

POLITICAL RISK INSURANCE IN THE LITIGATION TEST: BENCHMARKS AND PRACTICAL DETERMINANTS¹

SEGURO DE RISCO POLÍTICO NO TESTE CONTENCIOSO: BENCHMARKS E DETERMINANTES PRÁTICOS

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ABSTRACT: Companies expand their operations abroad despite the risk of government-related losses. Mitigating that risk is at the core of Political Risk Insurance (“PRI”). This paper delves into disputes among policyholders and private, public and multilateral insurers. In this litigation test, it seeks to identify benchmarks on practical determinants. Section II looks at the main aspects of PRI within the dynamic context of its insurable risks. Section III presents the principles of the international law on foreign investment that parallel PRI in the task of mitigating political risk for foreign investors. Section IV brings methodological notes on the case selection and Section V accounts for several benchmarks derived from case law. Section VI proceeds to a conceptual inquiry of three themes that enhance PRI as a legal tool: adequate boundaries between national and international law; party autonomy to determine the scope of protection; and enforcement of subrogation rights.

KEYWORDS: Political risk insurance; Foreign investment; litigation.

RESUMO: Empresas expandem suas operações no exterior apesar do risco de perdas decorrentes de ações governamentais. A mitigação desse risco está no cerne do Seguro de Riscos Políticos (“SRP”). Este artigo investiga as disputas entre segurados e seguradoras privadas, públicas e multilaterais. Neste teste contencioso, procura-se identificar benchmarks sobre determinantes práticos. A Seção II analisa os principais aspectos do SRP dentro do contexto dinâmico de seus riscos seguráveis. A Seção III apresenta os princípios do direito internacional sobre investimento estrangeiro que se equiparam ao SRP na tarefa de mitigar o risco político para os investidores estrangeiros. A Seção IV traz notas metodológicas sobre a seleção dos casos e a Seção V apresenta diversos benchmarks derivados da jurisprudência. A Seção VI procede a uma investigação conceitual de três temas que aprimoram o SRP como ferramenta jurídica: limites adequados entre o direito nacional e internacional; autonomia das partes para determinar o escopo da proteção; e aplicação dos direitos de sub-rogação.

PALAVRAS-CHAVE: Seguro de risco político; Investimento estrangeiro; litígio.

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1. Introduction

Companies expand their operations abroad despite the risk of government-related losses. Mitigating that risk is at the core of Political Risk Insurance (PRI). A global and multibillion dollar industry, it engages private, public and multilateral insurers. Under a framework of scant regulation, few disputes emerge. This paper delves into these disputes and identifies benchmarks on practical determinants. The first aim of this “litigation test” is to categorize useful arguments to practitioners. The second aim is to build on those arguments and illustrate how PRI can better perform the task of fostering foreign direct investment.

The first two sections introduce basic notions on the function of PRI. Section 2 looks at the main aspects of PRI within the dynamic context of its insurable risks. Section 3 presents the principles of the international law on foreign investment that parallel PRI in the task of mitigating political risk for foreign investors.

Section 4 brings methodological notes on the case selection and Section 5 accounts for several benchmarks derived from case law. It comprises a patchwork of concepts that define PRI. It also contains principles on how to interpret PRI contracts. One examines the liability of brokers for disclosure of material facts and the enforcement of subrogation rights. The connection of national and international law gains its own contours in PRI litigation.

Section 6 proceeds to a conceptual inquiry of three themes that enhance PRI as a legal tool. First: adequate boundaries between national and international law should exist, so that PRI supports the legal framework of foreign investment. Second: party autonomy to determine the scope of protection should allow parties to create tailor-made coverages. Third:

subrogation rights should be enforced, so that policyholders and insurers can extract the full economic benefits of insurance contracts.

2. Main Elements of Political Risk Insurance

2.1. The interdisciplinary and historical background of PRI

Political risk is an object of study in several disciplines: international politics, international economics, international business and international law. They capture the impact of governmental action on individuals, companies and other governments. The field develops from shifting configurations of politics, economics and business. Developments go beyond news-driven and trading-oriented, short-term variations driving speculative capital markets.³ In turn, PRI is replete of practical uses and challenges. Underwriting decisions that normally adhere to financial and commercial terms and limits, because of regulatory and supervisory constraints, are tasked to evaluate abundant information on sizeable and changing risks.

Available at least since the Marshal Plan of rebuilding Europe after the World War II, PRI is versatile.⁴ Companies deploy PRI to manage normative perils and physical threats. In 2006, a European bank struck a deal with a Kazakh bank to securitize and sell Kazakh mortgage loans in the global markets. The accord came “against a backdrop of improving economic conditions, declining interest rates and a growing mortgage market in the country”.⁵ Losses bred by interference of the Kazakh government with the financial success of the deal were insured. About the same time, an oil company doing business in an African country faced threats of armed groups at loggerheads with the central government. Against major losses in production and personal violence towards its employees, PRI purported to be an effective tool of damage control.⁶

Point 1: The political risk connection to several fields trickles down to a complex underwriting process adaptable to different historical and economic settings.

