussed below is largely consistent with the ILC Articles on State Responsibility ("ILC Articles"),[10] even though most of the references in the determinations are to the U.S. Restatement on Foreign Relations ("Restatement on Foreign Relations").[11]

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[8] OPIC, Memorandum of Determinations, Expropriation Claim of Mid-American Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527 and E759 (10 Nov. 1999) [hereinafter, *Mid-American Holding Determination*].

[9] OPIC, Memorandum of Determinations: Expropriation Claim of Bank of America as Trustee India – Contract of Insurance No. F401 (30 Sep. 2003) [hereinafter, *OPIC, BoA Determination*].

[10] Draft Articles on Responsibility of States for Internationally Wrongful Acts, *in* Report of the International Law Commission on the Work of Its Fifty-third Session [hereinafter, *ILC Articles*], UN GAOR, 56th Sess., Supp. No. 10, at 43, UN Doc. A/56/10 (2001), *available at*: http://www.un.org/law/ilc. The final articles, commentaries, prior drafts, tables showing the derivation of each provision, bibliography, and an informative introduction by the last special rapporteur on state responsibility, all appear in J. Crawford, THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES (2002).

[11] American Law Institute, RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1987).

In other respects, OPIC determinations elaborate on relatively obscure aspects of general international law, which have, to date, received little attention from international tribunals. For example, in the *BoA Determination*, OPIC had to consider whether acts of the Indian judiciary, including issuance of anti-arbitration injunctions and judicial delays, were in violation of international law.[12] Similarly, in the *Mid-American Holding Determination*, OPIC had to decide whether Indonesia's failure to comply with an arbitration award was in violation of international law.[13] OPIC's findings on both issues are again largely consistent with the findings made by the few international tribunals that have considered these issues; however, as explained below,[14] OPIC's position on these issues is arguably more favourable to investors than that of the international tribunals.

Summaries of both determinations will follow the same pattern. To start with, there will be a fairly lengthy description of the facts, followed by an explanation of the procedural context in which the claim arose. That will be followed by a brief discussion of the efforts, if any, made by OPIC and the U.S. government to negotiate a settlement with the host State. Finally, in the analysis section, an attempt will be made to put the determinations into context, by going through the various doctrinal steps outlined in the previous chapter. The final section will also highlight those aspects of the determinations where OPIC's findings can contribute to the development of general international law.

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12 *See, s.*3.

13 *See, s.* 2.

14 *See, infra* s. 3.4.

Looking ahead, this is the first of the three chapters in the thesis that contain case studies. As explained above, the case studies here are two OPIC determinations. The next chapters focus on specific areas of law, namely attribution and rules of State responsibility (Chapter 7) and compensation (Chapter 8).

2. Mid American Energy Holding (Indonesia, 1999)

2.1. Factual background

In December 1994, CalEnergy Company Inc. ("CalEnergy"), a U.S. based energy company, made certain investments in Indonesia.[15] Specifically, acting through its majority owned Indonesian subsidiaries - Himpurna California Energy Ltd. ("HCE") and Patuha Power Ltd ("PPL") (together, the "Local Subsidiaries") – CalEnergy entered into several agreements with certain Indonesian state-owned companies for the development and operation of two geothermal power projects in Indonesia. These State-owned companies were: PT (Persero) Perushaan Listruik Negara ("PLN") and Perusahaan Pertambangan Minyak Dan Gas Bumi Nigara ("Pertamina").

The agreements provided the Local Subsidiaries with exclusive rights to develop the fields and build generation facilities thereon, and obliged PLN and Pertamina to purchase the electricity for a period of forty-two years. In addition, the

[15] The following summary of facts has been taken largely from OPIC, Memorandum of Determinations, Expropriation Claim of Mid-American Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527 and E759 (10 Nov. 1999) [hereinafter, *Mid-American Holding Determination*]; M. Kantor, M. Nolan & K. P. Sauvant, REPORTS OF OVERSEAS PRIVATE INVESTMENT CORPORATION DETERMINATIONS, 728-43 (OUP: 2011) [hereinafter, *Kantor, OPIC Reports*]; Marcus Chadwick, *The Overseas Private Investment Corporation: Political Risk Insurance, Property Rights and State Sovereignty* (DPhil Thesis, 2006), available at: http://ses.library.usyd.edu.au/bitstream/2123/1857/4/01front.pdf [hereinafter, *Chadwick, OPIC and State Sovereignty*]; Mark Kantor, *International Project Finance and Arbitration with Public Sector Entities: When is Arbitrability a Fiction?*, 24 Fordham Int'l L. J. 1122, 1126-40 (2000) (discussing arbitrations against the Governments of Indonesia and Pakistan arising out of failed power projects) [hereinafter, *Kantor, International Project Finance*].

Government of Indonesia ("GOI") agreed to provide support letters which stated that the GOI "would cause" PLN and Pertamina "to honour their obligations" under the relevant agreements. The agreements and support letters provided that disputes relating to the relevant documents would be settled by arbitration in Jakarta, Indonesia, under UNCITRAL Rules.[16]

Before investing in Indonesia, CalEnergy had obtained political risk insurance from OPIC for its projects. The terms of the OPIC coverage are particularly interesting. Under section 4.01(a), the OPIC contract contained the standard coverage for expropriatory conduct, which provides for compensation if acts (other than acts that constitute breach of contract) attributable to the GOI deprive the insured party of its fundamental rights in its investment, violate international law, and continue for six months.[17] Section 4.01(b), however, provided a second alternative basis for pleading expropriation, provided the insured could show that it had "obtained a valid final arbitration award" against PLN or GOI, and the arbitral awards had not been paid for a period of 90 days in violation of international law, depriving the insured of its fundamental rights.[18]

In September 1997, facing a financial crisis, GOI issued a Presidential Decree dividing all power projects into three categories: (1) those that would be continued; (2) those that would be reviewed; and (3) those that would be postponed. Different units of CalEnergy's two projects were placed under different categories. Crucially, some

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16 *Kantor, International Project Finance*, *supra* note 15, at 1127.

17 *Mid-American Holding Determination*, *supra* note 15, at 9-10.

18 *Mid-American Holding Determination*, *supra* note 15, at 10.

of the units were classified as "postponed".[19] The unfavourable classification meant that various lenders decided to withhold their loans until CalEnergy and the Local Subsidiaries received assurances from GOI that it will continue to fulfill its contractual obligations. However, no such assurances were forthcoming. By June 1998, PLN and Pertamina stopped accepting delivery of power and also stopped making any contractual payments. And a few months later, GOI made it clear (both publicly and in direct conversations with OPIC) that the power projects were no longer "needed" and that GOI no longer considered itself to be bound by those agreements.[20]

Subsequently, the Local Subsidiaries jointly commenced arbitration against PLN and GOI under the UNCITRAL Rules, as provided in the contractual agreements.[21] In May 1999, the Local Subsidiaries won favourable awards against PLN ("PLN Awards").[22] No payment, however, was ever made under the PLN Awards. Instead, in July 1999, at GOI's request, an Indonesian court issued an injunction enjoining the enforcement of the PLN Awards, and restraining the Local Subsidiaries from initiating arbitration against GOI. In addition, GOI threatened to impose sanctions, including fines and penal sentence, against those who acted in breach of the injunctions.[23] Notwithstanding the injunctions and GOI's threats,[24] the

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19 *Mid-American Holding Determination*, *supra* note 15, at 1.

20 *Id.* at 2.

21 Neither subsidiary named Pertmina as a respondent in the proceedings. See *Kantor*, *International Project Finance*, *supra* note 15, at 1130.

22 *Patuha Power Ltd. (Bermuda) v. PT (Persero) Perushaan Listruik Negara* (May 4, 1999), 14 Mealy's Int'l Arb. Rep. B-1, B-23-24 (1999) (awarding US$180,570,322 to Patuha, one of the subsidiaries of Mid-American); *Himpurna California Energy Ltd. v. PT (Persero) Perushaan Listruik Negara*, 14 Mealy's Int'l Arb. Rep. A-1 (1999) (awarding US$391,711,652 to Himpurna, the other subsidiary of Mid-American).

23 *Mid-American Holding Determination*, *supra* note 15, at 4.

24 The GOI also unsuccessfully sought an injunction against the arbitration proceedings in the Dutch District Court and made an unsuccessful application to the Secretary General of ICSID for

Local Subsidiaries commenced arbitration against GOI at the Hague, Netherlands. On 16 October 1999, a truncated, two-member, tribunal[25] issued default awards - GOI did not participate in the proceedings - finding GOI to be in breach of its commitments under the Support Letters, and awarding investors damages in the aggregate amount of $577 million (the "GOI Awards").[26]

In May and October 1999, CalEnergy filed Claims A and B at OPIC, respectively, requesting compensation in the amount of $217,500,000. Claim A related to the expropriation coverage, whereas Claim B related to the arbitral award default coverage. The following section discusses OPIC's determination.

2.2. OPIC determination

In a determination issued in November 1999, OPIC upheld both Claim A and Claim B. As for Claim A, section 4.01(a) of the OPIC insurance policy, which contained provisions regarding expropriation, provided that compensation is payable if acts (other than acts that constitute breaches of contracts) are: (i) attributable to the GOI;

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removal of the Arbitral Tribunal. See OPIC, *Mid-American Holding Determination*, *supra* note 15, at 5; *International Project Finance*, *supra* note 15, at 1136.

[25] Most of the proceedings were carried out before a truncated, two-member tribunal as GOI instructed the member it had appointed - Professor Priyatna - not to participate in the proceedings. According to witness reports, upon arrival in the Netherlands, Prof. Priyatna was flown back to Jakarta against his will by Indonesian personnel. *See* OPIC, *Mid-American Holding Determination*, *supra* note 15, at 5. *See also*, *Kantor*, *International Project Finance*, *supra* note 15, at 1122-23, 1136-37 (discussing statements of other arbitrators - Mr. Albert de Fina and Mr. Jan Paulsson - and efforts made by them to locate Prof. Priyatna).

[26] *Patuha Power Ltd. (Bermuda) v. Republic of Indonesia* (Final Award, October 16, 1999), 15 Mealey's Int'l Arb. Rep. B-1 (2000) [hereinafter, *Patuha-ROI Final Award*]; *Himpurna California Energy Ltd. (Bermuda) v Republic of Indonesia* (Final Award, Oct. 16, 1999), 15 Mealey's Int'l Arb. Rep. A-1 (2000) [hereinafter, *Himpurna-ROI Final Award*].

(ii) violate international law; (iii) deprive the insured of its fundamental rights in its investments; and (iv) continue for a period of six months.[27]

The first and the fourth conditions set out above are not important in the present context and, therefore, would not be discussed further. The second requirement – violation of international law – was crucial. OPIC began by noting that "contractual rights" are a form of property that can be subject to expropriation under international law and cited several international authorities in support of that proposition.[28] Next, it noted that deprivation of property is a violation of international law if it is not accompanied by "prompt, adequate and effective" compensation.[29] Having set out those principles of international law, OPIC found that GOI had deprived the insured of its contractual rights, without offering any compensation. Moreover, GOI had interfered with the Local Subsidiaries' efforts to obtain redress through the judicial process, including by obtaining injunctions against enforcement of the arbitration award and threating sanctions. All of these acts, OPIC found, were in "violation of international law".[30]

As for the third requirement – deprivation of fundamental rights – OPIC considered the following acts of GOI deprived the insured of its "important rights" in the investment: (i) postponement of the project, which led to the "effective abrogation" of the PP; (ii) refusal to give reasonable assurances that the GOI will comply with the

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27 *MidAmerican Determination*, *supra* note 15, p. 4.

28 *MidAmerican Determination*, *supra* note 15, p. 4 (citing *Starrett Housing v. Islamic Republic of Iran*, 23 I.L.M. 1090 (Iran-U.S. Cl. Trib. 1993); *Libyan Am. Oil Co. v. Libyan Arab Republic*, 20 I.L.M. 1, 60 (1977); *see also*, O'Connell, INTERNATIONAL LAW 763-68 (2d. ed. 1970).

29 *MidAmerican Determination*, *supra* note 15, p. 4.

30 *Id.*

guarantees, leading to a "withdrawal of financing" for the project; and (iii) interference with the enforcement proceedings, which deprived the insured of the "value of the [arbitration] awards".[31]

Having determined Claim A, OPIC next considered CalEnergy's Claim B, which concerned non-payment of the arbitration award. Under the OPIC Contract, to bring a successful claim, CalEnergy was required to show that: (i) it had obtained "a valid final arbitral award" against PLN or GOI "as a result of events not constituting … expropriation"; (ii) GOI failed for a period of 90 days to pay such award in violation of international law; (iii) as a result of which CalEnergy was deprived of "fundamental rights"; and (iv) CalEnergy was not in "material breach" of the project agreements.[32]

Given the criteria set out above, OPIC had to first consider whether CalEnergy and the Local Subsidiaries had obtained valid arbitration awards. There was no question over the validity of the PLN Awards. However, the GOI Awards were issued by a truncated, two-member tribunal: as noted above, GOI instructed the member it had appointed - Professor Priyatna - not to participate in the arbitration proceedings and, in fact, GOI personnel forcefully took him away from the venue of the arbitration.[33] Therefore, OPIC had to decide whether those awards were valid. In this regard, OPIC noted that the tribunal's decision to proceed without the third member was "consistent with international arbitral practice" especially given that there was no valid justification for the third member's absence.[34] In any event, had the tribunal

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31 *Id.*

32 *Id.*

33 *See*, *supra* note 7 and accompanying text.

34 *MidAmerican Determination*, *supra* note 15, pp. 4-5.

waited to replace GOI's nominee, it would have delayed the proceedings and, therefore, allowed GOI to benefit from its own wrongdoing.[35]

Having concluded that the Local Subsidiaries had obtained valid arbitration awards, OPIC had to next consider whether the awards remained unpaid for a period of at least 90 days. In other words, non-payment by itself was not sufficient; CalEnergy also had to demonstrate that its subsidiaries made attempts, over a period of at least of 90 days, to enforce the award. By the time the OPIC determination was made the PLN Awards had been outstanding for over six months, but the GOI Awards had remained unpaid for less than 90 days. Yet, OPIC agreed to waive the time limitation because GOI had obtained injunctions from Indonesian courts prohibiting CalEnergy and the Local Subsidiaries from enforcing the award and threating criminal sanctions against anyone who assisted them in their enforcement efforts. In the circumstances, OPIC concluded that "[t]he Insured should not be expected to incur the sanctions threatened against it by attempting to enforce the awards, and a delay in making a payment to the Insured would serve no purpose".[36]

Next, OPIC considered whether GOI's failure to honour those awards amounted to a violation of international law. In this regard, OPIC cited Comment h to Section 712 of the Restatement (Third) of Foreign Relations Law, which provides that: "a state may be responsible . . . if, having committed itself to a special forum for dispute settlement, such as arbitration, it fails to carry out a judgment or award rendered by such . . . special forum".[37] In addition, OPIC relied upon Article II, Paragraph 1 of the

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35 *Id.*, p. 5.

36 *Id.*

37 *Id.*

New York Convention, under which contracting States to the Convention agree to support and enforce agreements to arbitrate disputes.[38] OPIC went on to note that lack of funds or an on-going financial crisis cannot excuse the State's failure to pay an arbitration award: "[t]he poverty of a country or its asserted inability to pay may not be set up as a defense to international responsibility".[39] Accordingly, OPIC concluded that GOI had committed a violation of international law by refusing to pay the awards.

As for the third element of the claim – deprivation of "fundamental rights" – OPIC had already concluded, in the context of Claim A, that the postponement of the project and GOI's failure to give assurances to CalEnergy and the Local Subsidiaries had effectively expropriated investor's contractual rights. In the circumstances, OPIC noted that CalEnergy's "sole remaining source of recovery of its investment" was through the arbitration process. However, by failing to pay the arbitration awards, OPIC had deprived the investor of its "remaining [fundamental] rights" in the project.[40]

Accordingly, OPIC found in favour of CalEnergy in respect of both Claim A and Claim B, and awarded US$217,500,000 in compensation.

2.3. Recovery process

After paying $217,500,000, OPIC, which had inherited rights under the awards against PLN and GOI, turned its efforts towards recovering that sum from GOI. Initially, the

38 *Id.*

39 *Id.*

40 *Id.*

Indonesian Finance Minister publicly stated that it would not reimburse OPIC.[41] However, Indonesia changed its position after the U.S. Government put pressure, which included threats by the U.S. Ambassador to Indonesia that the latter would face economic sanctions if it did not pay OPIC.[42] Those threats led to several rounds of negotiations between the various stakeholders. Finally, after nearly two years of negotiations, a final agreement was concluded between GOI and OPIC on 31 August 2001. According to the terms of the settlement agreement, GOI agreed to pay US$260 million to OPIC and another US$140 million to various lenders, over a period of 11 years at the interest rate of 6.125%, with a three-year grace period.[43] In return, OPIC agreed to transfer title over the project to GOI.[44]

2.4. Analysis

The *MidAmerican Determination* is instructive in several respects. First, it contains a helpful analysis of what is increasingly becoming a common basis for investors to invoke their treaty rights (i.e., denial of justice due to, and/or unlawful expropriation resulting from, non-enforcement of arbitration awards).[45]

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41 *See Kantor*, *International Project Finance*, *supra* note 15, at 1137; *Chadwick*, *OPIC and State Sovereignty*, *supra* note 15 at 104.

42 *See Kantor*, *International Project Finance*, *supra* note 15, at 1137 (citing a news article in which the U.S. Ambassador to Indonesia was quoted as saying: "There is always the possibility of declaring expropriation . . . If we were to do this, it would result in dramatic deterioration of the rupiah and would hurt Indonesia very much.").

43 *See*, No author, *Government Urged to Explain OPIC Deal to the Public*, Jakarta Post (1 Sep. 2001), *available at*: http://beta.thejakartapost.com/news/2001/09/01/government-urged-explain-opic-deal-public.html; *see also* Chadwick, *OPIC and State Sovereignty*, *supra* note 15, at 106-7.

44 *Id.*

45 *See, e.g, Saipem Spa v. the People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Award (2009) [hereinafter, *Saipem*]; *GEA Group Aktiengesellschaft v Ukraine*, ICSID Case No. ARB/08/16, Award (2011); *Frontier Petroleum Services Limited v Czech Republic*, UNCITRAL, Final Award (2010).

2.4.1. Denial of justice and intervention by domestic courts in enforcement of arbitration awards

As noted above, OPIC found that Indonesia's non-payment of the arbitration award was in breach of the separate coverage against arbitral award defaults (i.e. section 4.01(b) of the OPIC contract). However, OPIC's reasoning suggests that it would have reached the same outcome even if CalEnergy had not obtained insurance against arbitral award defaults, and had brought the claim solely under the expropriation head of the policy (i.e. section 4.01(a) of the OPIC contract). To reiterate OPIC's key findings in this regard, first, OPIC found that, because the arbitration award was the investor's "sole remaining source" to make a recovery on the investment, Indonesia's non-payment deprived the investor of its fundamental rights in the project. Secondly, and most crucially, according to OPIC, GOI's efforts to evade its obligation to pay the arbitration award, including by obtaining injunctions against enforcement and threatening criminal sanctions against those who tried to enforce the award, constituted a breach of international law. In support of the latter finding, OPIC cited the Restatement (Third) on Foreign Relations Law and the New York Convention.[46]

OPIC's findings are relevant for at least two reasons. First, whether a State's failure to comply with an arbitration award constitutes a breach of international law has been a recurring issue in the context of investment treaty arbitration. The leading case in this area is *Saipem v Bangladesh* ("*Saipem*").[47] That case involved a gas pipeline construction contract between Saipem, an Italian company, and Petrobangla,

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[46] *See, supra* notes 22 – 25 and accompanying text.

[47] *Saipem Spa v. the People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Award (2009).

a Bangladeshi State-owned gas company, with an ICC arbitration clause[48] After the project was completed, a contractual dispute arose between the parties, which led to an ICC award in favor of the claimant.[49] During the ICC proceedings, at the request of Petrobangla, the courts of Bangladesh issued various anti-arbitration injunctions that purported to revoke the authority of the ICC tribunal; however, the arbitration continued. After the award was issued, Petrobangla applied to set it aside and the Supreme Court of Bangladesh agreed to do so on the basis of the Tribunal's disregard of the anti-arbitration injunctions.[50] Thereafter, Saipem commenced ICSID proceedings arguing that, in essence, the actions of Bangladesh (through Petrobangla and the local courts) deprived Saipem of sums awarded to it by the ICC Award and thus amounted to an expropriation in breach of Article 5 of the Italy-Bangladesh BIT.

The ICSID tribunal ruled in favour of Saipem. Specifically, it found that the rights crystallised in the ICC arbitration award were capable of expropriation.[51] In the *Mid-American Determination*, OPIC did not have to define the scope of the insured's investment as, unlike in the context of investment treaty arbitration, the existence of a qualifying investment is not a jurisdictional hurdle for bringing a claim at OPIC. Next, the *Saipem* tribunal held that the actions of the Bangladeshi courts were tantamount to a taking as they resulted in substantially depriving Saipem of the benefit of the ICC

48 *Id.*, paras. 6, 7.

49 *Id.*, paras. 25 *et seq.*

50 *Id.*, paras. 48 *et seq.*

51 *Id.*, para. 128.

award.[52] As noted above, in the *Mid-American Determination*, OPIC had similarly found that interference with the enforcement of the arbitration awards deprived the insured of its "fundamental rights" in the investment because, among other reasons, the award debtors did not have any assets outside of Indonesia.[53]

Finally, the *Saipem* tribunal explained that, in order to give rise to a claim for expropriation, Bangladesh's actions must be illegal under international law (otherwise, any setting aside of an award would constitute expropriation).[54] It concluded that Bangladesh had acted unlawfully by abusing its rights and violating its obligations under the New York Convention.[55] Although OPIC did not refer to the doctrine of 'abuse of rights', like the *Saipem* tribunal, it too in the *Mid-American Determination* relied on the New York Convention to support its conclusion that Indonesia's actions were in violation of international law.[56]

The above discussion shows striking similarities between the analysis of the ICSID tribunal in *Saipem* and OPIC in the *Mid-American Determination*. *Saipem* tribunal's holding – that non-enforcement of an arbitration award can constitute unlawful expropriation – has been heavily criticized as pushing the law too far. Indeed, it has not been followed by future tribunals, which, as discussed below in the context of the *BoA Determination*, have preferred to consider non-enforcement as potentially

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52 *Id.*, para. 129.

53 *MidAmerican Determination*, *supra* note 1, p. 5.

54 *Saipem Spa v. the People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Award (2009); *Saipem*, *supra* note 45, para. 131.

55 *Id.*, paras. 133, 170 *et seq.*

56 *MidAmerican Determination*, *supra* note 15, p. 5.

establishing denial of justice, and not expropriation.[57] Yet, international law scholars have ignored the fact that, nearly 10 years before the *Saipem* award was issued, OPIC in the *Mid-American Determination* had reached largely the same conclusions.

2.4.2. Arbitral award default coverage

Another reason for which OPIC's findings in the *Mid-American Determination* are important is because they suggest that the expropriation coverage, when interpreted broadly, may make it unnecessary for investors to separately insure against the risk of non-payment of an arbitration award. Like other political risk insurers, OPIC sells Arbitral Award Default (AAD) coverage, which offers compensation in the event that the investor is unable to obtain timely enforcement of an international arbitral award issued against a foreign government or government owned entity.[58]

OPIC's findings in the *Mid-American Determination*, and indeed ICSID's tribunal's holding in *Saipem*, can be seen as potentially making this form of insurance redundant. That said, one critical difference could be that AAD coverage typically does not require the insured to show a violation of international law and, therefore, the insured may be able to recover in case of simple non-payment. That, however, would not be possible in case the insured has coverage against expropriation only because, under both the OPIC contract and the BIT, in order to prove expropriation it must be shown that by not paying the award the host State acted in breach of international law

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[57] *See, e.g.*, *GEA Group Aktiengesellschaft v Ukraine*, ICSID Case No. ARB/08/16, Award (2011); *Frontier Petroleum Services Limited v Czech Republic*, UNCITRAL, Final Award (2010). *See also*, F Francioni, *Access to Justice, Denial of Justice and International Investment Law*, 20 Eur. J. Int'l L. 3, 729 (2009); M. Sattorova, *Judicial Expropriation or Denial of Justice? A Note on Saipem v. Bangladesh*, 2 Int'l Arb. L. Rev. 35 (2010).

[58] *See*, OPIC's website: https://www.opic.gov/what-we-offer/political-risk-insurance/types-of-coverage/specialty-products.

(e.g. the State acted in violation of the New York Convention).

2.4.3. Article 31(3)(b) of the VCLT

Finally, and most crucially for the purposes of this thesis, the *MidAmerican Determination* provides a useful template for considering how practice of political risk insurers can be used for interpretation of investment treaties. The starting point is of course the OPIC determination itself. As explained in the previous chapter, OPIC is a U.S.-owned entity that exercises governmental authority and/or acts under the direction and control of the U.S. That means, OPIC's acts are attributable to the U.S. The next question is whether OPIC's practice is "in the application" of an investment treaty.[59] Whilst political risk insurers do not normally apply provisions of investment treaties in the same way as States do when, for example, they submit pleadings in treaty arbitrations, insurers do engage with concepts similar to those that are contained in investment treaties. That is particularly true in case of the *MidAmerican Determination*.

OPIC's findings were grounded in international law, as indicated by the various international law sources to which it referred in its determination. The findings also related to issues that are covered by U.S. investment treaties – compensation for expropriation is a standard protection in all U.S treaties. Indeed, regulatory delays and withdrawal of external financing are common bases on which investors bring investment treaty claims. Similarly, complaints about intervention with the arbitration proceedings – especially, by issuing anti-arbitration injunctions or failing to enforce

[59] Article 31(3)(b) of the *VCLT*.

an arbitration award – have become common. Therefore, the *MidAmerican Determination* is an example of U.S. state practice on "application" of concepts that are routinely found in U.S. investment treaties.

U.S. state practice, by itself, is not sufficient, however. In order to establish an "agreement" between the parties "regarding interpretation" of the treaty, the other State party must agree with that practice, or there need to be some form of commonality in the parties' positions. As explained above, Indonesia eventually entered into a settlement with the U.S. government pursuant to which it agreed to pay the sums it owed to OPIC. In that sense, therefore, it may be argued that Indonesia agreed with OPIC's determination and, indirectly, with the reasoning contained in the *Mid-American Determination*. However, as explained above, that settlement was clearly extracted after significant pressure was put on the Indonesian government. Indeed, the U.S. government threatened that should Indonesia fail to honour the terms of the OPIC Investment Agreement between the U.S. and Indonesia, it was within its rights to seize Indonesian government property in the U.S. equal to the value of the disputed OPIC claim payment.[60] This is important because in the same way as practice must be accompanied by *opinio juris* in order to create customary international law, for there to be an "agreement on interpretation", the relevant State practice must, at least in part, be motivated by principles of international law, as opposed to economic and political considerations. Indeed, Indonesia's acceptance of OPIC's determination appears to be similar to international "lump sum agreements".

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60 *Chadwick, OPIC and State Sovereignty*, *supra* note 15 at 104.

Lump sum agreements are effectively "negotiated settlements between governments in which the expropriating State pays a single sum in compensation for all affected interests to the other State's government, which then distributes the award".[61] There has been significant debate between international tribunals and scholars over whether such lump sum agreement can constitute a source of international law. In *Barcelona Traction*, for example, the ICJ expressly rejected lump sum agreements as a relevant form of state practice by declaring them as *sui generis*, i.e. having no legal effect beyond the unique circumstances giving rise to them.[62] Certain scholars have agreed with this analysis, arguing that lump sum agreements are mere political agreements that are not based on the law and, therefore, do not constitute relevant state practice.[63] However, that position has been criticized by those who argue that a large proportion of diplomatic protection type claims are resolved by lump sum agreements; therefore, to dismiss them completely would cause the tribunals to ignore a substantial way in which States resolve international claims.[64] On balance, it appears the better view is that lump sum agreements should be considered as a valid form of state practice, although its contribution to the formation of customary international law

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61 Howard S. Schrader, *Custom and General Principles As Sources of International Law in American Federal Courts*, 82 Colum. L. Rev. 751, 777 (1982); *See also*, M. Mendelson, *The Formation of Customary International Law*, 272 Hague Academy of International Law, Collected Courses (1998), 155-410, esp. at 172-76.

62 *See, Case Concerning Barcelona Traction, Light, and Power Company, Ltd (Belgium v. Spain)*, 1970 I.C.J. Rep. at 40.

63 *See, e.g.*, David J. Bederman, INTERIM REPORT ON "LUMP SUM AGREEMENTS AND DIPLOMATIC PROTECTION," INTERNATIONAL LAW ASSOCIATION: SECOND REPORT OF THE COMMITTEE ON DIPLOMATIC PROTECTION OF PERSONS AND PROPERTY 3 (2002).

64 *See, e.g.*, GEORGE T. YATES III & THOMAS E. CARBONNEAU, INTERNATIONAL CLAIMS: CONTEMPORARY BELGIAN PRACTICE, IN INTERNATIONAL CLAIMS: CONTEMPORARY EUROPEAN PRACTICE 96 (Richard B. Lillich & Burns H. Weston eds., 1982).

depends on the specific context in which such agreements are concluded.[65] Indeed, some States, such as the U.S. and Canada, expressly consider lump sum agreements as a valid form of state practice.[66]

Thus, despite obvious conceptual difficulties, most international lawyers consider lump sum agreements as valuable sources of state practice. The conceptual difficulties that exist in the context of context of negotiations that occur between the home State of the political risk insurer and the host State are no greater than those that apply in the context of lump sum agreement. That fact is amply demonstrated by the exchange between the U.S. and Indonesia in relation to the *Mid-American Determination*. There is, therefore, no reason why state practice in relation to settlement of claims made by insurers should be ignored completely. Ultimately, it is important to consider the specific circumstances under which the settlement took place, the legal background (if any) to the insurer's assertions and the kind of pressure that was put on the host State.

For example, if there were evidence to indicate that the host State was conscious that it has a duty to pay the insurer – i.e. if there was evidence of *opinion juris* – then it would be possible to consider the host State's actions as relevant State practice. Presumably, the same principles will apply to positive acts and abstention; therefore, if the host State decides to not pay because it considers itself to be under no such legal obligation, or it disagrees with the determination of the insurer, then again

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65 *Id.*

66 *Id.* In case of the U.S., *see* See RESTATEMENT (THIRD) ON FOREIGN RELATIONS, §§228-29 (discussing claims settlement commissions as part of US's historical "active diplomatic protection for United States nationals.").

those actions would constitute relevant state practice. On the other hand, if there is evidence to show that the host State did not consider its actions to have been "rendered obligatory by the existence of a rule of law requiring it", then such actions would be largely irrelevant for the purposes of Article 31(3)(b) of the VCLT.[67]

3. Bank of America/Dabhol (India, 2003)

3.1. Factual background

In the early 1990s, Enron Corp. ("Enron"), Bechtel Enterprises Holding Co. ("Bechtel"), and the General Electric Capital Corporation ("GE") made investments in Dabhol Power Company ("DPC"), an Indian company established to construct and operate a power station, in the State of Maharashtra, India.[68] A group of Indian and foreign banks, including Bank of America ("BoA") and several export credit agencies provided over $2 billion in loans for the project. OPIC acted as both a lender and an insurer for the project - it provided $160 million in loans as well as insurance coverage for equity stakes and loans of various American companies.[69] A Power Purchase Agreement ("PPA") was concluded between DPC and the Maharashtra State Electricity Board ("MSEB"), an enterprise owned by the Government of Maharashtra ("GOM"), pursuant to which MSEB would purchase electricity generated by DPC and

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67 *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v US)*, Merits, ICJ Reports 1986, p. 14 (citing *North Sea Continental Shelf (Germany v Netherlands; Germany v Denmark)*, ICJ Reports 1969, p. 6).

68 The following summary of facts has been taken largely from OPIC, Memorandum of Determinations: Expropriation Claim of Bank of America as Trustee India – Contract of Insurance No. F401 (30 Sep. 2003) [hereinafter, *BoA Determination*]; *Kantor*, *OPIC Reports*, supra note 1, at 832-52; *Chadwick, OPIC and State Sovereignty*, *supra* note 15, ch. 4.

69 *See* Request for Arbitration, *United States v. India* (4 Nov 2004), paras. 13, 20, *available at*: http://www.opic.gov/sites/default/files/docs/GOI110804.pdf [hereinafter, *Request for Arbitration*].

pay for it at a fixed-rate a twenty-year period, beginning in 1997.[70] The PPA was governed by Indian law and provided for arbitration in London pursuant to the UNCITRAL arbitration rules.

In 2000, a committee appointed by GOM found that MSEB was financially incapable of meeting its obligations under the PPA and recommended that MSEB should again renegotiate the PPA.[71] But even before the committee report was issued, MSEB began defaulting on its payments under the PPA. That, along with GOI's failure to honour its purported guaranty obligations, led DPC to declare default under the various project agreements and commence arbitration in London against MSEB, GOM and GOI.

In May 2001, MSEB rescinded the PPA and informed DPC that it would permanently cease to purchase electricity from the Dabhol plant. At the same time DPC also made an application to the Maharashtra Electricity Regulatory Commission ("MERC") seeking an order enjoining DPC from international arbitration against MSEB; MERC issued such an order shortly thereafter. In response, DPC sued MERC and the GOM in the Bombay High Court to reverse MERC's order. However, DPC's application was denied. Thereafter, DPC appealed Bombay High Court's decision to the Indian Supreme Court. The Indian Supreme Court, however, affirmed the lower court, and the injunction continued to remain in effect.[72]

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70 *Chadwick, OPIC and State Sovereignty*, *supra* note 15, at 136.

71 *Id.* at 143.

72 *BoA Determination*, *supra* note 68, at 11.

These actions of the Indian government and judiciary led the equity owners in the project – Bechtel and GE – to seek recovery from OPIC under their insurance policies. When it became clear that OPIC will not pay, Bechtel and GE (the Claimants) started arbitration proceedings against OPIC under the American Arbitration Association (AAA) Rules.[73] Separately, BoA brought a claim under its insurance policy against OPIC seeking recovery in respect of the loans that it had provided for the Dabhol power project. The following section summarizes the findings made in both the arbitration award issued by the AAA panel and the OPIC determination.

3.2. Arbitration and OPIC determination

Under Article IV of the OPIC insurance policy, in order to prevail in their expropriation claim, the Claimants (Bechtel and GE) were required to show that GOI's acts (i) violated international law; (ii) deprived the insured of its fundamental rights in its investments, and (iii) continued for a period of six months. [74]

As for the first requirement, the AAA panel found two separate violations of international law, namely: (a) breach of the PPA and various government guarantees "for political reasons and without any legal justification"; and (b) the "tak[ing] away [of] Claimants' international arbitration remedies under the PPA . . . in violation of established principles of international law, in disregard of India's commitments under the U.N. Convention as well as the Indian Arbitration Act".[75]

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73 *Bechtel Enters. Int'l v. Overseas Private Inv. Corp.*, AAA Case No. 50 T195 00509 02, at 22 (2003) [hereinafter, *Bechtel Arbitration*]; *see also,* Preeti Kundra, *Looking Beyond the Dabhol Debacle: Examining Its Causes and Understanding Its Lessons*, 41 Vand. J. Transnat'l L. 907, 923 (2008) [hereinafter, *Kundra*, *Looking Beyond*].

74 *Bechtel Arbitration*, *supra* note 73 at 24-26; *Kundra*, *Looking Beyond*, *supra* note 73 at 924-5.

75 *Bechtel Arbitration*, *supra* note 73, at 24; *Kundra*, *Looking Beyond*, *supra* note 73, at 924-5.

The second requirement – deprivation of "fundamental rights" – is, as explained in Chapter 3, similar to the international law requirement of "substantial deprivation". The AAA panel found that the investors' fundamental rights had been deprived for a variety of reasons, including that: (a) the MSEB discontinued payment to DPC and attempted to "rescind" the PPA; (b) the GOM and GOI failed to honor their respective guarantees; (c) the MSEB, MERC, and the Indian courts enjoined investors from terminating the PPA; and (4) denial of justice.[76]

Finally, the panel found that the effect of these expropriatory acts had not been remedied for a period of six months.[77] On that basis, it concluded that "total expropriation" within the meaning of the OPIC contract and awarded compensation of US$ 28,570,000 each to both Claimants.

Separately award, BoA brought a claim at OPIC seeking recovery under its insurance policy in respect of the loans it had provided for the power project. The insurance policy required BoA to show that acts attributable to the GOI were: (i) exprproriatory; (ii) violative of international law; (iii) a substantial factor in the payment defaults; and (iv) not excluded from the scope of the contract's coverage.[78]

OPIC began its analysis by explaining that, while a "creeping expropriation" may comprise a myriad of slight cuts, none of which by themselves rise to the level of expropriation, each element that supports a finding of creeping expropriation "must . . . contribute to that result, not just threaten or have an unrealized potential to so

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76 *Bechtel Arbitration*, *supra* note 73, at 25; *Kundra*, *Looking Beyond*, *supra* note 73, at 924-5.

77 *Bechtel Arbitration*, *supra* note 73, at 25; *Kundra*, *Looking Beyond*, *supra* note 73, at 924-5.

78 *BoA Determination*, *supra* note 68, at 17-18.

contribute".[79] OPIC found that most of the acts alleged by BoA met this standard as they, ultimately, weakened the project and were a part of "multi-pronged attack" on the project by various government bodies.[80] That said, the OPIC contract excluded from coverage any expropriatory acts taken by a government body "in its capacity, or through its powers" as a purchaser of electricity from the project or as a guarantor of any payment obligation to the project.[81] BoA argued that the exclusion applied only where the actions of the government bodies were "motivated by" commercial, rather than governmental, objectives. Because GOI had defaulted on the payment obligations and rescinded the PPA for governmental reasons, BoA argued, the exclusion did not apply.

OPIC, however, disagreed. It noted that even if the motivations were governmental, rather than commercial, they were irrelevant to the exclusion: "the exclusion is of actions taken by governmental actors through certain specifically cited relationships with the Project. The [alternative] interpretation would have the phrase 'in its capacity' read to mean, 'motivated by.'"[82] Having concluded that default on the payment obligations and cancellation of the contract were carried out in a governmental capacity and were, therefore, not expropriatory actions under the policy, OPIC next considered whether interference with DPC's arbitration rights was expropriatory. Because many of the allegedly unlawful acts were excluded by the exclusions clause in the contract, the question before OPIC was "whether [interference

79 *Id.* at 14.

80 *Id.* at 13.

81 *Id.* (citing section 4.02(b) of the OPIC contract).

82 *Id.* at 15.

with the arbitration], standing alone, constitute creeping expropriation".[83] The answer to that question, in turn, depended on whether GOI's actions violated international law.

According to OPIC, the actions of the GOM and the GOI in committing to international arbitration and then failing to honour that commitment, constituted "a denial of justice . . . in violation of international law".[84] OPIC specifically faulted the Indian government bodies and courts for: (i) blocking access to arbitration rights through "lawsuits [and] injunctions" and by "asserting contrary legal positions"; and (ii) rendering formal appeal rights ineffective by "delays in the Indian courts".[85] The "cumulative effect" of these actions, according to OPIC, was that DPC was prevented from exercising its international arbitration rights in a "fashion sufficiently timely to avoid the collapse of the [p]roject".[86]

As evidence for the conclusion that breach of the contractual right to arbitration gives rise to denial of justice, OPIC cited a diplomatic note written by the U.S. State Department in support of certain international arbitrations arising from concession contracts in Libya. Specifically, that note provided that "the failure of a government in respect of a contract with an alien to arbitration of disputes arising under that contract constitutes a denial of justice under international law".[87] OPIC's decision to rely on a diplomatic note issued by the U.S. State Department, as opposed to a general

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83 *Id.* at 19.

84 *Id.* at 22.

85 *Id.* at 21.

86 *Id.*

87 *Id.* at 22 (citing Diplomatic Note 139 of the United States Embassy in Paris, quoted in R.B. von Mehren and P.N. Kourides *International Arbitrations between States and Foreign Private Parties: The Libyan Nationalization Cases* 75 Am. J. Int'l. L. 487 (1981)).

source of international law, is less than satisfactory. That is especially the case given that the note was issued in a context where the U.S. government was advocating for the international law rights of its own citizens, as opposed to stating a general principle under international law. That said, OPIC's reliance on a U.S. diplomatic note further evidences the close relationship between OPIC and the U.S. government – U.S. government regularly advocates for the OPIC, while OPIC cites U.S. diplomatic notes to supports its findings. Given that relationship, it is even more obvious why actions of OPIC should be attributable to the U.S., as discussed in the previous chapter.

In respect of the alleged delays, OPIC noted that the Indian Supreme Court had attempted to accelerate the judicial process (it agreed to hear an appeal regarding MERC's jurisdiction before the lower court had issued a written decision). OPIC also recognized that DPC had not gone through the entire litigation process in India, i.e. that it had not exhausted all local remedies. However, it determined that exhaustion of local remedies was "not required" to show a breach of international law where, as here, the claimants would be exposed to "open ended postponements and delays that might indefinitely deny [the claimant] access to contractual rights".[88] In support of this conclusion, OPIC cited the Restatement (Third) of Foreign Relations, which provides that the exhaustion of local remedies is not necessary where "such remedies are clearly sham or inadequate, or their application is unreasonably prolonged".[89]

Accordingly, OPIC found that the interference with DPC's arbitration rights was an expropriarory act taken in violation of international law, which substantially

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88 *Id.*at 23.

89 *Id.*

contributed to the default in payments, entitling BoA to compensation equal to the principal amount of the outstanding loan, plus interest (a total of US$ 27,613,586).[90]

3.3. Recovery process

After OPIC paid claims brought by BoA and other DPC investors insured by OPIC – namely, GE, Bechtel and Enron – OPIC tried to use usual diplomatic channels to put pressure on GOI to reimburse the agency.[91] However, when none of those efforts paid dividends, the U.S. government decided to file for ad hoc State-to-State arbitration under Article 6 of the Investment Incentive Agreement between India and the U.S ("Bilateral Agreement") demanding $110 million.[92] This is the first and the only instance on which OPIC decided to make use of the dispute resolution clause in its bilateral incentive agreements.

In its Notice for Arbitration, the U.S. government explained the procedural context of the arbitration in the following fashion. First, under article 3(b) of the Bilateral Agreement, the GOI is obligated to recognize the transfer to OPIC of the right to "assert the claims" of any entity to which OPIC has made a payment "as Issuer of Investment Insurance or an investment guaranty in connection with any Investment Support". As noted above, OPIC had made multiple political risk insurance payments, totaling over $110 million, to the various sponsors and creditors of DPC. In return,

90 *Id.* at 18-19.

91 *See Chadwick, OPIC and State Sovereignty*, *supra* note 15, at 155-162.

92 *Notice of Arbitration, United States v. India* (4 November 2004), available at: https://www.opic.gov/sites/default/files/docs/GOI110804.pdf. The amount of US$110 million represented the combined value of five separate claims settled by OPIC: BoA, GE and Bechtel (US$27.5 million each) and two claims paid to the Enron Credit Committee for US$23.9 million in April 2004.

OPIC received assignments of certain rights, interests and claims to pursue recovery against the GOI.

Next, Article 6(c) of the Bilateral Agreement provides that disputes involving claims of OPIC "in connection with acts attributable to the Government of India that involve questions of liability under public international law" may be submitted by the U.S. government to *ad-hoc* arbitration. As noted above, OPIC had found that, because of actions attributable to India, the various investors and lenders had been stripped of their fundamental rights in the DPC project, in violation of international law. As such, the U.S. government argued, India was responsible to pay reparation for the losses OPIC had suffered due to India's violations of its international law obligations.[93]

Finally, Article 6(a) of the Bilateral Agreement permits the parties to submit a dispute to arbitration "... six months following a request for negotiations... [if] the two Governments have not resolved the dispute". In the Notice of Arbitration, the U.S. government explained that, over a period of 12 months, through OPIC and the U.S. Embassy in India, it had made several attempts to resolve the dispute with India. None of those attempts, however, were successful. Having satisfied the six-month cooling-off period, U.S. government argued, it was now entitled to trigger the arbitration clause in the Bilateral Agreement.[94]

As for the substantive claims, the U.S. government argued that GOI had committed the following violations of international law: (i) uncompensated expropriation of investments owned by the various lenders and investors in the DPC

93 *Notice of Arbitration*, *supra* note 63, at para. 8.

94 *Id.*at para. 9.

project; (ii) denying justice to DPC by interfering with its arbitration rights; and (iii) discriminatory repudiation of contractual rights owned by DPC. Accordingly, the U.S. government sought compensation from GOI in excess of US$ 110 million that OPIC had paid to the various investors and lenders of the DPC project.

The arbitration, however, never took place. On 15 July 2005, GOI reached a final settlement on the DPC project. According to the terms of the settlement agreement, OPIC received $110 million – the amount it had demanded in the arbitration – of which $20.7 million was payable immediately, with the outstanding balance due over eight years, at a nominal interest rate of 2%.[95]

3.4. Analysis

As with the *MidAmerican Determination*, the *BoA Determination* also raises issues that are important to investment treaty arbitration generally.

3.4.1. State interference with arbitration rights

First, the *BoA Determination* discusses an issue that has gained some prominence in recent investment treaty disputes: the responsibility of the host State in situations where local courts unduly interfere with investors' arbitration rights.