³ The BlackRock Geopolitical Risk Indicator “tracks the frequency of geopolitical risk mentions in media and brokerage report, adjusting for sentiment reflect in the text”. TURNILL, Richard, *A geopolitical risk worth worrying about in 2018*, 9 January 2018. Retrieved from <https://www.blackrockblog.com/2018/01/09/geopolitical-risk-2018/>.

⁴ WELLS, Louis T.; AHMED, Rafiq, *Making Foreign Investment Safe*, Oxford, 2007, 5.

⁵ DAVIES, Paul J., Kazakh bank in mortgage deal, *The Financial Times*, 21. Feb 2006. Retrieved from <https://www.ft.com/content/664a2262-a30a-11da-ba72-0000779e2340>.

⁶ CATAN, Thomas; MAHTANI, Dino, Shell’s problems in Nigeria mount up, *The Financial Times*, 6. Apr. 2006. Retrieved from <https://www.ft.com/content/8ff2c40a-c59e-11da-b675-0000779e2340>.

2.2. Definitions of political risk

A broad definition of political risk alludes to “any change in the fundamentals of business planning motivated by non-business factors [which] restrict[s] the scope of legitimate company decision making in such a way that use of options and/or profitableness of assets are temporarily or permanently reduced.”⁷ Political risk would not differ in substance from non-commercial risk. Scholars argue that “the official status of the causative agent, its nature or goals and the relative immediacy of the effect are irrelevant”.⁸ In other terms, political risk would be a “manifestation of instability and of a lack of security and legal protection”.⁹ Its effects are far-reaching and disturb a business in its financial, strategic and organizational confines.¹⁰

In the narrower sense of insurance, political risk ignores partisan connotations, but does place importance on the officiality of the causative agent. A link between a loss and a governmental action must be present, however indirectly or loosely defined in the policy. In this niche market, triggers for compensation “are usually discriminatory government actions affecting a company doing business in a foreign jurisdiction”.¹¹ Risks of this nature include “expropriation, blockade, confiscation, war, terrorism, strike, retroactive legislation, the retraction of approved licenses or the subsequent issuing of regulations”.¹²

Another way of classifying political risk, developed later in this research, designates the state activities giving rise to losses.¹³ They can be administrative, legislative or judicial in nature and comprise control on flow of investment, on-going regulations of business activities, contractual relationships between the state and the investor and the protection in situations of physical danger.

Point 2: Definitions of political risk can encompass any non-business alterations in a company’s realm of activity, but PRI assumes the officiality of the causative agent.

⁷ SIEGWART, Hans; CAYTAS, Ivo G.; MAHARI, Julian I., *Global political risk: dynamic managerial strategies*, Basel; Frankfurt/Main, 1989, 4.

⁸ *Ibidem*.

⁹ *Idem*, 20.

¹⁰ WHITE, Colin; FAN, Miao, *Risk and Foreign Direct Investment*, Basingstoke, 2006, 236-239.

¹¹ LIER, Marco, SwissRe Political Country Risk Rating, in: HABEGGER (Ed.), *International Handbook on Risk Analysis and Management*, Zurich, 2008, 177.

¹² SIEGWART, Hans; CAYTAS, Ivo G.; MAHARI, Julian I., *Global political risk: dynamic managerial strategies*, Basel; Frankfurt/Main, 1989, 1. The track record of Overseas Private Investment Corporation, since the 1960’s, concentrates on claims arising from events of inconvertibility, expropriation, war damage and political violence. Overseas Private Investment Corporation (OPIC), *Insurance Experience to Date: OPIC and its Predecessor Agency*. Retrieved from https://www.opic.gov/sites/default/files/files/2017_Annual_Claims_Report.pdf.

¹³ See Annex.

3. Political Risk Insurance and the International Law on Foreign Investment

3.1. Categories and perspectives of PRI

Market players in PRI advisory classify political risks following distinct frameworks. Aon's business-oriented concept puts "Supply Chain Disruption" as a separate criterion from the overall risk. This factor earmarks "the disruption to the flow of goods and/or services into or out of a country as a result of political, social, economic or environmental instability".¹⁴ Under the category of "Legal and Regulatory Risk", Aon accounts for the risk of "financial or reputational loss as a result of difficulties in complying with a host country's laws, regulations or codes".¹⁵ Other firms adopt variant gauges. Atradius ranks countries for political risk according to "Sovereign transfer risk", meaning failure to service or repay external debt. It also uses "Arbitrary action" to speak about a "capricious action by a government".¹⁶