As noted above, OPIC held that DPC's investment had been the subject of a creeping expropriation. It is important to note, however, that there is a crucial difference between how expropriation is defined under OPIC policies and how it is defined under investment treaties. Specifically, OPIC requires the insured to show that, among other things, the alleged expropriatory act of the host State violates

95 *See Chadwick, OPIC and State Sovereignty*, *supra* note 15, at 161.

international law. By contrast, investment treaty tribunals have repeatedly held that the key criterion in proving expropriation is whether the deprivation was "substantial"; there is no need to separately show that the underlying acts violated international law.[96]

In the *BoA Determination*, OPIC found that India's interference with DPC's rights to arbitrate was not only expropriatory, but it also violated international law by denying DPC justice.[97] OPIC's conclusion was premised on two wrongful acts of the Indian government: (i) the issuance anti-arbitration injunctions by the Indian courts, which had the effect of blocking DPC's arbitration rights; and (ii) "delays in the Indian courts", which rendered DPC's appeal rights ineffective.[98] OPIC's focus on the delay in the Indian courts is particularly interesting as that has been the subject of a famous investment treaty claim against India.

White Industries v India involved an ICC award that White Industries ("White"), an Australian mining company, had won against Coal India, an Indian government owned coal company, in 2002.[99] In September of the same year, Coal India moved to have the ICC award set aside in the Calcutta High Court.[100] Meanwhile, White filed an application in the Delhi High Court to enforce the award.[101] Several years of litigation followed. By 2009, when White commenced its arbitration

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96 *See, e.g.*, *Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award of 17 February 2000, 5 ICSID Reports 153, at 77-78; *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003); *Generation Ukraine Inc. v.Ukraine*, ICSID Case No. ARB/00/9, Award (2003).

97 *BoA Determination*, *supra* note 68, at 22.

98 *See supra* note 61 and accompanying text.

99 *White Industries Australia Ltd. v. India*, UNCITRAL, Award, para. 3.2.33 (Nov. 30, 2011) [hereinafter, *White Industries*].

100 *Id.*, para. 3.2.25

101 *Id.*, para. 3.2.25 – 3.2.26.

against India under the India-Australia BIT, White's appeal against Coal India's set-aside application was still pending before the Indian Supreme Court, while the enforcement proceedings had been stayed indefinitely.[102]

In the arbitration, White claimed that the inordinate delay in the enforcement of the award resulted in a breach of the provisions on fair and equitable treatment ("FET"), expropriation and the "effective means" standard incorporated by the MFN clause. The tribunal rejected White's claim for expropriation on the basis that the "the value of White's investment . . . nor its rights under the Contract . . . have been substantially affected by the fact that the Indian Courts have yet to dispose of either Coal India's set-aside application or White's Application for Enforcement of the Award".[103] In other words, the ICC award had not been 'taken' yet; all that had happened was that its enforcement had been delayed. *White* tribunal's conclusion in this respect is different to OPIC's holding in the *BoA Determination,* where the delay faced by DPC in the Indian courts, together with the anti-arbitration injunctions obtained by the Indian government, were found to be expropriatory acts under the insurance policy.[104]

As for White's claim for denial of justice, the tribunal noted that, in order to show that it had been denied justice, White had to meet a high threshold: "egregious conduct that 'shocks or at least surprises, a sense of judicial proprietary'".[105] Despite the long delays in Indian courts, which were "certainly unsatisfactory in terms of

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102 *Id.*, para. 3.2.63.

103 *Id.*, para. 12.3.6.

104 *BoA Determination*, *supra* note 68, at 22.

105 *Id.*, para. 10.4.23

efficient administration of justice", the tribunal concluded that White had not been denied justice.[106] The tribunal also noted that there was no "suggestion of bad faith" on part of India, which further weakened White's claim.[107] Again, the tribunal's conclusion differed from OPIC's findings in the *BoA Determination*. Specifically, OPIC had found that delays in Indian courts denied justice to DPC.[108] That said, one crucial difference is that, unlike in White's case, the Indian government had obtained anti-arbitration injunctions against DPC, which, arguably, evidenced bad faith on part of India (something that was lacking in the *White Industries* case).

Finally, in respect of White's 'effective means' claim, the tribunal noted that the "effective means" standard was a "distinct and potentially less demanding test, in comparison to denial of justice".[109] It went on to find that Indian judiciary's failure to deal with the set-aside proceedings in over nine years "amounts to undue delay and constitutes a breach of India's voluntarily assumed obligation of providing White with 'effective means' of asserting claims and enforcing rights".[110]

As with the *Mid-American Determination*, the *BoA Determination* demonstrates striking similarities, yet subtle differences, between OPIC determinations and investment treaty awards. Ultimately, the difference in the approaches adopted by the two forums may be attributed to the underlying instrument: whereas the UNCITRAL tribunal in *White Industries* had the benefit of applying an

106 *Id.*, para. 10.4.22.

107 *Id.*, para. 10.4.23.

108 *BoA Determination*, *supra* note 68, at p. 21.

109 *White Industries*, *supra* note 99, paras. 11.3.2(a), 11.33.

110 *Id.*, paras. 11.4.16 – 11.4.20.

investment treaty that contained various substantive protections, OPIC had to contend with an insurance policy that protected against expropriation only.

3.4.2. Denial of justice coverage

It is also worth noting that, in the same way as insurers now provide coverage against non-payment of arbitral awards and, therefore, investors do not have to rely on the expropriation coverage to protect them against the risk of non-enforcement, insurers have also started offering 'denial of justice' ("DOJ") coverage. Unlike the AAD coverage, which becomes relevant only after the insured has obtained an enforceable award, the DOJ coverage applies in circumstances where the host State obstructed the arbitration by, for example, issuing anti-arbitration injunctions or unduly delaying the arbitration proceedings.[111] Whilst insurance policies differ in their wordings, DOJ coverage typically includes these elements: (i) the host State refuses to cooperate in the initiation of the arbitration process, or thwarts its completion, or renders the process futile; (ii) the insured make diligent efforts to exercise its arbitration rights; and (iii) such circumstances exist for some stipulated period of time, often required to be "continuous".[112]

3.4.3. Article 31(3)(b) of the VCLT

Finally, and most crucially for the purposes of this thesis, the *BoA Determination* reminds us of the manner in which OPIC uses its political clout to extract settlements

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[111] *See*, *e.g.*, OPIC's website: https://www.opic.gov/what-we-offer/political-risk-insurance/types-of-coverage/specialty-products; Robert Wray, *Insuring Arbitration Outcomes*, available at: http://www.robertwraypllc.com/insuring-arbitration-outcomes/.

[112] Robert Wray, *Insuring Arbitration Outcomes*, available at: http://www.robertwraypllc.com/insuring-arbitration-outcomes/.

from host States, which in turn could lead to agreements on interpretation of treaties. As explained previously, the acts of OPIC are attributable to the U.S. The *BoA Determination* dealt with concepts that are often found in investment treaties; specifically, it considers circumstances in which frustration of arbitration rights could lead to expropriation or denial of justice, the requirement to exhaust local remedies in a setting whether the local courts are acting in an obstructive manner, and the difference between sovereign and commercial acts. Moreover, the findings made in relation to these concepts were grounded in international law and motivated by *opinion juris*, as indicated by the various international law sources cited in the *BoA Determination*. Given that, the only ingredient left to consider is the practice of India.

As noted above, India initially refused to comply with OPIC's demand, but the parties decided to settle after the U.S. commenced arbitration proceedings under the Bilateral Agreement. In the arbitration, the U.S. advanced the same claims that the insured parties had put forward before the AAA tribunal and OPIC, i.e. uncompensated expropriation and denial of justice. Moreover, as explained above, in its Notice of Arbitration, the U.S. repeatedly referred to the *BoA Determination* and the AAA tribunal's award, as those formed the basis for OPIC's decision to pay the insured parties. In the circumstances, it would appear that, at the time it decided to settle the arbitration, not only was India aware of its obligation under the Bilateral Agreement to reimburse OPIC for the payments made by it to the insured parties, but that India also, arguably, agreed with the conclusions reached by the AAA tribunal and OPIC in their award and determination respectively. Had India considered those conclusions to be groundless, it could have put up a defence in the arbitration, which it did not. Alternatively, even if India felt compelled to settle with the U.S. government, it could

have issued a statement noting that it disagreed with the U.S. position (in the same way as many financial institutions have recently settled with U.S. regulators, without admitting or denying liability).[113]

In the light of the above, OPIC's actions and India's decision to settle the arbitration arguably give rise to an agreement on interpretation of any investment treaty between the U.S. and India on concepts such as expropriation and denial of justice.

4. Conclusion

In the previous chapter, it was explained that the practice of State sponsored insurers in settling claims with the insured, together with the practice of the host States of the insured investments, could be relevant to the interpretation of investment treaties and, in certain circumstances, even create customary international law. This chapter has summarized two important OPIC determinations – the *Mid-American Determination* and the *BoA Determination* – that demonstrate how, in practice, this might occur. Specifically, it was shown that these determinations constitute 'subsequent practice' of the U.S. because: (i) the acts of OPIC are attributable to the U.S.; (ii) although these determinations do not apply any treaty (Article 31(3)(b) of the VCLT requires that the subsequent practice must be in the 'application of the treaty'), they typically relate to

[113] The most common way in which this result is achieved is through 'non prosecution agreements' ("A non-prosecution agreement is a written agreement between [a regulator] and a potential cooperating individual or company, entered into in limited and appropriate circumstances, that provides that [the regulator] will not pursue an enforcement action against the individual or company if the individual or company agrees to, among other things: (1) cooperate truthfully and fully in [the regulator's] investigation and related enforcement actions; and (2) comply, under certain circumstances, with express undertakings"). *See*, Robert A. Barron, *Some Comments on the Use of Non-Prosecution Agreements in the Foreign Corrupt Practices Act Context*, 41 No. 3 Securities Regulation Law Journal ART 5 (2013).

concepts that are covered in investment treaties; in fact, they often refer to BITs of the U.S. and awards made by investment treaty tribunals pursuant to those BITs; and (iii) the determinations are typically grounded in international law, and motivated by *opinio juris*, as indicated by the various international law sources cited in them.

That said, the practice of States that own and control the insurers is only side of the coin; in order to establish 'agreements on interpretation' of the treaties, it is necessary to also consider the practice of the host States of the investment. Even though the U.S. has signed bilateral agreements with all countries in which OPIC operates, pursuant to which the States receiving the investment agree to recognise OPIC's subrogation rights and reimburse it for the payments made by it to the insured parties, these State rarely, if ever, voluntarily comply with OPIC's demands. In case of the *Mid-American Determination* and the *BoA Determination*, OPIC's demands were initially refuted by Indonesia and India respectively. Eventually, Indonesia agreed to a settlement because the U.S. government threatened economic sanction. And India agreed to reimburse OPIC after the U.S. commenced arbitration proceedings under the bilateral agreement between Indian and the U.S.

The response of Indonesia and India show that host State's actions are likely to be motivated by a variety of considerations, legal and otherwise. In the circumstances, it is unlikely that every settlement between the home State of the insurer and the host State would contribute to the development of international law. Instead, the context of the settlement would have to be considered closely before any determination can be made.

Finally, this chapter has also discussed some of the noticeable features of the two determinations. An attempt was made to compare OPIC's findings with the findings made by tribunals in the context of investment treaty arbitrations. In particular, it was shown that the *Mid-American Determination* and the *BoA Determination* contain thorough analysis of the circumstances in which host State's frustration of the arbitration process give rise to a claim for expropriation or denial of justice. These are important contributions, which should not be ignored by investor-State tribunals and international law scholars.

CHAPTER 7: ATTRIBUTION AND RULES OF STATE RESPONSIBILITY

1. Introduction

In the previous chapter, two OPIC determinations were discussed at length: the *Mid-American (Indonesia) Determination*[1] and the *Bank of America (India) Determination*.[2] The purpose of that discussion was to demonstrate how the actions of OPIC can constitute "subsequent practice" of the United States, which, together with the reaction of the host States to these determinations, can give rise to

[1] OPIC, Memorandum of Determinations, Expropriation Claim of Mid-American Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527 and E759 (10 Nov. 1999).

[2] OPIC, Memorandum of Determinations: Expropriation Claim of Bank of America as Trustee India – Contract of Insurance No. F401 (30 Sep. 2003).

"agreements regarding interpretation" of treaties for the purposes of Article 31(3)(b) of the Vienna Convention on the Law of Treaties ("VCLT").[3]

This chapter, and the chapter that would follow, also contain case studies. However, their focus is going to be different. Instead of considering few OPIC determinations in great detail, these case studies will analyse large number of OPIC determinations on specific areas of law, namely attribution and rules of State responsibility (current chapter) and compensation (next chapter). The purpose of these case studies is threefold.

First, the determinations discussed in this chapter demonstrate that in certain areas OPIC simply applies general international law and reaches conclusions that any international tribunal applying international law principles would reach. For example, when it comes to State organs, OPIC considers that measures adopted at any level of the government (central or local) and by any branch of the government (legislature, executive or judiciary) are attributable to the State.[4] That is exactly what is provided under Article 5 of the ILC Articles on State Responsibility ("ILC Articles").[5] In this

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[3] On article 31(3)(b) of the *VCLT*, *see generally*, I. Sinclair, THE VIENNA CONVENTION ON THE LAW OF TREATIES 130-138 (Manchester, Manchester University Press, 1984); Anthea Roberts, *Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States*, 104 Am. J. Int'l. L. 179 (2010); Georg Nolte, International Law Commission, *First Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/660, (2013); Georg Nolte, International Law Commission, *Second Report on Subsequent Agreements and Subsequent Practice in relation to Treaty Interpretation*, A/CN.4/671 (2014); See generally, 31 ICSID Review 2 (2016) (Special Focus Issue on "The Intersection Between Investment Arbitration and Public International Law"); in particular, see Simon Oleson, *Attribution in Investment Arbitration*, 31 ICSID Review 2, 457-483 (2016); and Martins Papirinskis, *Circumstances Precluding Wrongfulness in International Investment Law*, 31 ICSID Review 2, 484-503 (2016).

[4] *See* s. 3.

[5] Draft Articles on Responsibility of States for Internationally Wrongful Acts, *in* Report of the International Law Commission on the Work of Its Fifty-third Session [hereinafter, *ILC Articles*], UN GAOR, 56th Sess., Supp. No. 10, at 43, UN Doc. A/56/10 (2001), *available at* <http:// www.un.org/law/ilc>. The final articles, commentaries, prior drafts, tables showing the derivation of each provision, bibliography, and an informative introduction by the last special rapporteur on state responsibility, all appear in J. Crawford, THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE

regard, therefore, OPIC's determinations therefore reaffirm the customary status of international principles governing attribution of measures adopted by State organs.

Secondly, in other respects, the determinations analysed in this chapter elaborate on those principles of general international that have not been widely applied by international tribunals. For example, ILC Article 10 provides that, in cases where an insurrectional movement achieves its aims and either installs itself as the new government of the State, the conduct of the successful insurrectional movement is attributable to the State.[6] There has been very little recent international judicial or arbitral practice in relation to principles laid down in ILC Article 10.[7] By contrast, OPIC has had the opportunity to consider revolution and civil war related claims on several occasions. When considering these claims, as discussed below, OPIC reached largely the same conclusions that any international tribunal would have reached in similar circumstances. Therefore, in that sense, OPIC's analysis adds further weigh to the argument that the rules set out in Article 10 are customary rules.[8] Another example of the same phenomenon is OPIC's experience of dealing with claims relating to

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RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES (2002) [hereinafter, *Crawford, Commenatries*].

6 *ILC Articles*, *supra* note 5, arts. 10 (1) – (2).

7 *See* Simon Olleson, The *Impact of ILC's Articles on Responsibility of States for Internationally Wrongful Acts* (BIICL, 2007), at 95 (noting in a study cataloguing the major instances of relevant judicial and arbitral practice in relation to the international law of State responsibility between 9 August 2001, the date of completion of the ILC's work on the topic of State responsibility, and 10 October 2007, that "[t]here appears to have been no international judicial reference to Article 10").

8 *See, e.g., Tulip Real Estate and Development Netherlands B.V. v. Republic of Turkey*, ICSID Case No. ARB/11/28, Award, 10 March 2014, para 281 ("ILC Articles constitute a codification of customary international law with respect to the issue of attribution of conduct to the State . . .").

political violence, an area where, with the exception of two popular claims, investor-State tribunals have had limited experience.[9]

Finally, there are certain areas where OPIC departs from established rules of international law. For example, under international law, the conduct of an entity that is controlled by the State is attributable to that State. This rule is codified in ILC Article 8. However, OPIC policies contain a different version of the control test: instead of focusing on the State's control of the entity, OPIC focuses on the entity's control over the relevant territory or project.[10] In fact, OPIC's control test looks nothing like the control test under international law; to the contrary, it looks a lot like the test for determining whether an entity is a 'de facto organ' of the State under ILC Article 4.[11] Nevertheless, as explained below, in practice, this difference may not be that relevant: on at least two occasions, OPIC has found that Central Banks exercise control over the relevant territory/ project and, therefore, their acts are attributable to the State, which is exactly the same conclusion that investor-State have reached in respect of Central Bank, albeit applying a different test.[12]

For these reasons, OPIC's determinations can contribute to the development of international law on State responsibility. This chapter follows the structure of ILC Articles. Accordingly, section 2 analyses OPIC determinations in relation to conduct of State organs (ILC Article 4). Next, section 3 consider OPIC's treatment of State

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9 The two claims, as discussed below, are *Asian Agricultural Products Limited (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, Award of June 21, 1990, 30 I.L.M. 577 (1991) and *American Manufacturing and Trading (AMT) v. Zaire*, ICSID Case No. ARB/93/1, Award of Feb. 21, 1997, 36 I.L.M. 1531 (1997).

10 *See* OPIC Form 234 KGT 12-58, s. 1.03(d).

11 *See* s. 5.

12 *Id.*

entities that exercise governmental authority (ILC Article 5), followed by an analysis of entities that are controlled by the State (ILC Article 8) in section 4. Section 5 and section 6 consider insurrectional movements (ILC Article 10) and claims for political violence.

2. Rules of attribution

International investment treaties do not normally provide any rules of attribution. Most treaties refer to "Contracting State's" or "Contracting Party's" obligations under the treaty but do not explain the meaning of the term "Contracting State" or "Contracting Party". Some treaties though go a bit further and provide specific obligations with regard to entities within host State's control. For example, Article 22 of the Energy Charter Treaty provides *inter alia*:

> Each Contracting Party shall ensure that if it establishes or maintains an entity and entrusts the entity with regulatory, administrative or other governmental authority, such entity shall exercise that authority in a manner consistent with the Contracting Party's obligations under this Treaty.[13]

Similar provisions are found in several U.S. treaties.[14] Indeed, the U.S. appears to be making a conscious effort to narrow the scope of protection under U.S. treaties by limiting the rules of attribution. It has narrowed the scope of such rules to where State enterprises exercise regulatory, administrative or other governmental authority that the

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13 Energy Charter Treaty, art. 22.

14 *See*, e.g., U.S. – Estonia BIT (1994) , art. II 2(b), which provides that: "[e]ach Party shall ensure that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under this Treaty wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges." *See also, Alex Genin, Eastern Credit Limited, INC. and A.S. Baltoil v. Republic of Estonia*, ICSID Case No. ARB/99/2, Award (2001) [hereinafter, *Genin v. Estonia*] where the Tribunal applied this provision of the U.S. – Estonia to find that the Central Bank of Estonia is a State agency whose acts are attributable to Estonia

State party has specifically "delegated" to it.[15] Likewise, article 2 of the recent US model BIT provides that a State party's obligations apply to a state enterprise when it exercises any regulatory, administrative, or other governmental authority delegated to it by that party.[16] The newly released Trans-Pacific Partnership agreement also contains a similar provision.[17] In fact, in a recent case - *Adel A Hamadi Al Tamimi v. Sultanate of Oman*[18] - an ICSID tribunal dismissed the investor's claims on the basis that the alleged wrongdoing was not attributable to Oman under the U.S.-Oman Free Trade Agreement ("FTA"). Specifically, the FTA required that the State-owned enterprise must be "exercise[ing] . . . regulatory, administrative, or other governmental authority" and that such authority must have been "delegated to it by that party".[19] The tribunal recognised that the test set out in the FTA was narrower than the test under customary international law – in particular, under international law, there is no requirement of delegation of authority – and that the investor had failed to meet that test.[20]

In the absence of specific rules of attribution in the large majority of investment treaties, tribunals always look to general international law to find rules of attribution. For example, in *Mafezini v. Spain*, the Tribunal observed that "[s]ince neither the

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15 *NAFTA*, art. 1503.

16 U.S. Model BIT (2011), art. 2.

17 Trans-Pacific Partnership Agreement (2016), art. 9.2(2)(b), available at: https://medium.com/the-trans-pacific-partnership/investment-c76dbd892f3a#.23ilk3uyp.

18 *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, ICSID Case No. ARB/11/33, Award, (2015); *see also*, Matthew Weiniger & Johanne Brocas, *A narrow test for state attribution* (GAR, 2016), available at: http://globalarbitrationreview.com/journal/article/34569/treaty-column-narrow-test-state-attribution/.

19 US-Oman Free Trade Agreement (2009), art. 10.1.2.

20 *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, ICSID Case No. ARB/11/33, Award, (2015) at Para. 320.

Convention nor the Argentine-Spanish BIT establish guiding principles for deciding the here relevant issues, the Tribunal may look to the applicable rules of international law in deciding whether a particular entity is a state body".[21] Similarly, in *Noble Ventures*, the Tribunal stated that "the [US-Romania] BIT does not provide any answer to this question [whether actions of State entities are attributable to the host State]. The rules of attribution can only be found in general international law which supplements the BIT in this respect".[22]

All investment treaty tribunals that have considered this issue agree that the ILC Articles are an authoritative formulation of the international law rules on attribution.[23] For example, in *Bayandir v. Pakistan*, the Tribunal had to decide whether the actions of the Pakistan's National Highway Authority were attributable to Pakistan. In its analysis, the Tribunal relied on the ILC Articles, and noted that "[t]he ILC Articles are widely regarded as expressing current customary international law."[24] Similarly, in *F-W Oil Interests v. Trinidad & Tobago*, the Tribunal noted that "the

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[21] *Emilio Agustín Maffezini v. The Kingdom of Spain,* ICSID Case No. ARB/97/7, Award (2000), paras. 74-76.

[22] *Noble Ventures, Inc. v. Romania,* ICSID Case No. ARB/01/11, Award (2005), para. 68.

[23] Respondent States have argued in investment treaty arbitrations that ILC Articles cannot be applied because the Articles only address state responsibility as between States. However, such arguments have usually been rejected as tribunals have found ILC Articles in relation to attribution to be of general application and therefore applicable to all international obligations of a State, regardless of whether the beneficiary of those obligations is another State or a private entity. *See* K. Hober, *State Responsibility and Attribution, in* P. Muchlinski, F. Ortino & C. Schreur, THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 553 (2008); *see also,* J. Crawford, *Investment Arbitration and the ILC Articles on State Responsibility*, 25 ICSID Rev. 127-135 (2010) [hereinafter, *Crawford, Investment Arbitration*] (criticizing tribunals for relying on ILC Articles as "a plank in a shipwreck"; yet, praising the efforts of certain tribunals in carefully applying the Articles, most notably in the field of attribution); D. Bodansky, J. Crook & D. Caron, *The ILC Articles on State Responsibility: The Paradoxical Relationship Between Form and Authority*, 96 Am. J. Int'l L. 857, 871 (cautioning arbitral tribunals that "[b]y [giving] too great and casual a deference to the *lex generalis* of the ILC draft articles, arbitrators may unconsciously undo the *lex specialis* of the parties"). *See also,* James Crawford, STATE RESPONSIBILITY: GENERAL PART 133-210 (Cambridge: 2014) [hereinafter, *Crawford Commentaries*].

[24] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan,* ICSID Case No. ARB/03/29, Award (2009), n. 19.

ILC's draft Articles, together with the Commentaries to them, which, although not in themselves binding, clearly reflect the underlying general legal principles."[25] In fact, one study has found that investment treaty tribunals have at least once referred to 32 of the 59 Articles, with maximum references made to the Articles on attribution, particularly Articles 4 and 5.[26]

In contrast with investment treaties, OPIC contracts provide at least a few basic rules on attribution. To establish a *prima facie* claim for expropriation, OPIC requires the investor to show, inter alia, "[t]he [allegedly expropriatory] acts are attributable to a foreign governing authority which is in *de facto* control of the part of the State in which the project is located".[27] Thus, the investor must show: (a) a "foreign governing authority" is in de facto control of the territory in which the investment has been made; and (b) the allegedly expropriatory acts are "attributable" to that authority. The term "attributable" is not defined in the OPIC contract.[28] The term "foreign governing authority" was similarly not defined in the new form contract when it was first adopted in 1985. However, for reasons that may have to do with investors' demands for further clarity on this issue, OPIC decided to include a definition of a foreign governing authority in the latest version of the new form contract. Section 1.01(3) of the OPIC

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25 *F-W Oil Interests, Inc. v. The Republic of Trinidad and Tobago*, ICSID Case No. ARB/01/14, Award (2006), para. 202.

26 *See, Crawford, Investment Arbitration*, *supra* note 23, at 131 (2010).

27 OPIC Form 234 KGT 12-58, s. 4.01(a). The September 2005 version of the OPIC contract does not use the term "attributable" or "de facto control"; instead, it simply requires that the allegedly expropriatory acts are those of a "foreign governing authority". OPIC Form 234 KGT 12-58 (rev. 09/05), s. 4.01.

28 The old form contract provided that expropriatory acts must be "*taken, authorized, ratified or condoned* by the Government of the Project Country." OPIC Form 234 KGT 12-70, art. 1.13 (emphasis added). However, the new form contract simply states that the expropriatory acts must be "attributable" to the foreign governing authority. *See* OPIC Form 234 KGT 12-85, s. 4.01(a).

Contract provides that, a "foreign governing authority" means any of the following four entities: " (a) the central government of the project country; (b) the government of any political subdivision of the project country; (c) any organ, agency, official, employee or other agent or instrumentality of either (a) or (b), acting within the scope of its authority or under colour of such authority; and (d) the governmental authorities in de facto control of that portion of the project country in which the project is located".

This definition is very similar to the definition found in the old form contract. The old form contract, which did not use the term "foreign governing authority" and instead required that the expropriatory acts must have been taken by the "government of the project country", defined the latter term as "[t]he present or any succeeding governing authority . . . or authorized agents thereof, in effective control of all or any part of the Project Country or of any political or territorial subdivision thereof . . ."[29]

However, unlike the old form contract, the new form contract does not try to avoid the common international law question regarding whether a particular authority qualifies as an official "government". The old form contract did so by clearly stating that it does not matter whether the government of the project country is "recognised by the Government of the United States" or is formally described as such, as long as it is "in effective control" of the place where the foreign enterprise operates. Nevertheless, it seems safe to assume that if a question were to arise before OPIC in connection with the U.S. recognition of (or lack thereof) a foreign government, OPIC would follow the approach laid out in the old form contract.

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[29] *OPIC Form 234 KGT 12-70*, at s. 1.16.

Another development in recent OPIC contracts is the exclusion from the definition of a "foreign governing authority" any entity, fully or partially owned by the host government, that performs commercial functions directly related to the project.[30] The relevance of this amendment, however, is to some extent obviated by one of the standard exclusions present in OPIC contracts, providing that no compensation for expropriation shall be payable when "[t]he [expropriatory] actions are those of the foreign governing authority exercising commercial (as distinguished from governmental) functions in relation to the project".[31] This exception is discussed in further detail in section 3 below.

Thus, unlike BITs that do not define the term "Contracting party" or "State party", OPIC form contracts do explain which entities within the host government's structure are capable of performing expropriatory acts. That said, both definitions – "government of the foreign country" (in the case of old form contact) and "foreign governing authority" (in case of new form contract) – are consistent with general international law that the only conduct attributed to the State at the international level is that of its organs of government, or of others who have acted under the direction, instigation or control of those organs, i.e., as agents of the State.[32] Specifically, the ILC Articles different between conduct by the organs of the State (Article 4) and other

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30 *See, e.g.*, OPIC Memorandum of Determination, *Expropriation Claim of Alliant Techsystems, Inc. Belarus - Contracts of Insurance Nos. D955 and D965* (4 June 1997), available at: https://www.opic.gov/sites/default/files/docs/alliantbelarus1997.pdf [hereinafter, *Alliant - Belarus*], at 5; OPIC Memorandum of Determination, *Expropriation Claim of Alliant Techsystems, Inc. Ukraine - Contracts of Insurance Nos. D919 and D920* (27 June 1999), available at: https://www.opic.gov/sites/default/files/docs/alliantukraine1999.pdf [hereinafter, *Alliant - Ukraine*] at 7.

31 OPIC Form 234 KGT 12-85 (rev. 9/05), s. 4.03(b).

32 *See Crawford, Commentaries, supra* note 23, at p. 91.

entities, which are empowered to exercise elements of government authority (Article 5) or act under the control of the State (Article 8). In the following section, each of those tests are considered in greater detail, though the lens of OPIC determinations.

3. Organs of the State

Investor-State tribunals have been able to apply the rules of attribution in respect of State organs without much difficulty. Put simply, a State is responsible for all its organs, at all levels.[33] As such, tribunals have found legislative enactments,[34] executive actions (such as orders passed by a government ministry[35] or actions taken by the police[36]) and judicial orders[37] as conduct that give rise to the responsibility of the State. These rules have been applied to organs at all levels of government (central, state and local).[38] To determine whether a particular entity is a State organ, the national

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[33] *See* ILC Article 4 ("Conduct of organs of a State").

[34] *See, e.g., Compañía de Aguas del Aconquija SA and Vivendi Universal v Argentine Republic ('Vivendi II')*, ICSID Case No. ARB/97/3, Award of 20 August 2007, para. 2.2.2 (noting that it was not in dispute that acts of central and provincial legislative bodies are attributable to Argentina).

[35] *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, (2010), para. 293 (noting that orders issued by the Ghanian Ministry of Finance are attributable to Ghana).

[36] *Id.* at 292 (noting that the police force is clearly a State organ and the acts performed during a police investigation are therefore attributable to the State).

[37] *Robert Azinian, Kenneth Davitian & Ellen Baca v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award (1999), para. 99 (noting that a "Court decision itself could be in violation of a treaty obligation" and thus giving rise to the international responsibility of the State); *see also The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Decision on Hearing of Respondent's Objection to Competence and Jurisdiction (2001), para. 47 (citing *Azinian v. Mexico*); *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award (2003) (same). *But see* Bodansky, J. Crook & D. Caron, *The ILC Articles on State Responsibility: The Paradoxical Relationship Between Form and Authority*, 96 Am. J. Int'l L. 857, 871-2 (criticizing the application of ILC Articles by the *Loewen* tribunal).

[38] *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, (2000), para. 73 (noting that there could be no dispute that "Mexico is internationally responsible for the acts of SLP [a Mexican state] and [the Municipality of] Guadalcazar".); *Generation Ukraine Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award (2003), para. 10.3 (noting that there is no doubt that "the conduct of a municipal authority such as the Kyiv City State Administration . . . is capable of being recognised as an act of the State of Ukraine under international law.")

law concerned would be relevant, though not exclusively: a body which, in practice, acts as an organ of the State will be so considered under international law even if domestic law denies it that status.[39] Moreover, a State would be responsible for actions of its organs even if those actions were *ultra vires* (i.e., they were carried out in violation of internal law or instructions).[40]

As in the case of investment treaty law, in the OPIC context as well the least controversial category of tortfeasors whose actions are attributable to the host State are the State organs. As noted above, section 1.01(3) of the OPIC contract provides a broad definition of a "foreign governing authority", including "the central government", "the government of any political subdivision" and "any organ [or] agency. . . acting within the scope of its authority". This definition effectively lays down the same basic principle of attribution that are also stated in paragraph (1) of ILC Article 4 – that the conduct of all individual and collective entities which make up the organization of the State and act on its behalf is attributable to that State.

As under international law, OPIC also applies this principle of attribution to all organs of the government of whatever kind or classification, exercising whatever functions – legislative, executive or judicial – and at whatever level in the hierarchy, including those at provincial or even local level.[41] This principle is evident from the *Exotica* claim, which concerned a legislative act of the government of Chile.[42] The

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39 *See* ILC Article 4(2) and related commentary.

40 *Ioannis Kardassopoulos v. The Republic of Georgia*, ICSID Case No. ARB/05/18, Award (2010), paras 273-280.

41 *Id.*

42 *Chile Copper Co. (Exotica)*, Contract No. 5850, Memorandum of Claim Determination (OPIC) (1972). *See*, Zylberglait, Pablo M., *OPIC's Investment Insurance: The Platypus of Governmental*

Chilean Parliament had passed a constitutional amendment – called the Chilean Copper Nationalisation Law – that provided for the nationalisation of investor's project and all its assets. On October 11, 1971, the Comptroller General of Chile announced that $10,010,445 was proper compensation for the nationalisation, but the investor disputed the adequacy of the amount. On February 10, 1972, the investor filed a claim with OPIC in the amount of $11,890,000. In its determination, OPIC declared that the government of Chile, through the passage of the nationalisation law, had expropriated the investor's property. OPIC consequently compensated the investor and later entered into a settlement with the government of Chile.[43]

As with legislative acts, executive and judicial acts of even territorial units of the host State are attributable to that State. In the *Bank of America (Dabhol) - India* claim, for example, OPIC found that the refusal of the government of one of the Indian states - the Government of Maharashtra - to honour its guarantee under the power purchase agreement and the orders of various Indian courts preventing the U.S. investors from exercising their right to international arbitrations were expropriatory acts attributable to India.[44]

The OPIC contract also provides that the term "foreign governing authority" includes state officials who are "acting within the scope of [their] authority or under

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Programs and its Jurisprudence, 25 Law & Pol'y Int'l Bus, 359 374-5 (1993) [hereinafter, *Zylberglait, Platypus*].

[43] *Id.*

[44] OPIC Memorandum of Determination, *Expropriation Claim of Bank of America, as Trustee India - Contract of Insurance No. F041* (Sep. 30, 2003), available at: https://www.opic.gov/sites/default/files/docs/BankofAmerica-September30-2003.pdf [hereinafter, *Bank of America (Dabhol) - India Claim*].

colour of such authority . . . . "[45] This statement refers to another basic rule of attribution under international law according to which official conduct of a state organ, even if such conduct is unauthorized, is attributable to the state, whereas private conduct of a state organ is not. For example, in the *Bucheit-Gaza* claim, Mr. Bucheit (the insured), who made an investment in Gaza, alleged that the custom officials of the Palestinian Authority ("PA") had expropriated his investment by seizing and retaining the title documents of the equipment that the investor had imported into Gaza.[46] Although OPIC eventually denied the claim, the agency agreed with Mr. Bucheit that the "PA was a 'foreign governing authority in *de facto* control of' Gaza during the [relevant period]"and that if he "were to demonstrate that the alleged acts were committed by PA customs officials [acting in their official capacity] . . . such acts were attributable to the PA".[47]

The above discussion demonstrates that, when it comes to State organs, OPIC has consistently applied general rules of international law, as reflected in ILC Articles

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45 OPIC Form 234 KGT 12-85 (rev. 9/05).

46 OPIC Memorandum of Determination, *Political Violence and Expropriation Claims of Bucheit International Ltd. Contract of Insurance No. E177* (Aug. 2, 2002), available at: https://www.opic.gov/sites/default/files/docs/Bucheitclaim2002.pdf [hereinafter, *Bucheit-Gaza Claim*]. Over the years OPIC has insured several investments and provided funding for many projects in West Bank and Gaza. OPIC's activities in West Bank and Gaza are carried out pursuant to an OPIC Bilateral Incentive Agreement signed in 1994 between the U.S. Government and the Palestinian Liberation Organisation ("PLO"), the latter acting on behalf of the Palestinian Authority. At the same time the U.S. Government entered into the Bilateral Incentive Agreement with PLO, the U.S. Government also entered into a parallel agreement with the Israeli Government under which the latter agreed to support OPIC's activities in West Bank and Gaza. *See Agreement on Encouragement of Investment Between the United States of America and the Palestinian Liberation Organisation for the Benefit of the Palestinian Authority* (1994), available at: http://www.opic.gov/sites/default/files/docs/africa/WestBank-Gaza1994.pdf. Like other Bilateral Incentive Agreements, the Agreement with PLO includes a subrogation clause permitting the U.S. Government to bring a claim against the PLO (or whichever organization is in charge of the Palestinian Authority) for any claims paid out by OPIC. *See also*, *Foreign Private Investment in Palestine: An Analysis of the Law on the Encouragement of Investment in Palestine*, 19 Ford. Int'l L. J. 529 (1995) (discussing foreign investment into Palestine, including efforts of OPIC).

47 *Id*. at 36.

4 and 7, i.e. a State is responsible for all its organs and that the acts of a State's organs will be attributed to the State even if they are contrary to internal law or in violation of instructions.

4. Entities exercising governmental authority

In many countries, State organs do not handle policy issues and operational matters concerning foreign investments. Instead, it is common for States to create corporate entities by statute to handle such matters. Such entities, despite being owned and controlled by the State, usually have a separate corporate personality under the internal law of that State. International law also recognizes this distinction and such entities, commonly referred to as para-statal entities, are generally considered to be separate to the State and their actions are therefore not attributable to the State. However, at least three exceptions qualify this general rule. First, the separation will not be respected if the corporate veil has been created as a means of fraud and evasion.[48] Second, as provided in ILC Article 5, if the corporate entity is exercising elements of "governmental authority", its acts would be attributable to the State, provided the entity is acting in its governmental capacity in that particular instance.[49] The third exception applies in situation where the State exercises control over the entity itself (see ILC Article 8), though there is no consensus yet over the degree of control that must be exercised by the State in order for the conduct to be attributable (this will be discussed further in section 4 below).

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[48] *See Crawford, ILC Commentary*, *supra* note 23 at 48 (citing *Barcelona Traction, Light and Power Company Limited (Belgium v. Spain), Second Phase*, I.C.J. Reports 1970, p. 3, at p. 39, paras. 56-58).

[49] *Id.* at 101.

OPIC also has had to deal with situations where the allegedly expropriatory acts were not carried out by the State organ, but by an entity that has a separate legal personality under national law and which is structurally or functionally related to the State. In the discussion that follows OPIC's analysis of these situations would be considered closely. However, before proceeding further with that analysis, it is worth repeating that Section 1.01(3) of the OPIC Contract provides that a foreign governing authority includes:

> (c) any . . . instrumentality of either [central government or government of a political subdivision of the project country], acting within the scope of its authority or under colour of such authority; and (d) the governmental authorities in *de facto* control of that portion of the project country in which the project is located.

Thus, there are two situations under which acts of State entities are attributable to that State. First, where the entity is an instrumentality of the State – i.e., the entity is not part of the formal structure of the State but is nevertheless empowered by internal law to exercise public functions. And, second, where the entity is a governmental authority that is in "de facto control" of that "portion" of the country where the project is located. The first situation will be discussed in this section, whereas the second situation will be discussed in section 4 below.

As in the case of international law, OPIC coverage treats acts by a host government in a commercial, rather than government, capacity, as being outside the scope of compensable expropriations. The latest version of the OPIC policy provides that "actions . . . of the foreign governing authority exercising commercial (as

distinguished from governmental) functions in relation to the project" are excluded from OPIC's expropriation coverage.[50]

However, as seen in decisions of treaty tribunals presiding over expropriation claims, or domestic courts considering the "commercial" exception to sovereign immunity under the U.S. Foreign Sovereign Immunities Act and the U.K State Immunity Act, it is not always easy to distinguish between private acts (*acta iure gestionis*), which are not attributable, and public acts (*acta iure imperii*), which are attributable.

OPIC claim determinations have also addressed this issue on a few occasions.[51] In the *Marine Shipping Corporation – Egypt* determination, for instance, OPIC ruled that the conduct in question – the decision of an Egyptian port authority to levy fees for dredging and berthing facilities at the port – was commercial in character, not governmental.[52] OPIC noted that the Egyptian "entities involved were para-statal corporations acting for commercial reasons in a commercial capacity rather than from governmental motives".[53]

In the *Bank of America – India* determination, a claim concerning the Dabhol Power Company (DPC), OPIC had the chance to consider slightly differently drafted

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50 234 KGT 12-85 (rev. 9/05), s. 4.03(b).

51 *See* 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 & K. Martin (eds.), International Political Risk Management: Needs of the Present, Challenges for the Future 144, 152-9 (World Bank Group, Fall 2007) (discussing various relevant OPIC cases) [hereinafter, *Mark Kantor, Are you in Good Hands*].

52 OPIC Memorandum of Determinations, Confiscation Claim of Marine Shipping Corporation, Contract of Insurance No. CO15 (July 2, 1999) [hereinafter, *Marine Shipping Corporation – Egypt*], available at: https://www.opic.gov/sites/default/files/docs/claim_marine_shipping.pdf.

53 *Id.* at 2-3.

policy exclusion. Bank of America's (BoA's) OPIC policy excluded acts by a state authority "in its capacity or through its powers" as a commercial counterparty.[54] Applying the policy exclusion, OPIC found that the decision of the Maharashtra State Electricity Board (MSEB) to rescind the Power Purchase Agreement (PPA) was an action by MSEB in its capacity, or through its powers, as the sole purchaser of electricity from DPC and was, therefore, subject to the policy exclusion.[55] Most importantly, OPIC held that the exclusion would apply even if MSEB's actions were politically motivated or were taken in response to governmental pressure. In so doing, OPIC clearly distinguished between, on the one hand, motivation for the entity's acts, which in OPIC's view is legally irrelevant, and, on the other hand, the capacity in which the entity acts, which is dispositive of the insured's claim.

However, in *Bechtel Enterprises International (Bermuda) Ltd. et al. v. Overseas Private Investment Corporation*, an American Arbitration Association (AAA) tribunal reached the opposite conclusion based on the same facts involved in the Dabhol dispute, upholding a PRI claim against OPIC by GE and Bechtel affiliates for expropriation.[56] In tribunal's view, the finding that MSEB's actions were politically motivated was decisive; that is, any actions taken by MSEB for political reasons cannot conceivably be considered as having been taken in the agency's commercial capacity. In other words, the AAA tribunal interpreted the term "through

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54 *Bank of America (Dabhol) - India Claim*, *supra* note 44, at 7.

55 *Id.* at 8.

56 *Bechtel Enterprises et al v OPIC*, AAA Case No. 50 T195 00509 02 (Sep. 3, 2003), available at: https://www.opic.gov/sites/default/files/docs/2294171_1.pdf.

its capacity" to include "motivated by", an interpretation that OPIC expressly rejected.[57]

The difference between OPIC's and AAA Tribunal's approach lies in the extent to which the decision-maker is willing to look beyond the form of the conduct under question and include in its analysis the reasons that motivated that conduct. It is submitted that OPIC's approach is too formalistic and should not be followed in future determinations. In today's world where State enterprises increasingly serve intertwined regulatory and commercial functions, OPIC's approach serves to undermine investor protection and provides an unfair opt-out to host States from their international obligations. Take, for instance, an international power project (IPP) that purchases its fuel under a long-term gas supply agreement with the State's oil and gas monopoly and sells all of its electricity to the state's monopoly national power company.[58] In response to rising gas prices and falling electricity demand, State government encourages the gas supplier to cease providing gas at a now-below market price. At the same time, the State government discourages the national power company from renegotiating the power purchase agreement to reflect the increase in gas prices. In such circumstances, the IPP will have little option but to shut its operations; its investment having been expropriated by the actions of the two state-controlled entities. Nevertheless, under OPIC's approach, the State would escape liability because the two State-controlled entities were acting in their commercial capacity – specifically, in their capacity as supplier of gas and purchaser of electricity,

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57 *Id.* at pp. 16-17.

58 This example is a modified version of one provided in Mark Kantor, *Are You in Good Hands*, *supra* note 51, at 157.

respectively. This result, however, is undesirable as it sends the wrong message to states that they can escape liability for unlawful conduct by structuring their dealings with foreign investors via state-controlled entities.

Another OPIC determination that offers guidance for answering these questions is the *Ponderosa – Argentina* determination.[59] There, OPIC held that repudiation by the Government of Argentina ("GOA") of the license to transport gas was not excluded by the commercial acts exclusion, even though GOA was a contracting party. The major difference between *Ponderosa* and *Bank of America* determinations, however, is that in *Ponderosa* the conduct that caused the breach was enactment of an Emergency Law by the Argentinean legislature. The legislature is an organ of the state (it is part of the "foreign governing authority" as defined in the OPIC contract) and therefore all its actions are, by definition, of a governmental nature. That was not the case in *Bank of America* where the conduct in question was carried out by a State-controlled entity. Moreover, there were no doubts about the public policy motives of the Emergency Law, as the Law itself provided it was required to curb the risk of inflation and to control the flight of foreign exchange from Argentina.

As these determinations demonstrate, distinguishing between "commercial" and "governmental" conduct is difficult under OPIC's policy language. What makes it particularly challenging is that the policy does not make clear the meaning of the term "capacity". As explained earlier, it makes sense to interpret the term more

[59] OPIC Memorandum of Determinations, *Expropriation Claim of Ponderosa Assets, L.P. Argentina-Contract of Insurance No. D733* (8 Feb 2005) available at: https://www.opic.gov/sites/default/files/docs/Ponderosa_Assets_L.P._202005.pdf [hereinafter, *Ponderosa – Argentina*].

broadly than OPIC has done so far and look beyond the form of the conduct, including the motivations of the actor.

OPIC's practice also reveals important differences and similarities with the practice of investor-State tribunals. ILC Article 5 covers the exercise of governmental authority by State-owned entities; the key term being 'governmental authority'. According to the Commentary to ILC Articles, to be regarded as an act of a State for the purposes of international responsibility, the conduct of the entity must concern "governmental activity and not other private or commercial activity".[60] However, the Commentary does not define what 'governmental' means, preferring to instead rely on the particular society and its traditions.[61] Moreover, the Commentary offers a set of further set of criteria on which the designation will depend: (a) the content of the powers, (b) the manner in which they are conferred on the entity, (c) the purposes for which the powers are to be exercised, and (d) the extent to which the entity is publicly accountable for their exercise.[62]

The third criterion clearly suggests that the purpose for, or motivations behind, the conduct are relevant. If the conduct has been motivated by sovereign objectives – as was the conduct of MSEB in the *Bank of America – India* case discussed above – then it is likely that, under general international law, the acts of the entity would be attributable to the State. However, OPIC reached the contrary conclusion, arguably

60 *Crawford, Commentary*, *supra* note 23, at 101.

61 *Id.*

62 *Id.*

because of the specific wording of the OPIC policy, which excluded acts of MSEB in its capacity, or through its powers, as the sole purchaser of electricity.

The above discussion shows that, unlike in case of State organs, where OPIC's practice is completely consistent with general international law, that may not necessarily be the case when it comes to acts of State entities. That said, the difference may also be explained by the fact that, as noted above, there is no consensus under international law as to what is meant by the term 'governmental authority'.

5. Direction or control by the State

The other situation in which acts of para-statal entities may be covered by an OPIC contract depends on the level of control exercised by that entity. This situation, however, is somewhat unique to OPIC, as it re-casts international law's control test, as articulated in ILC's Article 8, in a different mould. Unlike under international law, where a tribunal looks at the degree of control exercised by the State over that entity, OPIC's control test looks at the degree of control exercised by the entity over the "portion of the project country in which the project is located". The latter phrase, which is not defined in the contract, has been interpreted by OPIC to apply to both the territory in which the investment is located and the industry in which the investment has been made. Thus, acts of an entity that has actual control over the affairs of the part of the host State where the investment is located are as much attributable to that State as are acts of an entity that, through its rule-making or supervisory powers, has control over the affairs of the industry in which the investment was made.

For example, in *Belfinance Haussmann - Georgia*, a group of U.S. based investors brought a claim alleging expropriation of its investments made in a Georgian

bank, called Absolute Bank.[63] Specifically, the insured alleged that they lost their investments due to a series of acts carried out by the National Bank of Georgia ("NBG") - Georgia's central bank - including placing Absolute Bank under temporary administration, revoking the Bank's banking license and ultimately liquidating the Bank.[64] In determining whether or not the investment had been expropriated, OPIC had to first decide whether the NBG's actions were attributable to Georgia. OPIC found that the NBG's actions were attributable to Georgia because the type of authority exercised by NBG - placing the bank under temporary administration, conducting audits to determine whether the bank was insolvent, transferring bank's assets to a third party and eventually liquidating the bank - demonstrated that the NBG "was in effective control of the U.S. Investors' insured investment in Foreign Enterprise".[65] OPIC also noted that the NBG's actions coupled with its exclusive authority for regulating the banking sector in Georgia demonstrated that the NBG "was in de facto control of the area where the Foreign Enterprise was located".[66]

Similarly, in *Citibank-Sudan I* (2000), a claim brought under the shadow of the old form contract, Citibank alleged that its branch in Khartoum, Sudan was prevented by Sudan's Central Bank ("SCB") from repatriating profits earned by that branch in the years 1996 and 1997.[67] To determine whether or not the SCB's restrictions on

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63 Expropriation Claim of Belfinance Hausmann, L.L.C. Georgia - Contract of Insurance No. E307 (OPIC, Dec. 22, 2004), available at: https://www.opic.gov/sites/default/files/docs/belfinance_haussmann_2004.PDF [*Belfinance Haussmann – Georgia*].

64 *Id.*

65 *Id.* at 10.

66 *Id.*

67 Expropriation Claim of Citibank N.A. Sudan - Contract of Insurance No. X002 and Annex XC796 (OPIC, Sep. 22, 2000), available at: https://www.opic.gov/sites/default/files/docs/citibankclaim2000.pdf [hereinafter *Citibank-Sudan I*]; *see*

Citibank's ability to repatriate its earnings constituted expropriation, OPIC had to first determine whether the SCB's actions could be considered as actions of the "government of the project country".[68] In other words, OPIC had to determine whether the SCB or its agents were in "effective control of all or any part of the Project Country".[69] While summarising the facts of the case, OPIC noted that the SCB is the "governmental entity that regulates banking activity in Sudan" and that the SCB was responsible for conducting annual inspections of activities of foreign banks, and on the basis of such inspections, SCB would approve or deny a foreign bank's application to remit profits.[70] On the basis of these facts, OPIC reached a conclusion that, for the purposes of the OPIC contract, "SCB falls within [the] definition 'of government of the project country'".[71]

OPIC's control test is very different to ILC Article 8, which uses the criterion of State control over the entity, as opposed to entity's control over the project.[72] Indeed, OPIC's control test appears to be closer to the general international law test for "de facto organs" (i.e. entities that are not defined as organs of the State under

also Expropriation Claim of Citibank N.A. Sudan Claim II - Contract of Insurance No. X002 and Annex XC796 (OPIC, May 14, 2001) (a related claim brought after the SCB declined Citibank's request to remit two deposits previously made with the SCB), available at: https://www.opic.gov/sites/default/files/docs/citibankclaim2001.pdf [hereinafter, *Citibank - Sudan II*].

68 Because Citibank insurance contract was based on OPIC's old form contract, it used the term "government of the project country," rather than "foreign governing authority."

69 *Citibank-Sudan I*, *supra* note 67, at p. 8.

70 *Id.* at 1 - 2.

71 *Id.* at 8.

72 *See*, *Crawford*, *Commentary*, *supra* note 23, at pp. 112-113.

internal law, but act in "completely dependence" on the State).[73] If an entity is considered as a de facto organ, all of its acts are attributable to the State.[74]

However, ultimately, there may no practical difference between the two tests. As noted above, in the *Belfinance Haussmann – Georgia* and *Citibank-Sudan I* cases, OPIC found that the acts of the Central Banks were attributable to the State because, among other things, those banks exercised exclusive regulatory control over the domestic financial sector.[75] Investor-State tribunals have twice considered whether acts of Central Bank are attributable. On both occasions they have ruled in favour of attribution: in one case, the tribunal applied ILC Article 4 (de facto organ)[76] and, in the other case, ILC Article 5 (exercise of governmental authority).[77] In other words, at least as far as conduct of Central Banks is concerned, OPIC and investor-State tribunals have reached the same conclusion, albeit via different routes.

6. Mob violence, insurrection, revolution and civil war

The rule under international law is that the State should not be held liable for the internationally wrongful acts committed by an unsuccessful insurrectional movement in its struggle for independence.[78] In contrast, in case the movement achieves its aims and either installs itself as the new government of the State or forms a new State in

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73 James Crawford, STATE RESPONSIBILITY: GENERAL PART 125 (Cambridge: 2014).

74 *Id.*

75 *See supra note* 67.

76 *See Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Government of Mongolia*, Award on Jurisdiction and Liability, UNCITRAL (2011) at paras. 581-586.

77 *See Genin v. Estonia, supra* note 14, at para. 327.

78 *See* Patrick Dumberry, *New State Responsibility for Internationally Wrongful Acts by an Insurrectional Movement*, 17 Eur. J. Int'l L. 606, n. 2 (2006) [hereinafter, *Dumberry, New State Responsibility*] (citing various historical precedents in support of this principle). *See also Crawford, ILC Commentary, supra* note 23, art. 10, para. 4.

part of the territory of the pre-existing State or in a territory under its administration, ILC Article 10 provides for the attribution of the conduct of the successful insurrectional or other movement to the state.[79]

There has been very little recent international judicial or arbitral practice in relation to principles laid down in ILC Article 10 (except in the context of claims brought before the Iran-U.S. Claims Tribunal).[80] In contrast, however, OPIC has had the opportunity to consider revolution and civil war related claims on several occasions.

For convenience, the discussion below is divided into two separate sub-categories: (i) claims arising out of the Iranian Revolution; and (ii) other claims involving mob violence and insurrection.

6.1. Claims arising out of Iranian Revolution

During the early 1980s OPIC received many claims from American investors in Iran who had lost their investments during the so-called Iranian revolution.[81]

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79 *ILC Articles*, *supra* note 5, arts. 10 (1) – (2).

80 *See* Simon Olleson, The *Impact of ILC's Articles on Responsibility of States for Internationally Wrongful Acts* (BIICL, 2007), at 95 (noting in a study cataloguing the major instances of relevant judicial and arbitral practice in relation to the international law of State responsibility between 9 August 2001, the date of completion of the ILC's work on the topic of State responsibility, and 10 October 2007, that "[t]here appears to have been no international judicial reference to Article 10"). On Iran-U.S. Claims Tribunal cases, *see, e.g., Kenneth P. Yeager v. Islamic Republic of Iran*, 17 Iran-U.S.C.T.R. 92 (1987) (holding Iran responsible for the acts of those who abducted Mr. Yeager)*; Alfred L W Short v. Islamic Republic of Iran*, 16 Iran-U.S.C.T.R. 76 (1987) (finding Iran not responsible for the wrongful expulsion of the claimant); and *Arthur Young and Company v. Islamic Republic of Iran*, 17 Iran-U.S.C.T.R. 245 (1987) (same).

81 *See, e.g.*, Phelphs Dodge Corp., Contract of Insurance No. 8660, Memorandum of Determination (OPIC,undated) [hereinafter, *Phelphs Dodge - Iran Claim*]; Expropriation Claim of Dresser A.G. (Vaduz) Under Contracts of Insurance Nos. 8553 and 9200R – Iran, Memorandum of Determination (OPIC) [hereinafter, *Dresser - Iran Claim*]; Expropriation Claim of Foremost-McKesson, Inc. — Iran — Contracts of Insurance Nos. 8340 and 9456, Memorandum of Determination (OPIC) [hereinafter, *Foremost-McKesson - Iran Claim*]; Expropriatory Action Claim of Cabot International Capital Corporation — Iran — Contract of Insurance Nos. 8383, Memornadum of Determination (OPIC) [*Cabot International - Iran Claim*]; Expropriation Claim of CPC International,

Determinations issued by OPIC in these cases provide an excellent account of OPIC's position on host State responsibility for actions taken by protestors and revolutionaries. While each determination contains an impressively detailed account of the political situation in Iran and the events leading to the establishment of a new government, a complete analysis of Iran's political situation during the 1970s and 80s is unnecessary for current purposes. It is nevertheless important to recount a few key facts.

By fall of 1978, there was intense and often violent agitation against the existing regime ("Shah's regime") with significant amount of the revolutionary activity aimed at foreigners, especially the Americans. Although the anti-Shah movement comprised several factions of various political philosophies, the predominant group, and the one that ultimately gained control of Iran, was the "Islamic Revolution", led by Ayatollah Ruhollah Khoemini. The Shah's response to the situation was mixed - while the Shah did not in any manner condone the activities of the revolutionaries, he did take several steps, such as releasing political prisoners, as a way of offering inducements to prevent further agitation. The Shah's approach, however, proved unsuccessful and early in 1979 the Shah was ousted and a transitional government headed by Shahpour Bakhtiar was installed. Bakhtiar's government also fell prey to the ongoing protests in Iran, and on 5 February 1979, Ayatollah Khoemini led revolutionaries assumed power of the Iranian state. Even after the fall of the

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Inc. Contract of Insurance No. 9302R, Memorandum of Determination (OPIC) [*CPC International - Iran Claim*]; Expropriation Claim of Carrier Corporation Contract of Insurance No. 8535 [*Carrier - Iran Claim*]. All of these determinations are available at: https://www.opic.gov/what-we-offer/political-risk-insurance/claims-determinations. It is worth noting that some of the investors who sought compensation from OPIC also commenced proceedings against Iran at the Iran-US Claims Tribunal. See, e.g., *Phelps Dodge International Corp. v The Islamic Republic of Iran, Award No.* 217-99-2 (1986) (finding Iran responsible for the taking and awarding compensation to the investor).

official government, Ayatollah Khoemini continued his anti-American rhetoric and in a now infamous speech given on 28 October 1979, he exhorted Iranians to take up arms against the Americans. A few days later, militant students captured the United States Embassy in Tehran and took 60 hostages, who were not released by the militants for 444 days.[82] In November 1979, the new constitution of the Islamic Republic was adopted by national referendum. Khomeini was instituted as the Supreme Leader (supreme jurist ruler), and officially became known as the "Leader of the Revolution". On 4 February 1980, Abolhassan Balisadr was elected as the first president of Iran.

Against this backdrop of events, various investors brought claims before OPIC for losses they had suffered as a result of violence that ensued in Iran before Ayatollah Khoemini's revolutionaries assumed power and due to the deliberate anti-American policies followed by the Government of Iran after the revolutionaries' rise to power. In each of its determination, OPIC laid out the general principles on attribution as follows.

First, OPIC held that, even though the group led by Ayatollah Khoemini may have exercised control over different parts of Iran at different points of time, until the demise of Bakhtiar led government, the Shah's government constituted the "government of the project country".[83] OPIC's holding is both interesting and important because it seems to suggest that even if the official government of the country does not exercise effective control over certain parts of the country, it would

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82 In a subsequent decision, the ICJ held that the Government of Iran had violated its international obligations by failing to control the militants (early phase) and approving the acts of the militants (later phase). *See Case Concerning US Diplomatic and Consular Staff in Tehran (U.S. v. Iran)* 19 ILM 553 (1980) [hereinafter, *United States Diplomatic and Consular Staff in Tehran*].

83 *Phelphs Dodge - Iran Claim, supra* note 81, at 19.

still be considered as the "government of the project country" for the purposes of the OPIC contract. (None of the OPIC determinations define the term "effective control"; it is therefore possible that under certain circumstances the control exercised by the official government is so tenuous that OPIC would be willing to recognise a separate entity as the "government of the project country").

Second, OPIC held that from the time the Bakhtiar led government fell until at least through the release of the diplomatic hostages, "Ayatollah Khoemini and his cohorts either constituted the 'government of the project country' or exercised sufficient influence over those directly in control of the [Government of Iran]" such that their acts could be attributed to the "government of the project country".[84] Again, this is an important holding because it suggests that, in cases where private persons are directing government policies, OPIC is willing to pierce the veil and attribute the conduct of such persons to the government of the host State. Under general international law as well, in cases where there has been a partial or total collapse of the regular government (for instance, during a revolution or armed conflict) resulting in private persons exercising elements of governmental authorities, the conduct of such private persons is attributable to the State.[85] The Iran-US Claims Tribunal, for instance, found that the Revolutionary Guards' acts of performing immigration, customs and similar functions at Tehran airport in the immediate aftermath of the Iranian revolution triggered the international responsibility of Iran because the Guards were exercising "elements of governmental authority in the absence of official

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84 *Phelphs Dodge - Iran Claim*, *supra* note 81, at 19; *see also Carrier - Iran Claim*, *supra* note 81, at 15.

85 *See ILC Articles*, *supra* note 5 at art. 9.

authorities, in operations of which the new Government must have had knowledge and to which it did not specifically object".[86]

Third, OPIC held that while acts of "private individuals and [rebellious movements] are not attributable to a government", in case such acts are encouraged or condoned by the government, they would be attributable to the government of the project country.[87] Moreover, in case the rebellious movement is successful and is able to install itself as the new government, the earlier acts of the movement (before it succeeded as the new government) are attributable to the State.[88] Following these principles, OPIC found that normally the anti-American actions of revolutionaries under the Shah and Bakhiatir led governments would not be attributable to Iran because at the time such actions were not encouraged by the government of Iran. But because the Khoemini led revolutionaries were successful in coming to power, even their prior actions were attributable to the host State. As with previous rulings of OPIC, this ruling is also consistent with general international law; specifically, the principle expressed in ILC's Article 10.

Interestingly, in laying down these general principles OPIC cited important sources of international law. In addition to citing the 1980 decision of the ICJ concerning diplomatic hostages in Iran,[89] OPIC also cited the 1961 Harvard Draft Convention on International Responsibility of States for Injuries to Aliens and a

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86 *Kenneth P. Yeager v. The Islamic Republic of Iran*, Iran-U.S.C.T.R., vol. 17 , p. 92, at p. 104, para. 143 (1987).

87 *Phelphs Dodge - Iran Claim, supra* note 81, at 22; *see also, Carrier - Iran Claim, supra* note 81, at 15.

88 *Phelphs Dodge - Iran Claim, supra* note 81, at 25; see *also, Carrier - Iran Claim*, supra note 81, at 15.

89 *See, e.g., Phelphs Dodge - Iran Claim, supra* note 81, at 26.

statement on rules of attribution issued by the U.S. State Department issued after the 1958 Cuban Revolution.[90] This is important because as discuss earlier in the thesis, there is significant overlap between OPIC jurisprudence, on the one hand, and international law, on the other, and the apparent consistency between the two is not a coincidence but the result of a concerted effort on the part of OPIC to look at broadly accepted sources of international law to inform its analysis.

6.2. Other Claims involving mob violence and insurrection

Another area where attribution can be a problematic issue is where there are two warring fractions both of which at different times exercise "effective control" over the territory in which the project is located. The claim of *Indian Head Mills Inc*. illustrates these difficulties.[91] There, Indian Head Mills held an equity interest in a local company called Abatex, which operated a cotton mill in a region of Nigeria that seceded under the name of Bifaria in 1967. Before the secession occurred, Abatex was party to a cotton supply agreement with a Nigerian government agency. However, the government agency cancelled the contract when the civil war began. Moreover, Nigria imposed a general embargo, which prevented Abatex from importing raw material and exporting the finished product. As a result, Abatex decided to terminate operations, at

90 *See, e.g., Phelphs Dodge - Iran Claim*, *supra* note 81, at 25.

91 *Indian Head Mills, Contract No. 5045,* Memorandum of Determination (AID Sep. 10, 1968) [hereinafter. *Indian Head Mills Claim*]. The copy of a memorandum prepared by OPIC in relation to the *Indian Head Mills Claim*, titled "Action Memorandum for the Assistant Arbitrator", dated Nov. 26, 1968, is on file with the author. However, that memorandum does not contain the facts of the case. The factual summary presented here has been taken from Vance R. Koven, *Expropriation and the 'Jurisprudence' of OPIC*, 22 Harv. Int'l. L. J. 269, 286-7 (1981).

which the Bifarian army "confiscated" the plant in order to manufacture uniforms and other military material.[92]

In response to these actions of the Bifarian military and the Nigerian government, Indian Head filed an expropriation claim under its insurance policy with AID, the predecessor of OPIC. AID found that while the actions of the Nigerian government - imposition of an embargo on raw materials and blockage of exports - were not expropriatory acts, requisitioning of the factory followed by its operation by the Bifarian army were in fact expropriatory acts.[93] However, by the time the one-year waiting period passed and Indian Head's claim matured, the civil war had ended and the Nigerian government once more controlled the area where the project was located.[94] This set of rather unusual circumstances gave rise to an anomalous situation where the "foreign governing authority" which committed the expropriatory acts (Bifarian military) had, by the time of maturity of the claim, been replaced by a new authority (Nigerian government).

Nevertheless, AID honoured the investor's claim because under the old form contract, the definition of a foreign government includes "present or any succeeding governing authority."[95] Because the succeeding government authority - the Nigerian government - did not return the investment, AID concluded that an expropriation had occurred.

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92 *Id.*

93 *See Id.* at 287 (1981) (citing *Indian Head Mills, Inc., Contract No. 5045*, Memorandum Concerning Liability at 12 (AID undated)).

94 *Id.*

95 234 KGT 12-70, *supra* note 29, at s. 1.16.

The result that AID reached in the *Indian Head Mills* case strikes one as being slightly unusual at first because the agency appears to be holding the Nigerian government responsible for the private acts of the Bifarian military. However, that is not the case. AID found that both the Bifarian military and the Nigerian government had independently expropriated the cotton mill. Initially, the Bifarian military expropriated the mill by confiscating the plant and taking over its operations. A year later, when the Nigerian government crushed the rebellion and re-established its control over the Bifarian region, the mill was effectively expropriated for the second time as the Nigerian government refused to return the investment. It is submitted that the agency's finding in this case is consistent with the international law rule that purely private conduct can be considered an act of a State "if and to the extent that the State acknowledges and adopts the conduct in question as its own".[96] While the Nigerian government did not "adopt" the acts of the Bifarian military, in the same way as, for example, the Iranian State had expressly approved the seizure of the American Embassy and detention of its inmates as hostages,[97] the Nigerian government did effectively adopt the expropriatory acts of the Bifaran army by maintaining the ongoing situation and refusing to return the investment of Indian Head Mills.

7. Political violence

In addition to providing coverage against the risk of expropriation, OPIC also covers the risk of political violence. In fact, OPIC has a long history of dealing with claims arising out of political violence. Its first political violence claims arose as a

96 *ILC Articles*, *supra* note 5 at art. 11.

97 *See, , United States Diplomatic and Consular Staff in Tehran*, *supra* note 82.

consequence of the rebuilding efforts by the Organization of American States following political strife in Dominican Republic in 1967. Since then, OPIC has addressed political violence claims relating to projects in, *inter alia*, Pakistan, Bangladesh, Chile, Indonesia, Nicaragua, Haiti, the Philippines, Rwanda, Democratic Republic of Congo, Sierra Leone, Gaza, Colombia and Afghanistan.[98] In total, OPIC has so far issued over 50 determinations relating to its political violence coverage, dealing with claims for damages suffered as a consequence of declared war, violent secessions, military coups, civil war, or revolution.

Although this thesis is not an occasion to review OPIC's determinations on political violence, it is worth noting two determinations that provide an important counterpoint to investment treaty jurisprudence in this area. They also provide a rather unique way of assessing state liability that does not depend on rules of attribution, but on the nature of violence, the identity of the actor perpetrating that violence and rules of causation.

In the first of these two determinations -- *Freeport Minerals – Indonesia* -- OPIC was presented with a claim by Freeport after its facilities had suffered damage during fighting between an Indonesian dissent group, called Organisasi Papua Merdeka ("OPM"), and the Indonesian government forces.[99] OPIC determined that

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[98] See Mark Kantor, Michael D. Nolan & Karl P. Sauvant, *Political Violence and PRI*, OUP Blog (31 March, 2011), *available at*: http://blog.oup.com/2011/03/opic/ [hereinafter, *Kantor et al., Political Violence*].

[99] *Claim of Freeport Minerals – War, Revolution, and Insurrection (Contract of Guaranty No. 7034 and Contract of Insurance No. 9704)*, Memorandum of Determinations (OPIC) (1986) [hereinafter, *Freeport Minerals – Indonesia*]; *See also* Mark Kantor, Michael D. Nolan & Karl P. Sauvant, REPORTS OF OVERSEAS PRIVATE INVESTMENT CORPORATION DETERMINATIONS, 552-62 (OUP, 2011) [hereinafter, *Kantor et al, Reports of OPIC Determinations*]. *See also* an earlier claim by Freeport for losses incurred as a result of political violence in Indonesia. *Kantor et al, Reports of OPIC Determinations*, at 538.

because the acts in questions were not acts of war between two sovereign states, a two-part test had to be satisfied. First, the group allegedly responsible for the acts must be an organized revolutionary or insurgent force acting to overthrow the existing political regime. Second, the injury suffered by the insured must have been inflicted either by that group or by government forces defending against such a force.[100]

OPIC agreed that OPM constituted a revolutionary force because it urged the violent overthrow of the government and conducted armed guerilla campaigns. OPIC also noted that, even though OPM was a loosely affiliated collection of various revolutionary groups and lacked a common command structure, it had nevertheless operated as OPM for twenty-three years, which was sufficient to meet the standard of a revolutionary force under the contract.[101] OPIC further applied a "preponderance" test on the basis of which it determined that it was more likely than not that the harm done to Freeport's facilities was the result of OPM attacks and Indonesian forces' retaliatory efforts, as opposed to other causes.[102]

OPIC reached the same determination in a claim brought by American Standard after its operations suffered damage during a military confrontation between a revolutionary group demanding independence, called Frente Sadanista de Liberacion Nacional ("FSLN"), and the Nicaraguan National Guard.[103] As in *Freeport-Indonesia*, OPIC applied a two-part test in the *American Standard – Nicaragua* determination.

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100 *Freeport Minerals – Indonesia*, *supra* note 99, at 6-7; *Kantor et al*, *Reports Of OPIC Determinations*, *supra* note 99, at 557.

101 *Id.*

102 *Id.*

103 *Claim of American Standard, Inc. – War, Revolution and Insurrection – Contract of Insurance No. 8106,* Memorandum of Determinations (OPIC) (1983) [hereinafter, *American Standard – Nicaragua*]; *see also Kantor et al, Reports of OPIC Determinations*, *supra* note 99, at 128-139.

First, it determined that FSLN was a revolutionary force because it was organized with the objective of overthrowing the existing political regime and was indeed successful in accomplishing that objective after engaging in a bloody offensive against government forces.[104] Second, OPIC found that, even though the insured had to evacuate all personnel from the project site and therefore there were no eyewitness affidavits, given the circumstantial evidence, it was highly probable that the damage suffered by the insured was the result of fighting between FSLN and military forces.[105] As such, OPIC concluded that American Standard's damages were caused by political violence and that the company had presented a valid claim.

By contrast, international treaty tribunals so far have had relatively limited occasion to examine political violence claims. The two significant exceptions are: *Asian Agricultural Products Limited (AAPL) v. Sri Lanka*[106] and *American Manufacturing and Trading (AMT) v. Zaire*[107]. In both cases, the tribunals examined claims of political violence in light of the international law standard of "full protection and security" contained in the underlying bilateral investment treaty. In interpreting the underlying treaty provisions, both tribunals rejected a strict liability standard for purposes of the treaty.[108] Instead, *AAPL* tribunal adopted a standard of "diligence", meaning "the reasonable measure of prevention which a well-administered

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104 *American Standard – Nicaragua*, *supra* note 103, at 4-5; *Kantor et al, Reports of OPIC Determinations*, *supra* note 99, at 132.

105 *American Standard – Nicaragua*, *supra* note 103, at 5-7; *Kantor et al, Reports of OPIC Determinations*, *supra* note 99, at 132.

106 *Asian Agricultural Products Limited (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, Award of June 21, 1990, 30 I.L.M. 577 (1991) [hereinafter, *AAPL*].

107 *American Manufacturing and Trading (AMT) v. Zaire* ICSID Case No. ARB/93/1, Award of Feb. 21, 1997, 36 I.L.M. 1531 (1997) [hereinafter, *AMT*].

108 *AAPL*, *supra* note 106, at para. 50; *AMT*, *supra* note 107, at para. 6.05.

government could be expected to exercise under similar circumstances".[109] Whereas, *AMT* tribunal adopted a similar, but differently worded, standard of "vigilance", meaning that the host State "must show that it has taken all measures of precaution to protect the investments … on its territory".[110]

The *AAPL* tribunal found that Sri Lanka had failed to meet the "diligence" threshold when Sri Lankan military forces destroyed AAPL's facilities during an attack against Tamil rebels. The tribunal in *AMT* concluded that Zaire too failed in its "vigilance" obligations towards AMT because it did not take any measures to stop repeated looting by rebel insurgents.

Both *AAPL* and *AMT* involved organized rebel forces against which a well-equipped government can reasonably be expected to provide protection to foreign investors. But in situations like the ones that existed in Tunisia, Egypt and Libya during the 2011 Arab Spring, groups often operated separately to each other and lacked any common command or organizational structure. In such cases, it is difficult to see how the prevailing standards of "diligence" or "vigilance" can apply – a state cannot reasonably be expected to exercise the same level of "diligence" or "vigilance" against a large number of unrelated rebel groups as it should exercise against one well-known and organized rebel group, like the Tamil Tigers in *AAPL* or the insurgents in *AMT*. It is of course difficult to tell, without the benefit of a concrete claim, whether investment treaties provide effective remedies to investors who suffered damages as a result of acts of political violence committed during the Arab Spring. The analyses in *AMT* and

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109 *AAPL*, *supra* note 106, at para. 77 (quoting Professor Freeman).

110 *AMT*, *supra* note 107, at para. 6.05.

AALP point towards recovery of damages in certain limited cases. However, generally speaking, these arbitration awards leave too many issues unaddressed for a business to know with reasonable certainty the extent of its protection.[111] In those instances, OPIC determinations may provide helpful context to treaty tribunals presiding over political violence claims. Moreover, the definite nature of OPIC's jurisprudence compared to the undecided state of investor-state jurisprudence in this area should make investors planning investments in one of the troubled countries to seriously consider adding political risk insurance to their risk mitigation portfolio.[112]

8. Conclusion

The material presented in this chapter reveals important similarities and differences between OPIC determinations and investor-State awards. As for similarities, both OPIC and investor-state tribunals start their analysis of an expropriation claim by first addressing the rules of attribution. In case they find that the alleged conduct, no matter how egregious, is not attributable to the host State, they deny the claim without addressing the substance of the claim. Another similarity is that both OPIC and investor-State tribunals rely on ILC's Articles on State Responsibility to determine whether the alleged conduct is attributable to the host State. Tribunals, however, look at ILC's Articles more often because, unlike OPIC policies, BITs rarely contain their own rules of attribution. Finally, in case of both forums, challenging issues that prompt detailed analysis usually surround attribution of actions carried out by para-statal entities – actions that normally fall within the purview of ILC Articles 5 and 8.

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111 *See Kantor et al., Political Violence*, *supra* note 98.

112 *Id.*

As for differences, the first and most obvious difference is the procedural context in which the two forums analyze the issue of attribution. Investor-State tribunals do not have the authority to decide all types of disputes. Their jurisdiction is limited to only those disputes with respect to which host States have provided their consent. For this reason, an award rendered in a dispute over which the tribunal does not have jurisdiction is in excess of tribunal's powers. An OPIC panel presiding over an insurance claim, on the other hand, is not the creation of host State's consent. Rather, an OPIC panel's task is to simply establish the validity of a claim put forth by the insured, a process in which the host State has no involvement. As such, it is absurd to talk about OPIC's jurisdiction (or, put differently, OPIC has unlimited jurisdiction over all claims relating to its policies).

To give effect to the limited nature of tribunal's authority, and to promote the efficient administration of the arbitral process, tribunals routinely bifurcate arbitral proceedings into two stages. That is, in case there are any jurisdictional objections, tribunals tend to first conduct a hearing on jurisdiction, and in case the claimant is successful, a separate hearing on liability. Issues related to attribution can arise at both stages, though they are most commonly addressed at the jurisdiction stage. That is so because if the alleged actions of a state-controlled entity are not attributable to the host State, the dispute effectively becomes a disagreement between two private entities (the foreign investor and the state-controlled entity) over which a treaty tribunal has no jurisdiction. On the other hand, because jurisdiction is a non-issue in case of OPIC, there is no need to bifurcate proceeding and, therefore, all issues, including attribution, are decided at the same time.

The second difference is substantive. As explained above, OPIC policies contain quite elaborate rules of attribution, including a definition for "foreign governing authority" which specifies circumstances in which private acts may be attributable to the host State. On the hand, barring a few exceptions, such as the NAFTA, investment treaties do not contain any rules of attribution, as a result of which treaty tribunals have to rely on customary international law to derive the relevant rules.

The third difference relates to the two forums' practical experience. For example, over the years, OPIC has issued determinations in several cases where the wrongdoing was carried out by revolutionary forces or insurrectionist groups. Some of these cases arose under OPIC's expropriation policies, whereas others arose under the agency's political violence policies. Similarly, OPIC has had the opportunity to consider claims arising in contexts where the legal status of the territory in which the insured investment was made is in question: for example, in the *Indian Head Mills* case, at the time the hostilities began, Bifaria had seceded from Nigeria and, therefore, OPIC had to consider whether the acts of the rebels could be properly attributed to the Nigerian government.

On the other hand, barring two disputes – *AAPL v. Sri Lanka* and *AMT v. Zaire* – investor-State tribunals have not had a chance to consider claims arising in revolutionary circumstances. Given the recent events in the Middle-East following Arab Spring, and in Ukraine following Russian annexation of Crimea, it is likely that there will be more investor-State claims relating to political violence. Indeed, few Ukrainian companies with investments in Crimea have already commenced arbitration

proceedings against Russia under the Ukraine-Russia BIT.[113] Lawyers as well as arbitrators involved in these arbitrations would benefit from looking at some of the OPIC determinations discussed in this chapter.

[113] *See* Global Arbitration Review, Crimea Claims Threatened Against Russia (10 July 2015), available at: http://globalarbitrationreview.com/news/article/33957/crimea-claims-threatened-against-russia.

CHAPTER 8: QUANTIFICATION OF COMPENSATION

1. Introduction

In the previous chapter, several OPIC determinations were discussed in order to highlight the insurer's rich jurisprudence on rules of attribution, and to also identify areas where OPIC's experience can assist in the development of international law. In particular, three aspects of OPIC's determinations were highlighted: (i) where OPIC

applied general international law and its determination reinforced customary rules (e.g. OPIC's treatment of State organs); (ii) where OPIC elaborated principles of international law which have not been applied regularly by international tribunals (e.g. situations in which the conduct of insurrectional movements was found to be attributable to the State); and (iii) where OPIC departed from established principles of international law (e.g. OPIC's "control" test for State entities).[1]

This chapter focuses on quantification of compensation. As with rules of attribution, when it comes to compensation, OPIC policies are more prescriptive than IIAs. Specifically, they not only identify the standard of compensation ("full compensation"), they also note the method that should be used to calculate compensation ("book value").[2] In addition, they contain various limitations on the amount of compensation that can be ordered, including, for example, an upper limit based on the "insured amount" and a requirement for "self-insurance" (usually around 10%).[3] OPIC policies also require the investor to assign its rights in the investment to OPIC upon receiving compensation (something that IIAs do not do, and investor-State tribunals arguably lack the jurisdiction to order).[4]

Because of these differences, certain losses suffered by investors would lie outside the scope of a typical OPIC policy. However, the investor would have the option to recover the remaining losses under an IIA. In addition, the insurer would have the option, as a subrogee, to recover from the host State in arbitration the sums it has paid

1 *See supra* Chapter 7, s.5.

2 *See infra* s. 3.1.

3 *See infra* s. 3.5.

4 *See infra* 3.4.

under the PRI policy. Consequently, as explained in section 4 below, the same event would give rise to three distinct claims: (i) a claim by the investor against the insurer under the PRI policy to recover covered losses; (ii) a claim by the investor against the host State under the IIA to recover uncovered losses; and (iii) a claim by the insurer, as a subrogee, against the host State to recover its losses. However, in practice, it is not clear whether these three claims would be pursued separately.

In any event, the pursuit of these multiple claims, raises important policy questions. For example, should the investor be required to disclose the existence of a PRI policy and its terms to an investor-State tribunal? How can a tribunal ensure that the investor does not double recover? These and other similar questions are also discussed in section 4. Finally, section 5 concludes.

2. Rules of compensation for expropriation

2.1. International investment agreements

IIAs, on the whole, adopt the 'full compensation' standard for expropriation. The relevant standard is expressed differently in different IIAs; some of the commonly found formulations include 'equivalent to actual value', 'prompt, adequate and effective compensation', 'fair market value', 'just compensation' and 'actual value'. Despite these differences, investor-State tribunals have given a largely uniform interpretation to the various standards as requiring payment of full compensation – in the sense of fair market value of the expropriated investment as of the date of expropriation (or a later date in case of unlawful expropriation).[5]

[5] *See generally, Borzu Sabahi, Compensation and Restitution in Investor-State Arbitration: Principles and Practice (2011); Irmgard Marboe,* CALCULATION OF COMPENSATION AND DAMAGES IN INTERNATIONAL INVESTMENT LAW *(2009) [hereinafter, I. Marboe, Calculation of Compensation];*

There are different accounting methods by which the fair market value of an asset is calculated. The methodology used depends on the type of assets and circumstances of the case. For tangible assets, which do not produce income on their own (such as machinery, land, buildings etc), the market value is usually easily determinable by reference to the asset's market price. Investor-State disputes, however, rarely involve expropriation of tangible assets; instead, the investment in question is normally an income-producing business, which must be valued by reference to the cash flows that the business is expected to generate during its lifetime.

When it comes valuation of businesses, the three most recognised approaches are: (i) income based approach (or the discounted cash flow ("DCF") method); (ii) market based approach (or the 'comparable transactions' method); and (iii) asset based approach (or the 'book value' method).[6] The market based approach, which purports to determine the value of a business by reference to the value at which comparable businesses were sold in the market, is rarely employed by investor-State tribunals (presumably because data for comparable sales is rarely available).[7] Accordingly, this approach will not be discussed further in this chapter.

Mark Kantor, VALUATION FOR ARBITRATION *(2008); Sergey Ripinsky & Kevin Williams, DAMAGES IN INTERNATIONAL INVESTMENT LAW 35 (2008) [hereinafter, Ripinsky, Damages]; Pierre Bienvenu & Martin J. Valasek, "Compensation for Unlawful Expropriation, and Other Recent Manifestations of the Principle of Full Reparation in International Investment Law", in 50 YEARS OF THE NEW YORK CONVENTION 231-37 (Albert Jan van den Berg ed. 2009). See also* Newcombe & Lluis Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 383-5 (Kluwer, 2009) [hereinafter, *Newcombe et al, Standards of Treatment*].

6 *See, Id.*

7 *Ripinsky, Damages, supra* note 5, at 212-215 (citing *CME Czech Republic B.V. v. Czech Republic, Final Award*, UNCITRAL, (2003)as the only case which confirmed that the market-based approach, by itself, is a valid valuation approach in the investor-State arbitration context).

The asset-based approach calculates the value of a business by summing up the value of the individual assets that make up that business. To calculate the value of those individual assets, different proxies are used, including 'book value' (which considers the value recorded on the balance sheet of the business), 'replacement value' (the amount that would have to paid to purchase a similar asset on the market), and 'liquidation value' (the amount that the asset would generate if it were sold in a liquidation).[8] There are important differences between these three proxies; however, this is not an appropriate juncture to discuss those differences. Nevertheless, it should be noted that, and as explained further below, most PRI policies provide that compensation would be paid in accordance with the 'book value' of the expropriated investment. In other words, not only do PRI policies prescribe an asset-based approach for valuation, they also provide that the value of the assets must be calculated by reference to the value recorded on the balance sheet of the business.

The valuation methodology that is most commonly adopted by investor-State tribunals is the income-based, or DCF, method.[9] Simply put, the DFC method purports to determine the value of a business by computing the 'present value' of the earnings that the business is likely to generate during its economic life. Generally speaking, there are two steps involved. First, the business's expected future earnings are calculated by projecting the net cash flows it is likely to generate in each future year of its economic life. Second, those future earnings are discounted to their present

8 *Id.* at 218-226.

9 *Id.* at 195-212 (identifying the various cases where the DCF method has been adopted, as well as the limited instances in which it has been rejected).

value, by applying the appropriate 'discount rate' for each year.[10] The choice of discount rate is meant to reflect the 'time value of money' (i.e. the risk-free alternatives available in the market, such as U.S. government bonds), plus the various risks associated with the business (including business risk, macro-economic risk, exchange rate risk and political risk).[11] Ultimately, the higher the discount rate, the lower the value of the business generated by the DCF method.

2.2. OPIC insurance policies

In contrast to IIAs, which, as noted, provide for 'market value' compensation, PRI policies reimburse only for 'book value' losses.[12] The Model OPIC contract states that "[c]ompensation is computed as of the date the expropriatory effect commences (4.01(c)) and the *book value* of the insured investment is based on financial statements maintained by the Investor in accordance with 9.01.6 for the foreign enterprise".[13] Similarly, MIGA's equity PRI policy provides that "[i]n case of total expropriation of equity investments" the compensation to be paid "to the insured party is based on the net book value of the insured investment".[14]

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10 *See*, *Amoco International Finance v Iran*, Award, Iran-US CTR 189 (1987) at , para 213.

11 *Ripinsky*, *Damages*, *supra* note 5, at 196-198.

12 *See generally*, Pieter Bekker & Akiko Ogawa, *The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the 'BIT Bang'*, 28 ICSID Review 2, 314, at 333-334 (2013) [hererinafter, *Bekker*, *BITs and PRI*]; Mark Kantor, *Comparing Political Risk Insurance and Investment Treaty Arbitration*, 12 Transnat'l. Disp. Mgmt. 5, 455, at 463 (Nov. 2015) [hererinafter, *Kantor*, *BITs and PRI*]; Robert Ginsburg, *Political Risk Insurance and Bilateral Investment Treaties:Making the Connection*, 14 J. World Inv. & Trade 943–977 (2013) [hererinafter, *Ginsburg*, *BITs and PRI*].

13 OPIC Contract of Insurance Against Inconvertibility, Expropriation, Political Violence, Form 234 KGT 12-85, art 5.01.

14 MIGA, Investment Guarantees, Terms and Conditions, available at http://www.miga.org/investmentguarantees/index.cfm?stid=1799.

What is meant by 'net book value' and how it compares to IIA's 'market value' standard will be discussed in the following section, however, for now it suffices to say that the former standard is likely to undercompensate the investor, especially where he owns a profitable business. In other words, the compensation that the investor would receive from an insurer is likely to be less than the market value of the investment, leaving the investor with a potential claim under an IIA for the difference between the market value and the net book value of the investment.[15] Aside from that difference, there are at least two other reasons why the insurer may not compensate the investor in full.

First, most PRI policies have ceilings for the available insurance cover. For example, the ceiling for an OPIC equity political risk guarantee is typically 270% of invested capital, regardless of the market value loss the investor may have suffered: "[f]or equity investments, OPIC typically issues insurance commitments equal to 270 percent of the initial investment—90 percent representing the original investment and 180 percent to cover future earnings".[16] Similarly, MIGA "may insure up to $220 million per project, and if necessary more can be arranged through syndication of insurance".[17]

Secondly, most insurers have a self-insurance requirement, which purports to encourage risk sharing between the investor and the insurer. Insurers will cover typically only 90% of the loss, not 100%: "OPIC can insure up to 90 percent of an

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15 *Kantor, BITs and PRI, supra* note 12, at 463.

16 OPIC, Extent of Coverage, available at http://www.opic.gov/what-weoffer/political-risk-insurance/extent-of-coverage.

17 MIGA, Investment Guarantees, Terms and Conditions, available at http://www.miga.org/investmentguarantees/index.cfm?stid=1799.

eligible investment. OPIC's statute generally requires that the investor bear at least 10 percent of the risk of loss".[18]

As a result of the insurance limit and self-insurance requirement in the PRI policy, coupled with the policy's less favourable compensation standard, even after the insurer has reimbursed an investor, the investor is likely to have a sizeable compensation claim under an IIA. In addition, as explained in Chapter 3 above, after the insurer has paid out under the policy, the policy's subrogation principles allow it step into the shoes of the investor and bring a claim against the host State, either under an IIA or under a specially negotiated agreement (as in the case of OPIC and MIGA)[19].

3. Comparison between the two approaches

As noted above, there are important differences between the rules of compensation in OPIC insurance policies and IIAs. This section analyses those differences in greater detail, by making reference to relevant OPIC determinations and investor-State awards.

3.1. Book value versus market value

As noted above, PRI policies typically reimburse only for 'book value' losses. By contrast, IIAs reimburse for 'market value' losses. Under previous OPIC contracts (i.e. contracts in force prior to the adoption of the Contract Form 234 KGT 12-85 in 1986), compensation for total expropriation was determined under the definition of

[18] OPIC, Extent of Coverage, available at http://www.opic.gov/what-weoffer/political-risk-insurance/extent-of-coverage.

[19] *See supra* Ch. 3, s. 3.

"net investment".[20] Specifically, the old form contract provided that "the amount of compensation shall be the Net Investment determined as of the Date of Expropriation, less [any sums] . . . which are received, directly or indirectly, by the Investor [from other sources]".[21] The terms "net investment" was defined in the contract as:

> [t]he amount of Investment contributed by the Investor for equity Securities owned by the Investor on such date less the Return of Capital on such equity Securities, adjusted for the United States dollar equivalent (determined at the Reference Rate of Exchange on such date) of such equity Securities' ratable share of net retained earnings and losses (including but not limited to realized capital gains or losses as well as any retained earning's capitalized through the issuance of stock dividends) of the Foreign Enterprise accruing after the date of acquisition by the investor of the Securities.[22]

As per the above definition, OPIC would have compensated the investor for the actual investment made by the investor as of the date of expropriation, adjusted by the net retained earnings or losses made on that investment. Therefore, in case of creeping expropriation, for instance, OPIC would compensate the investor for the investments it had made in the project, as well as any losses it had suffered while it was subject to the creep, provided those losses are attributable to the government's expropriatory acts.[23]

In the revisions that were made to the OPIC standard form contract in 1986, the "net investment" formula was replaced by the "book value" concept, as the latter

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[20] OPIC Insurance Contract Form, 234 KGT 12-85, 51 *Fed. Reg.* 3438, at 3441(1986) [hereinafter, *OPIC Contract Form 234 KGT 12-85*] (referring to the previous OPIC contracts (234 KGT 12-70 (Revised) and 234 KGT 12-70 (Second Revision)).

[21] See OPIC Memorandum of Determination, *Expropriatory Action Claim of Cabot International Capital Corporation v Iran*, Decision (27 December 1980) [hereinafter, *OPIC, Cabot-Iran Determination*], in Kantor, Nolan & Sauvant, Reports of Overseas Private Investment Corporation, Determinations, 1:844 (OUP, 2011) [hereinafter, *Kantor et al, Reports of OPIC Determinations*] (referring to clause 20.02 in the old for OPIC contract).

[22] *Id.* at 1:845; *see also Bekker, BITs and PRI, supra* note 12, at 334.

[23] *Id.*

concept "is more familiar to accountants and business people".[24] However, at a practical level, OPIC's approach remained unchanged. As it explained, "[e]ssentially, book value means the initial investment in a project, adjusted by the net retained earnings or losses of the project".[25] In other words, despite the change in terminology, OPIC continued to compensate investors according to the actual investment they had made in the project.

In contrast with OPIC, which appears to conflate the 'book value' approach and the 'actual investment' approach, investor-State tribunals tend to distinguish between the two approaches. Book value is an accounting concept, which represents the original (historic) cost of the asset, adjusted downwards to reflect the ageing of the asset (i.e. depreciation or amortization).[26] The value is recorded on the business' balance sheet and is, therefore, easy to verify. Moreover, because balance sheets are prepared for reasons other than litigation, the book value of an asset is less likely to be contested by the other side.[27] That said, this method is inherently "backward looking" and is unlikely to represent the present value of the investment.[28] With the passage of time, the market value of the business may be higher than its book value (because, for instance, the business has accumulated significant good will or has achieved excellent

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24 *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, at 3441.

25 *Id.*

26 *Ripinsky*, *Damages*, *supra* note 5, at 221.

27 *Newcombe et al*, *Standards of Treatment*, *supra* note 5, at 390.

28 *Id.*

earning potential) or lower (due to, for example, technological advancement).[29] For these reasons, investor-State tribunals rarely rely solely on the book value approach.[30]

The 'net investment' or 'actual investment' approach, on the other hand, purports to value an asset or business by calculating the total amount spent by the investor in the investment in question. This approach has been applied by a variety of tribunals, especially in cases where the business has not started operating yet (as in *Wena v Egypt*[31]) or it has not been in operation for long enough to permit an accurate projection of future profits (as in *Metaclad v Mexico*[32]). Generally speaking, the 'actual investment' approach is likely to be more favourable to an investor than the 'book value' approach. That is because, whilst the latter approach only considers the value of the assets, the former approach takes into account all types of costs, including not only the costs of acquiring the assets, but also investment planning costs, wages, traveling and accommodation expenses etc.[33] Moreover, book value takes into account depreciation, something that is largely ignored by the actual investment approach.[34] That said, both approaches fail to compensate the investor for the profit making potential of the business and are, therefore, likely to lead to a valuation that is below the market value of the investment.

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29 *Id.*; *Ripinsky*, DAMAGES, *supra* note 5, at 221-2.

30 *See Ripinsky*, DAMAGES, *supra* note 5, at 222-3 (identifying investor-State arbitrations that have rejected this approach as being unsatisfactory for valuation of businesses).

31 *Wena Hotels Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award (2000), paras. 122-25.

32 *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (2000), paras. 119-130.

33 *Ripinsky*, DAMAGES, *supra* note 5, at 230.

34 *Id.*

Ultimately, it appears that OPIC's decision to apply the 'book value' or 'actual investment' approach is driven by both considerations of ease and economics. A valuation approach based on the actual costs expended by the investor, as recorded on its balance sheets, is far less speculative than an approach based on revenue projections. In addition, in most cases, the actual investment approach would lead to a value that is somewhere between the DCF value and the book value of the business. In other words, by applying the actual investment approach, OPIC is able to strike a balance between the investor's need to be compensated at market levels and OPIC's institutional need to keep compensation payout at a manageable (and also at a level where they are recoverable from the host States in settlements).

3.2. Causation

There are a few other compensation related rules in the OPIC standard form contracts that are worth identifying here. For instance, OPIC will only compensate for losses which were caused by the government's expropriatory acts. If some of the losses suffered by the investor are attributable to other causes, then those losses are not recoverable under the OPIC policy. It is not always easy, however, to isolate the causes for an investor's loss.

For example, in the *Cabot International – Iran* case, Cabot was a 50% owner of a carbon black company, called ICC, in Iran. The remaining stake in ICC was held by Iranian state owned companies. After several years of successful operation, Cabot started facing problems in Iran. Among other things, starting June 1979, ICC's management stopped communicating with Cabot completely (including refusing to send monthly management and financial reports), no shareholders meetings were held

(presumably to prevent Cabot's participation) and no dividends were distributed to the shareholders. OPIC found that, by 30 April 1998 (the last date by when, under Iranian law, shareholders' meeting for the fiscal year 1979 had to be arranged), "this continuing course of conduct had attained a cumulative effect" equivalent to total expropriation.[35]

Next, in order to calculate compensation for expropriation, OPIC had to determine which of the losses suffered by Cabot during the 1979-80 period were caused by Iran's expropriatory acts, as opposed to "general economic conditions in Iran [which had] deteriorated greatly and were the major cause of the losses sustained".[36] This, OPIC noted, was a "particularly difficult" task.[37] Ultimately, it decided that it was impossible to isolate the causes and agreed to compensate the investor up to the insurance limit.[38]

OPIC's approach to causation is essentially the same as that which investor-State tribunals apply, given that, under international law, a State is responsible for making reparations for only that injury which was caused by its acts.[39] The key difference, however, is that investor-State arbitrations often involve claims for both uncompensated expropriation and various treaty breaches (e.g. breach of the treaty's 'fair and equitable treatment' standard). Therefore, an investor is able to claim losses

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35 OPIC, *Cabot-Iran Determination*, *supra* note 21, in *Kantor et al*, *Reports of OPIC Determinations*, *supra* note 12, at 1:842.

36 *Id.* at 1:845.

37 *Id.*

38 *Id.* at 1:846.

39 *See* ILC Articles on State Responsibility, art. 31.

caused by a State's non-expropriatory acts as well, which is not possible in case of claims made under a typical OPIC policy.

3.3. Accounting rules

The third rule worth highlighting is that OPIC policies not only identify the valuation methodology, they also specify the accounting standards that the investor must follow in computing the book value of its project. The book value must be based on financial statements maintained by the investor in accordance with accounting principles generally accepted in the United States ("GAAP") and translated into dollars in accordance with GAAP.[40] While the investor has some discretion in choosing its own accounting methods, OPIC expressly warns against using accounting techniques that have the effect of inflating the investor's claim: "any accounting treatment which substantially overstates the fair market value of the insured investment or the foreign enterprise viewed as an independent entity will not be accepted".[41]

By contrast, IIAs do not specify the accounting rules to be used in order to compute compensation owed to the investor. Indeed, party appointed valuation experts often disagree over the accounting principles to be applied in valuing an asset.[42]

3.4. Assignment

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40 *OPIC Contract Form 234 KGT 12-85, supra* note 20, at 3441.

41 *Id.* at 3441-2.

42 *See* Mark Kantor, VALUATION FOR ARBITRATION: COMPENSATION STANDARDS, VALUATION METHODS AND EXPERT EVIDENCE 239-44 (Wolters Kluwer, 2008) [hereinafter, *Kantor, Valuation For Arbitration*].

Next, under the OPIC policy, prior to payment of compensation, the investor must transfer to OPIC "all interests attributable to the insured investment . . . as of the date the expropriatory effect commences, including claims arising out of the expropriation . . . ."[43] Prior to the time that the investor assigns rights in the insured investment to OPIC, the investor is obliged, at its own expense, to take all reasonable measures to preserve its property, including pursuing administrative and judicial remedies and negotiating with the government of the host State.[44] After the transfer of property or rights to OPIC, the investor has a duty to cooperate with OPIC in any actions which OPIC may take in order to preserve its rights in the property and prosecute any claims.[45] Moreover, if the property remains subject to the investor's effective control after the expropriation, OPIC may decline to accept the assignment of rights to that property and may deduct from the compensation payable the property's book value.[46]

The provisions described above effectively ensure that the investor is not over compensated, and that OPIC is in a position to recover its losses by pursuing a settlement with the host State.

For example, assume that an investor made an insured investment in a project consisting of a rubber plantation and a rubber vulcanizing plant and that the plantation, but not the plant, was expropriated.[47] If the plantation constituted a substantial portion of the project's assets, OPIC would pay compensation for total expropriation in the

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43 *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, at 3447 (section 8.02).

44 *Id.* at 3448 (section 9.08.9).

45 *Id.*

46 *Id.* at 3444 (section 5.03.4).

47 This example has been adapted from a similar example presented in *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, at 3442.

amount of the insured investment's pro rata share of the book value of the total project. However, before compensating the investor, OPIC would expect the investor to take all reasonable steps to preserve its investment, including pursuing any proceedings in local courts. After the compensation has been paid, OPIC would receive an assignment of the investor's interest in the entire project.[48] However, under sections 5.03.4(b) and 8.02 of the new contract, OPIC could refuse to accept an assignment of the investor's interest in the plant, if it remained subject to the investor's effective disposition and control and commercially viable. The book value attributable to the plant would be deducted from compensation.

The approach under IIAs is markedly different. To start with, there is no obligation on the investor to take "reasonable measures to preserve [its] investment" from adverse government actions[49]. OPIC, for instance, expects the investor to "pursue available administrative and judicial remedies, and to negotiate in good faith with the governing authority of the country in which the project is located and other potential sources of compensation". By contrast, typically, IIAs do not require the investor to exhaust local remedies before commencing arbitration.[50] In fact, that is one of main procedural benefits of investor-State arbitration. Moreover, on payment of

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48 *Id.* at 3447 (section 8.02).

49 However, the investor may be under a duty to take reasonable steps to 'mitigate' its losses after the adverse government step has been taken. Investment treaties do not contain an express duty to mitigate; however, the principle of mitigation is well-recognized under international law and has been referred to in the Commentary to the 2001 ILC Articles on State Responsibility (*see* Commentary to Article 31, para 11). In the investment treaty context, tribunals have referred to the duty to mitigate on a few instances. *See Ripinsky, Damages, supra* note 5, at pp. 322-325.

50 One of the main exceptions to this rule is the claim for 'denial of justice', where it is necessary to exhaust local remedies as a matter of the primary obligation. *See*, e.g., *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 , Award (2002), para. 96 (noting that "under NAFTA it is not true that the denial of justice rule and the exhaustion of local remedies rule 'interlocking and inseparable").

compensation, investor-State tribunals do not require the investor to assign its interest in the investment to the State. The lack of any such mechanism in investor-State arbitration can, however, lead to significant errors in computation of compensation (to the detriment of the host State), especially in claims brought by shareholders for 'reflective loss'.

In a situation where a shareholder is bringing a claim for reflective loss based on the total destruction of the shareholding due to expropriation of the company's assets, there are no real computational challenges. The investor should be entitled to recover the market value of the shares before the expropriation occurred.[51] However, the situation is less straightforward when there is no expropriation, but the State's unlawful acts have adversely affected the value of its shares, which continue to be in the ownership and control of the investor. That is exactly what happened in *CMS v Argentina*.

In *CMS*, the tribunal held that there was no expropriation because the investor remained in control of the investment.[52] However, it found that redenomination of tariffs in pesos amounted to a breach of the treaty's FET standard and umbrella clause.[53] As those breaches caused a drop in the value of the shares, the investor was entitled to damages equal to the diminution in the shareholding value during the relevant period. The tribunal was able to determine that diminution by applying the DCF method; however, it faced an additional problem. As long as the investor

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[51] *See* Douglas Zachary, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS 440 (Cambridge, 2012) [hereinafter, *Zachary*, *Investment Claims*].

[52] *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (2005) at para 263 [hereinafter, *CMS v Argentina* (*Award*)].

[53] *Id.* at paras 302-3.

remained in control of the shares, and the company a going concern, there remained a possibility that the shares will go up in value in the future, leading to overcompensation for the investor.[54] To avoid that difficulty the investor offered – and the tribunal agreed – that Argentina should purchase investor's shares, in return for the investor receiving the entire value of the shares (as if they had been expropriated).[55] The tribunal assessed the damages caused to the investor at US$133.2 million, whereas the residual value of the investor's shares was valued at approximately US$2.1 million (which Argentina would only have to pay in case it accepted investor' offer to acquire the shares).[56]

The upside of the approach adopted by the *CMS* tribunal is that it, effectively, gave the government an option to avoid the risk of double recovery by acquiring the investor's shares. If the government agreed to acquire the shares, and their value increased in the future, the government, and not the investor, would benefit from that increase. However, investor-State tribunals do not have any jurisdiction to impose "compulsory purchase orders" on the States.[57] Therefore, it is necessary that there is consent from both the investor and the State. In scenarios where the parties have not consented, it might not be possible for the tribunal to avoid double recovery. By contrast, under OPIC policies, such concerns do not arise, as the investors are contractually obliged to assign their interests and rights in the property, as a pre-

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54 *See Zachary, Investment Claims, supra* note 51, at 440 (noting that, at para. 446, the *CMS* tribunal assumed significant improvements in gas demand at the time of applying the DCF method).

55 *CMS v Argentina* (*Award*), supra note 52, at paras. 464-6.

56 *Id.*

57 *See* Zachary, *Investment Claims*, *supra* note 52, at 441.

condition to receiving compensation.[58] Not only that, after the transfer of property or rights to OPIC, the investor has a duty to cooperate with OPIC in any actions which it may take in order to preserve its rights in the property and prosecute any claims.[59]

3.5. Limitations on compensation

The final compensation related rule in OPIC policies that is worth highlighting is that the policies contain substantial limitations on the amount of compensation available. To start with, OPIC does not cover the full amount of an investor's investment in the project. Instead, it covers only that portion of the investment which has been identified in the contract as "insured investment".[60] In other words, in the event of an expropriation, OPIC does not pay compensation based on the full book value of the investor's investment in the project, but only for the pro rata share of book value attributable to the portion of the investment in the project that is insured by OPIC.[61] For example, if an investor has insured only half of the investment it has made in a project, compensation for expropriation would be based on 50% of the project's book value. If the investor contributes additional sums to the project, but does not obtain additional OPIC cover, those sums would be deduced in calculation of the project's book value.[62]

Moreover, OPIC sets upper bounds on the amount of investment it will insure. Normally, it insures investment up to $250 million only; however, in case of oil and

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58 *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, at 3447 (section 8.02).

59 *Id.*

60 *Id.* at 3441.

61 *Id.*

62 *Id.*

gas projects, it can provide coverage up to $400 million.[63] Finally, the investor is required to bear the risk of loss of at least 10% of the book value of its interest in the project (the "self-insurance" requirement).[64] This requirement makes sense. By making the investor responsible for the first 10% of its loss, OPIC is ensuring that the investor has an incentive to protect its investment. Put differently, the self-insurance requirement means keeps the interests of the investor and the insurer aligned.

The approach under IIAs is starkly different. First, there is no concept of "insured investment" under IIAs. Indeed, under IIAs, there is no link between the investment made in the project and the compensation awarded by the tribunal (unless, of course, the tribunal is measuring compensation by employing the "actual investment" approach[65]). The fair market value is "the price that a willing buyer would pay to a willing seller" and it can be substantially more, or less, than the initial investment made by the investor.[66] Nor are there any upper bounds on the compensation that a tribunal can award. Whist, as noted above, OPIC would not compensate investors in excess of US$ 400 million, investor-State tribunals routinely award significantly larger amounts in compensation.[67]

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63 OVERSEAS PRIVATE INV. CORP. HANDBOOK 16 (2015), *available at* http:// www.opic.gov/sites/default/files/docs/OPIC_Handbook.pdf [hereinafter *OPIC Handbook*].

64 *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, at 3449 (section 9.01.3).

65 See *supra* notes 26 – 27 for examples of cases where tribunals have employed the 'actual investment.

66 *Starret Housing Corp. v. Iran*, Final Award, 16 Iran US CTR 112 at 201.

67 A recent study showed that the average award (where investors succeed) is for US$ 76,331,000. See Matthew Hodgson, "*Counting the Costs of Investment Treaty Arbitration*", Global Arbitration Review http://www.allenovery.com/SiteCollectionDocuments/Counting_the_costs_of_investment_treaty.pdf (2014) (the study involved a review of some 221 cases in which an award or decision was publicly available on 31 December 2012). However, tribunals routinely award damages far in excess of that sum: see *id*. at 4 (noting that "[t]he combined value of the awards in *Occidental Petroleum v Ecuador*

Finally, there is no "self-insurance" requirement under IIAs. As noted above, under OPIC policies – and indeed, under most PRI policies – investors have to bear the risk of loss of at least 10% of the project's book value. Put differently, OPIC applies a 10% deductible in its insurance contracts. That is one way in which OPIC tries to address the moral hazard associated with PRI, i.e. the incentive for additional risk taking that investor will have once he's protected against the loss of his investment.[68] Another way in which insurers try to mitigate moral hazard is by requiring the investor to take all reasonable steps to avoid the adverse government action, including by seeking local remedies and negotiating with the host government.[69] Ultimately, these clauses in the insurance contract try to "align the insured's interests with those of the insurer".[70] However, there are no such clauses in IIAs. That, in turn, increases the risk that the investors would choose to invest in riskier environments or be less accommodating when disputes with host governments' arise (because they know that they can recover the market value of the investment in treaty arbitration).[71]

4. Using IIAs and PRI policies together

The discussion set out in section 3 above demonstrates that, even when the investor has insured his investment, he may not be able to recover all of the losses resulting

II, *CSOB v Slovakia*, *CME v Czech Republic* and *Siemens v Argentina* alone was approximately US$3.12 billion, exerting significant upward pressure on the average".)

68 Kathryn Gordon, *Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development*, OECD Investment Policy Perspectives (2008), at 93-94, available at: http://www.oecd.org/finance/insurance/44230805.pdf [hereinafter, *Gordon, Investment Guarantees*]

69 *See supra* note 39 and accompanying text.

70 *Gordon, Investment Guarantees*, *supra* note 68, at 94.

71 *See generally*, Jonathan Bonnnitcha, SUBSTANTIVE PROTECTION UNDER INVESTMENT TREATIESA LEGAL AND ECONOMIC ANALYSIS 336 – 62 (Cambridge, 2014).

from the expropriation of his investment. In particular, the following losses would lie outside of a typical PRI policy: (i) market value loss exceeding the net book value of the project; (ii) losses not relating to the "insured investment"; (iii) losses exceeding the policy ing; and (iv) deductibles, if any (e.g. the 10% self-insurance requirement under OPIC policies).

In the circumstances, the investor would have the option to recover the uncovered portion of his losses under an IIA, together with seeking recovery of the covered losses from the insurer. In addition, the insurer would have the option, as a subrogee, to recover from the host State in arbitration the sums it has paid under the PRI policy.[72] In effect, therefore, the same event may give rise to three distinct claims: (i) a claim by the investor against the insurer under the PRI policy to recover covered losses; (ii) a claim by the investor against the host State under the IIA to recover uncovered losses; and (iii) a claim by the insurer, as a subrogee, against the host State to recover its losses. However, in practice, it is not clear whether these three claims would be pursued separately. That is because, as discussed below, it appears that there is nothing in IIAs, or in investment treaty law generally, that would prevent an insured investor from seeking both its covered and uncovered losses from the host State, even where the investor's covered losses have been reimbursed to it by the insurer already. However, there is a preceding question that must be answered first: is the investor under an obligation to disclose to an investor-State tribunal that it has a PRI policy? These two questions will be explored in the following sub-sections.

4.1. Investor's obligation to disclose the existence of a PRI policy

[72] *See also Kantor, BITs and PRI, supra* note 12, at p. 463.

Most public, and all private, PRI policies contain confidentiality clauses.[73] These clauses prohibit the investor from disclosing the terms of the insurance contract to any third person, including the host State.[74] Such clauses exist both to protect against adverse action by the host government (e.g. the government might be more likely to expropriate the property where it knows that the investor has a PRI policy) and as a matter of proprietary commercial information.[75] One exception, however, is OPIC, which deliberately informs the host government of the existence of investments insured by it.[76] Presumably, OPIC does so because it believes that the host government is less likely to injure a foreign investment that it has insured, than otherwise.[77]

Let us assume that the investor has made an investment that is covered by PRI. The insurance contract contains a confidentiality clause. The host government expropriates the investment and the investor is able to recover compensation from the insurer for the book value of the investment, minus 10% that had to be self-insured. Next, the investor brings a claim under an IIA against the host State. In the ensuing investor-State arbitration, is the investor under an obligation to disclose the existence of the PRI policy and the fact that it has already recovered part of its losses? If so, what is the basis for such obligation? And, if not, would the investor's failure to disclose not lead to impermissible double recovery?

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73 *See* Maura B. Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation*, 36 Va. J. Int'l L. 511, 585 (1996) [hereinafter, *Perry, A Model for Efficient Foreign Aid*].

74 *Perry, A Model for Efficient Foreign Aid*, *supra* note 73, at 585.

75 *See, e.g.*, MIGA Contract of Guarantee for Equity Investments, cl. 16.3, available at: https://www.miga.org/documents/disclosure/Contract%20of%20Guarantee%20for%20Equity%20Investments.pdf

76 *Perry, A Model for Efficient Foreign Aid*, *supra* note 73, at 555.

77 *Id.*

The question over disclosure of a PRI policy is similar to that which is often raised in the context of third party funding. Like insurance contracts, most funding arrangements contain confidentiality clauses.[78] And like PRI policies, funding arrangements are disconnected with the arbitration agreement.[79] Therefore, in the same way an investor-State tribunal has no jurisdiction over disputes relating to a PRI policy or any authority over the insurer, the tribunal also has no jurisdiction over disputes relating to a funding arrangement or any authority over a funder. Yet, concerns over conflicts (i.e. whether one of the arbitrators has a relationship with the funder) and allocation of costs (i.e. whether the funded party is in a position to pay security for costs) have led tribunals to order the investor to disclose the existence of and, on one instance the terms of, a funding arrangement.[80] As for the basis for making a disclosure order, one of the tribunals cited its "inherent powers to make orders of the nature requested where necessary to preserve the rights of the parties and the integrity of the process".[81]

Indeed, General Standard 6(b) of the IBA Guidelines on Conflict of Interests in International Arbitration (2014) has been amended so that a any person having a "controlling influence" on a party or "a direct economic interest in . . . the award to be

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78 Alison Ross, *The dynamics of third-party funding*, Global Arbitration Review (2012), available at: http://globalarbitrationreview.com/journal/article/30372/dynamics-third-party-funding-in-full.

79 *Id.*

80 Jean Christophe Honlet, *Recent Decisions on Third-Party Funding in Investment Arbitration*, 30 ICSID Review 3, 699, at 708-709 (noting that in: (i) *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, ICSID Case No. ARB/14/14 (2015), an ICSID tribunal ordered the investor to divulge the identity of the funder in order for the arbitrators to check that they did not have a conflict of interest; and (ii) *Muhammet Çap & Sehil In_aat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, ICSID Case No. ARB/12/6, (2015), another ICSID tribunal ordered the disclosure of the identity of a third-party funder and, for the first time apparently, the terms of funding).

81 *Muhammet Cap & Sehil Insaat Endustri ve Ticaret Ltd Sti v Turkmenistan*, ICSID Case No ARB/12/6, Procedural Order No 3, n. 60 (2015).

rendered in the arbitration" is considered to "bear the identity" of that party.[82] The explanation to the amendment clarified that "third party funders and insurers" may have a direct economic interest in the award" and may, therefore, be considered to be the "equivalent of that party".[83] This revision means that parties who have third party funding arrangements are now expected to disclose the existence of such funding, although not necessarily the terms of the arrangement.

The IBA Guidelines correctly note that, like a funder, an insurer may have a "direct economic interest in the award".[84] Most insurance contracts require that, after the insurer has been subrogated to the claims of the investor, the investor must assist the insurer in prosecuting those claims.[85] Such claims include arbitration under IIAs. In fact, OPIC contracts contain a special provision for cases where the investor has access to ICSID arbitration. Since only non-government bodies can be claimants before ICSID,[86] OPIC requires the investor to take the lead in any ICSID arbitration that may have to be commenced.[87] The insurer typically pays any costs expended by the investor in the pursuit of such claims.[88] Moreover, if in the arbitration, the investor

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82 International Bar Association, Guidelines on Conflict of Interests in International Arbitration (2014), available at: file:///Users/Rishab/Downloads/IBA%20Guidelines%20on%20Conflict%20of%20Interest%20NOV%202014%20FULL%20(1).pdf

83 *Id.*

84 Indeed, in a recent investor-State arbitration, when discussing quantum, an ICSID tribunal compared a PRI policy to a third party funding arrangement. *See Hochtief v Argentina*, ICSID Case No. ARB/07/31 para 309 (2015).

85 *See*, *e.g.*, *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, section 9.01.9.

86 *See* Ch. 3, s. 3.4.

87 *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, section 9.01.11.

88 *Id*. at section 9.01.9 (providing that "after a transfer of rights or delivery of local currency, *in exchange for reimbursement of reasonable out-of-pocket expenses*, the Investor shall take all actions reasonably requested by OPIC to assist OPIC in preserving the property and rights transferred to OPIC and in prosecuting related claims".) (emphasis added).

recovers compensation in excess of the amount paid by the insurer, the investor is entitled to retain that additional sum.[89]

In the light of the above, it is evident that, at least as far as interest in the outcome of the arbitration is concerned, there is not much difference between a funder and a subrogated insurer. If investor-State tribunals have the authority to order disclosure of funding arrangements, and there are legitimate concerns regarding any relationship between the arbitrator and the funder, there seems to be no reason why tribunals should not similarly order disclosure of a PRI policy (if not the terms of the policy, at least the existence thereof).

4.2. Compensation available under an IIA to an insured investor

Let us assume that an investor has received an insurance payment from an insurer after the host government expropriated his assets. The investor has now commenced arbitration under an IIA. The investor-State tribunal is aware of the insurance payment (for the purposes of this discussion, it does not matter whether the investor voluntarily disclosed that it has received the payment, or was ordered to do so). Should the tribunal take the insurance payment into account when awarding compensation?

That is exactly the question that an ICSID tribunal had to deal with in *Hochtief v Argentina*.[90] Hochtief, a German company, was part of an international consortium selected to construct and operate a road and bridge link between the Argentine cities of Rosario and Victoria. In the arbitration, the company alleged that measures taken during Argentina's financial crisis breached contractual commitments, which provided

89 *Id.* at section 8.04 ("Excess Salvage Value").

90 *Hochtief v Argentina*, ICSID Case No. ARB/07/31 (2015).

for the calculation of road-tolls in US Dollars, and for periodic adjustments of toll charges in line with US inflation indices. Prior to commencing the arbitration, "the German Government agreed to pay Claimant EUR 11,359 million under a political risk insurance policy that covered the losses encompassed within the claims made in the present case".[91]

At the quantum phase, Argentina argued that the insurance payment should be deducted from any compensation awarded to Hotchief. However, the tribunal disagreed. According to the tribunal, no "principle of international law requires that such an arrangement [PRI policy], to which Respondent was not a party, should reduce Respondent's liability".[92] It went on to note that it is possible that under the PRI policy the investor is required to hand over to the insurer some of the damages recovered in the arbitration; however, "that is a matter of private contract, into which the Tribunal has no cause to inquire".[93]

Hotchief tribunal's dismissal of Argentina's argument appears to be based on two incorrect assumptions. First, the tribunal is focussing solely on the "Respondent's liability" and not on the injury of the investor, when in fact the law on reparation provides the opposite (the only exception to this rule is the principle of contributory fault; however, that principle is not relevant here).[94] The obligation to pay reparation

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91 *Id.* at para. 185.

92 *Id.* at para. 309.

93 *Id.*

94 *See* Judith Gill & Rishab Gupta, *The Principle of Contributory Fault after Yukos*, 9 No 2 Disp. Res. Int'l. 93 (Oct. 2015).

under international law "is limited by the damage suffered".[95] Where the injured party has been able to mitigate its losses from other sources, the host State's responsibility to pay compensation will also reduce.[96] Otherwise, the injured party would be able to double recover.

Secondly, the tribunal assumes that the insured would never double recover because it would have to return to the insurer that portion of the award, which was paid to it previously. Normally, that assumption will be true. For example, under OPIC policies, after receiving the compensation, the investor has a duty to assist OPIC in recovering the losses, including by prosecuting any claims.[97] Although the OPIC policies do not directly address this point, it is likely that the obligation to assist the insurer in recovering its losses includes an obligation to return any excess compensation received. Nevertheless, it appears that whether or not the investor under that obligation should be specifically established in each case. That can be done by either seeking disclosure of the insurance policy or by requiring the investor to give an undertaking that it will return any additional sums to the insurer.

The importance of ensuring that the investor does not double recover cannot be overstated. As explained previously, the insurer, after it has been subrogated to the claims of the insured, is usually in a position to bring a claim against the host State directly, either under an IIA or pursuant to a specially negotiated arbitration agreement.[98] The insurer's right to seek compensation from the host State is not

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95 James Crawford, STATE RESPONSIBILITY: GENERAL PART 125 *(*Cambridge*: 2014)* [hereinafter, Crawford Commentary].

96 *Id.*

97 *OPIC Contract Form 234 KGT 12-85*, *supra* note 20, section 9.01.09.

98 *See* Ch. 3, s.3.

extinguished by the award of full compensation to the investor. Therefore, if the investor receives full compensation, which for whatever reason is not shared with the insurer, then the latter may seek to rely on its arbitration rights against the host State. If the insurer were to be successful in the arbitration and the host State is ordered to pay compensation, it would effectively mean that the host State has to pay twice for the same loss.

That said, many IIAs, including all U.S. BITs, contain specific provisions prohibiting the host State from raising an objection on the basis that the investor has received, or will receive, compensation from an insurer.[99] The Germany-Argentina BIT, which was at issue in the *Hochtief* case, however, did not contain such a clause. Unless the tribunal was of the view that these clauses have become part of general international law and, therefore, apply in all cases (irrespective of the treaty language), it is not clear why Argentina's argument for a reduction in damages should have been dismissed so easily.

5. Conclusion

This chapter has analysed the key differences between compensation rules for expropriation in IIAs and OPIC policies. Aside from setting out the standard of compensation ("full compensation"), IIAs generally do not contain many rules on compensation.[100] In particular, they do not set out the approach that should be adopted

[99] *See*, e.g., U.S. - Argentina BIT, art. VII (7): "In any proceeding involving an investment dispute, a Party shall not assert, as a defense, counterclaim, right of set-off or otherwise, that the national or company concerned has received or will receive, pursuant to an insurance or guarantee contract, indemnification or other compensation for all or part of its alleged damages".

[100] *See generally*, *Ripinsky, Damages*, *supra* note 5; *Kantor, Valuation For Arbitration*, *supra* note 12; *I. Marboe, Calculation of Compensation*, *supra* note 5.

to calculate damages (which often leads to methodological disputes between party-appointed experts in the arbitration). [101] Nor do they contain any limitations on the amount of damages recoverable. In fact, any limitations on recovery – such as the rules on causation/ remoteness of damages,[102] requirement to mitigate damages,[103] or the prohibition against double recovery[104] - are imposed by general international law.

By contrast, OPIC policies – and indeed most PRI policies – contain several rules on compensation. These rules generally have the effect of limiting the amount of compensation that is recoverable under an insurance policy. Typically, the following losses would lie outside of an OPIC policy: (i) market value loss exceeding the net book value of the project; (ii) losses not relating to the "insured investment"; (iii) losses exceeding the policy ceiling; and (iv) deductibles, if any (e.g. the 10% self-insurance requirement under OPIC policies).[105] That difference, however, should be recoverable in an investor-State arbitration. In addition, the insurer would have the option, as a subrogee, to recover from the host State in arbitration the sums it has paid under the PRI policy. The ability to seek compensation across different forums gives rise to complex issues concerning double recovery, standing and disclosure, none of

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101 *See supra* s. 3.4 on different type of approaches to calculation of damages.

102 *See* Crawford, *Commentary*, *supra* note 95, art. 31, para. 10; *Ripinsky, Damages*, *supra* note5, at 240-245; *Joseph C. Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Award, para. 170 (2011).

103 *See Crawford, Commentary*, *supra* note 95, art. 31, para. 11; *Ripinsky*, *Damages*, *supra* note 5, at 322-324; *Hrvatska Elektroprivreda d.d. v. Republic of Slovenia*, ICSID Case No. ARB/05/24, Award, paras. 215, 386 (2015).

104 *Bernhard von Pezold and others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Award, (2015) at paras 937-8; *Chevron Corporation (U.S.A.) and Texaco Petroleum Corporation (U.S.A.) v. Republic of Ecuador [I]*, PCA Case No. AA 277, Partial Award on the Merits, (2010) at paras. 557-8; *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic*, ICSID Case No. ARB/07/26, Decision on Jurisdiction (2012) at para. 253.

105 See *supra* s. 3.4.

which have been properly analysed by an international tribunal to date.[106] This chapter has made an attempt to look at some of these issues and suggest ways in which future tribunals might approach them.

[106] *Hochtief v Argentina*, ICSID Case No. ARB/07/31 para 309 (2015) (discussed above) and *Case concerning the Aerial Incident of July 27th, 1955* (*Israel v Bulgaria*) (discussed in chapter 3) are rare exceptions.

CONCLUSION

The political risks inherent in making large foreign investments have led investors to find ways to mitigate those risks. This thesis discusses the relationship between two risk-mitigation tools: PRI schemes and BITs.

As a starting point, this thesis considers the key similaries and differences between BITs and PRI policies. These were explored in Chapter 2. In particular, three differences are likely to prove critical. First, PRI policies are expensive and require payment of substantial premiums,[1] whereas BIT protections come for free. Indeed, at least one study has suggested that the proliferation of BITs between 1996 and 2005 may have been one of the reasons for decrease in demand for OPIC policies during

[1] See *supra* Introduction, n. 10 (noting that, as of February 2016, OPIC's indicative premiums are US$0.18 – 0.42 for inconvertibility, US$0.28 – 0.60 for expropriation and US$0.21 – 0.53 for political violence, per US$100 of investment. These are individual rates and, therefore, in order to cover against all three risks, an investor would have to pay the combined total of these rates. By way of illustration, if an investor is making an investment for US$100 million and the investment has an average risk profile, the insurance premiums would be approximately US$ 0.30 for inconvertibility, US$0.44 for expropriation and US$0.33 (assuming an average risk profile leads to middle of the range premium). Therefore, the combined premium would be US$1.07 per US$100 of investment, which is equal to US$1,070,000 yearly for the US $100 million of insurance cover. So, if the investment is expropriated five years after having been made, the investor will have already paid $5,350,000 in premiums). See also Mark Kantor, *Comparing Political Risk Insurance and Investment Treaty Arbitration*, 12 Transnat'l. Disp. Mgmt. 5, 455, at 473-474 (Nov. 2015).

that period,[2] though ultimately that study did not find any "direct causal link" between the two trends.[3]

Secondly, BITs and PRI schemes do not cover the same risks and, even where they cover similar risks, the extent of protection differs. For example, both BITs and PRI policies cover expropriation, but OPIC has more readily found indirect expropriation in case of adverse government interference, as compared with BIT tribunals. The case of *Enron/Ponderosa Assets* – discussed at length in the thesis – provides an excellent illustration.[4]

After Argentina enacted the Emergency Law, which cancelled the rights of gas distribution and transportation companies, Enron/ Ponderosa Assets submitted a claim at OPIC and initiated ICSID arbitration under the US-Argentina BIT within a period of one year.[5] The ICSID tribunal found that the Emergency Act was not expropriatory because Enron/Ponderosa continued to maintain their control over the local company.[6] (Although the ICSID tribunal did find breach of other treaty

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2 Pieter Bekker & Akiko Ogawa, *The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the 'BIT Bang'*, 28 ICSID Review 2, 314, at 333-334 (2013) (explaining that "we compared … two time ranges, from 1976 to 1985 (pre-BIT proliferation) and from 1996 to 2005 (post-BIT proliferation). From 1976 to 1985, OPIC entered into 1058 contracts, while only 517 contracts were issued from 1996 to 2005. By comparison, the United States entered into six BITs with other countries during the period 1976–85, while it concluded 10 BITs during the period 1996–2005, that is, two-thirds more than in the earlier period. At the same time, there were fewer claims determinations between 1996 and 2005 compared to the period from 1976 to 1985").

3 *Id.* at 336 ("it is difficult to establish a direct causal link between the proliferation of BITs and the decline in the number of public PRI policies witnessed during the period immediately following the 'BIT Bang").

4 *See supra* Chapter 4, s. 4.3.

5 The ICSID claim was registered on April 11, 2001 and the final award was issued on May 22, 2007; whereas, the OPIC claim was filed on August 12, 2002 and the determination was issued on August 2, 2005.

6 *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (2007) at paras 245-6 [hereinafter, *Enron Award*].

provisions, including 'fair and equitable treatment' and 'umbrella clause'.)[7] On the other hand, OPIC found that the Emergency Act was expropriatory because it had the effect of repudiating a contractual commitment for non-commercial reasons, which deprived the investor of its fundamental rights in the investment.[8]

Protection against acts of physical violence is another important point of departure.[9] Most BITs contain the 'full protection and security' standard, which has been interpreted to mean that the State must take "reasonable measures" in protecting the foreign investment against physical violence.[10] However, it is unclear how that standard will apply in cases of violence in countries such as Tunisia, Egypt and Libya during the Arab Spring, or to Syria in light of the on-going insurgency and terrorist attacks.[11] On the other hand, OPIC has had a long history of dealing with claims arising out of political violence. It has issued over 50 determinations relating to political violence coverage, dealing with claims for damages suffered as a consequence of declared war, violent secessions, military coups, civil war, or revolution, in countries such as Pakistan, Bangladesh, Chile, Indonesia, Nicaragua, Haiti, the

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7 *Id.* at paras 269-77; see also *supra* Chapter 4, s. 4.3.

8 OPIC Memorandum of Determination, Expropriation Claim of Ponderosa Assets, L.P. – Argentina – Contract of Insurance No. D733 [hereinafter, *Ponderosa Determination*].

9 *See supra* Chapter 7, s. 7 (discussing problems with the "due diligence" standard under international law).

10 *See*, e.g., *Asian Agricultural Products Limited (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, Award of June 21, 1990, 30 I.L.M. 577 (1991), at para. 77 [hereinafter, *AAPL*]; *American Manufacturing and Trading (AMT) v. Zaire* ICSID Case No. ARB/93/1, Award of Feb. 21, 1997, 36 I.L.M. 1531 (1997), at para. 6.05 [hereinafter, *AMT*].

11 *See supra* Chapter 7, s. 7.

Philippines, Rwanda, Democratic Republic of Congo, Sierra Leone, Gaza, Colombia and Afghanistan.[12]

Yet another area where investment treaty tribunals have had very little experience, as compared with OPIC, is restrictions against transfer of funds. While there is hardly any investment treaty jurisprudence on this issue, OPIC and its predecessor (AID) have issued in excess of 170 determinations on 'currency inconvertibility' (making it the most commonly invoked ground under OPIC policies).

The third critical difference between PRI policies and BITs is in respect of the compensation structure under the two regimes. This was discussed at length in Chapter 9. Here, BITs are more generous to investors than PRI policies. OPIC and MIGA policies provide that compensation should be calculated applying the 'book value' method only (which is likely to lead to a lower level of compensation than the 'discounted cash flow' method that most treaty tribunals apply).[13] Moreover, these policies contain various limitations on the amount of compensation that can be ordered, including, for example, an upper limit based on the "insured amount" and a requirement for "self-insurance" (usually around 10%).[14] OPIC policies also require the investor to assign its rights in the investment to OPIC upon receiving compensation (something that BITs do not do, and investor-State tribunals arguably lack the

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[12] *See supra* Chapter 7, s. 7 (discussing OPIC determinations relating to political violence, including *Claim of Freeport Minerals – War, Revolution, and Insurrection (Contract of Guaranty No. 7034 and Contract of Insurance No. 9704)*, Memorandum of Determinations (OPIC) (1986); *Claim of American Standard, Inc. – War, Revolution and Insurrection – Contract of Insurance No. 8106*, Memorandum of Determinations (OPIC) (1983)); see also Mark Kantor, Michael D. Nolan & Karl P. Sauvant, *Political Violence and PRI*, OUP Blog (31 March, 2011), *available at*: http://blog.oup.com/2011/03/opic/.

[13] *See supra* Chapter 8, s. 3.1.

[14] *See supra* Chapter 8, s. 3.5.

jurisdiction to order).[15] For all these reasons, the pay out under BITs is likely to be larger than under PRI policies.

However, the possibility of a larger pay out under BITs must be balanced against the litigation and enforcement risk that investors face in investment treaty arbitration. To start with, investment treaty arbitrations are lengthy and expensive, as compared to OPIC proceedings. Studies show that the mean length of ICSID arbitrations tends be around 3 years and 7 months,[16] whereas the average party costs in treaty arbitrations is around USD 4.5 million.[17] On the other hand, the mean length for OPIC proceedings (i.e. from the time the claim is filed to the time the loss determination is made) is around 4.75 months.[18] No data is available about the legal costs expended in making claims before OPIC, but they are likely to be substantially less than the average costs spent on a treaty proceedings, both because of the shorter length of time and the non-adversarial nature of these proceedings.[19]

Aside from being longer and more costly, the OPIC claim process is more certain. Success in treaty arbitration does not guarantee payment as the host State

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15 *See supra* Chapter 8, s. 3.4.

16 *See* Matthew Hodgson, "*Counting the Costs of Investment Treaty Arbitration*", Global Arbitration Review http://www.allenovery.com/SiteCollectionDocuments/Counting_the_costs_of_investment_treaty.pdf (2014) (the study involved a review of some 221 cases in which an award or decision was publicly available on 31 December 2012).

17 *See* Anthony Sinclair, "*ICSID arbitration: how long does it take?*", Global Arbitration Review, www.globalarbitrationreview.com/news/article/19164 (2009) (the study was based on a survey of 115 ICSID cases that went to a final award through to 1 July 2009).

18 Pieter Bekker & Akiko Ogawa, *The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the 'BIT Bang'*, 28 ICSID Review 2, 314, at 327.

19 *See* OPIC, How to Present an OPIC Insurance Claim Effectively, available at https://www.opic.gov/sites/default/files/docs/opic_claim.pdf.

might not voluntarily comply with the award (leaving the investor with no option but to commence enforcement proceedings). On the other hand, success in the OPIC proceedings guarantees payment, leaving OPIC with the burden of seeking recovery from the host State under OPIC's Bilateral Incentive Agreements.[20]

Having considered the key differences between BITs and PRI policies, the thesis moves on to study the many ways in which the two instruments interact with each other.

To start with, the presence of BITs facilitates the business of PRI providers. For example, the German government controlled insurance provider – NEXI – regards BITs as a pre-condition to extending insurance coverage. In case of host countries with which Germany has not concluded a BIT - such as Brazil and Colombia - the insurer undertakes a "country risk assessment" to ascertain whether, in light of the prevailing economic and political conditions, the legal system of the host State is sufficiently capable of protecting the investment.[21] Other insurers, like MIGA, do not make BITs a pre-condition, but take them into account when pricing PRI policies.[22]

BITs are also important means of recovery for PRI providers. Most BITs contain subrogation clauses, which allow insurers to 'step into the shoes' of the investor and sue the host State for compensation.[23] Chapter 3 of the thesis discussed

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[20] *See supra* Chapter 2, s. 2.8.1.

[21] *See supra* Chapter 1, s. 3.3 (citing AGAPortal, Country Risk Assessment, available at: http://www.agaportal.de/en/dia/deckungspraxis/laenderdeckungspraxis.html).

[22] *See supra* Chapter 1, s. 3 (citing Multilateral Investment Guarantee Agency, Operational Regulations (2002), s. 1.38, available at: https://www.miga.org/Documents/miga_documents/Operations-Regulations-030115.pdf).

[23] U.S. BITs are an exception in this regard as they do not contain subrogation provisions. That is the case because, as explained in Chapter 2, the U.S. government has concluded agreements with a large number of countries around the world, under which those countries agree to recognise OPIC's

the concept of 'subrogation' at length. As there is no international law of insurance, analogies were drawn from domestic laws (in particular, English law) and certain general principles were identified which can be applied by international tribunals when they encounter subrogation claims.[24] It is surprising that so far there are no publicly known claims brought by insurers exercising their subrogation rights. That could be for several reasons.

As a preliminary point, subrogation rights under treaties are typically limited to only government-owned insurers, who are less likely than private insurers to bring claims.[25] Further, a subrogated insurer is not required to bring a claim under its own name: after a payment under the insurance policy, the insurer becomes the beneficial owner of the claim (up to the value of the insurance payment made); however, the investor continues to be the legal owner and, therefore, the proper claimant for all of the claims.[26] Therefore, it is possible that there are cases where the investor is bringing a claim effectively on behalf of the insurer, but because the named claimant in the arbitration continues to be the investor, the identity of the insurer is not known.

Another area of overlap between BITs and PRI policies emerges from the reference made in PRI policies to 'international law'. In other words, many insurers, including OPIC, require investors to show that the adverse government action breached international law. As a result, determinations issued by OPIC often cite various sources of international law, including decisions of international tribunals.

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subrogation rights and also agree to submit any disputes relating to OPIC's claim to international arbitration. *See* Chapter 2, s.2.8.

24 *See supra* Chapter 3, s. 3.1.1.

25 *See supra* Chapter 3, s. 3.1.3.

26 *See id.*

This coupled with the fact that PRI providers such as OPIC are arms of States, must mean that their practice contributes to the development of international law. In particular, as explained in Chapter 5, the practice of State sponsored insurers can constitute "subsequent practice" of that State, as well as "agreement regarding interpretation" of an investment treaty between the home State of the insurer and the host State. To demonstrate how in practice OPIC's practice might contribute to the development of international law, Chapter 6 analyses two major, and relatively recent, OPIC determinations – the *Mid-American Holding Determination*[27] and the *BoA Determination*.[28]

Furthermore, detereminations issued by PRI providers such as OPIC can make a significant contribution to the growth of international law. To demonstrate this fact, the thesis studies OPIC jurisprudence on two specific subjects: attribution (Chapter 7) and calculation of compensation (Chapter 8). The analysis showed that in certain cases, OPIC simply applies well-accepted rules of international law, while in other cases it elaborates on principles that have not been widely applied by tribunals. The former practice has the effect of reaffirming the principle's customary status, while the latter creates jurisprudence that can guide future tribunals when they face similar issues.

Ultimately, the aim of this thesis has been to study two separate risk mitigation tools (PRI policies and BITs) and explore the relationship between them. While a lot

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[27] OPIC, Memorandum of Determinations, Expropriation Claim of Mid-American Energy Holdings Company (formerly CalEnergy Company, Inc.), Contracts of Insurance Nos. E374, E453, E527 and E759 (10 Nov. 1999).

[28] OPIC, Memorandum of Determinations: Expropriation Claim of Bank of America as Trustee India – Contract of Insurance No. F401 (30 Sep. 2003).

has been written about BITs in the past few years, legal scholars have devoted very little attention to PRI policies. It is hoped this thesis has made a contribution in filling that void.

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