A macro perspective of political risks assumes country risks for all foreign firms. Micro risks are tied to given industries, firms or projects.¹⁷ To insurers, this dynamic risk scenario is technically effortful both at a policy and at a portfolio level.¹⁸ Individual countries, industries and legal arrangements for the project interlope at the variance and extent of losses. This duality in perspectives compels policyholders to implement on-going risk assessments. Procuring a policy is but a step on the intelligence work of mitigating risks, since they often "include a continuing obligation on the part of the insured to disclose information that may lead to a claim".¹⁹

¹⁴ Aon Risk Solutions, *2017 Risk Maps*, Aon's guide to Political Risk, Terrorism & Political Violence. Retrieved from <http://www.aon.com/2017-political-risk-terrorism-and-political-violence-maps/pdfs/2017-Aon-Risk-Maps-Report.pdf>, 27.

¹⁵ *Ibidem*.

¹⁶ Atradius, *The STAR rating*: Background information. Retrieved from <https://group.atradius.com/publications/trading-briefs/risk-map.html>, 3.

¹⁷ SCHEFER, Krista Nadakavukaren, *International Investment Law, Text, Cases and Materials*, Cheltenham, 2013, 510, quoting FEILS, Dorethe J.; SABAC, Florin M., The Impact of Political Risk on the Foreign Direct Investment Decision: A Capital Budgeting Analysis, 45 (2), *The Engineering Economist* 129, 129-43 (2000).

¹⁸ A methodology for insurance pricing involves calculating the distribution of political risk losses "based on the entity's political risk exposure by country, long term country risk ratings, percentage of defaults within a country, political risk default rates, severity rates, and regional/trade correlation assumptions". ALWIS, Athula; KREMERMAN, Vladimir; LANTSMAN, Yakov; HARGER, Jason; SHI, Junning, *Political Risk Reinsurance Pricing: A Capital Market Approach*. Retrieved from https://www.willis.com/Documents/Publications/Services/Political_Risk/Willis%20Re_Political%20Risk%20Reinsurance%20Pricing_June%2027.pdf, 4.

¹⁹ THAYER, Sandra Smith, Political Risk Insurance: Coverage for Your International Investment, in: *International Insurance Law Client Strategies: Leading Lawyers on Developing Purchase Strategies and Overcoming Regulatory Challenges*, Inside the Minds, 2015, 40.

Point 3: The categories of political risk vary in accordance to how different businesses work. The underwriting decision and performance of an insurance contract must consider macro and micro magnitudes of political risk.

3.2. The obsolescing bargain theory and the institutional analysis

The officiality of the causative agent embodied by international law on foreign investment is integral to PRI. It allows for models to explain political risk in the interaction between foreign investors and host states. Foreign investors are keen on striking long-term deals with governments. A traditional model puts forward an “obsolescing bargain” theory. This model does not maintain that the intentions of the state are seeming, but rather that over time states have an incentive to change the original terms of the deal. Investors’ means of enforcing the bargain correspondingly become obsolete. In this scenario, investment treaties and arbitration are risk-mitigating factors.²⁰

A converging blueprint to the bargain theory is that of an institutional analysis. States have an incentive to balance their revenue streams on the short-term by sacrificing those with long-term perspectives. They do so by trying to secure the maximum amount of revenue without alarming future investors. Political risk is contingent on a distorted behavior of state agents choosing this circumstantial interest over the state’s long-term interest.²¹

To clarify the implications of these models on the insurance strategies companies adopt, one can appreciate that the bargain and the institutional model account, respectively, for an increasing and a permanent component in political risk. The behavior of political risk is crucial to the duration of the insurance cover. But as PRI policies move from annual expiry dates to ever longer terms, practitioners draw attention to the fact that political risk reaches a plateau. They maintain that investors’ greater need for protection in the early stages of the project, as opposed to “seasoned” projects, elucidate the low usage of PRI.²²

²⁰ CHERNYKH, Svitlana; ELKINS, Zachary; GINSBURG, Tom, Commitment and Diffusion: how and why national constitutions incorporate international law, 2007, University of St. Gallen Law School. *Law and Economics Research Paper Series*. Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=999544, 1.

²¹ JAIN, Arvind K., Governance and Political Risk, in: CHOI; CLICK; REID (Ed.), *Value Creation in Multinational Enterprise*, Amsterdam, 2007, 457-458.

²² HAMDANI, Kausar; LIEBERS Elise; ZANJANI George, *An Overview of Political Risk Insurance*, Federal Reserve Bank of New York, May 2005. Retrieved from <https://www.bis.org/publ/cgfs22fedny3.pdf>, 8.

Point 4: The obsolescing bargain theory and the institutional analysis of political risk lay the foundations for insurance strategies that optimize the moment and the duration of coverage.

3.3. Remedies to losses

Frequent events confirm the explanatory power of these models and suggest that political risk will always be a part of doing business abroad. PRI's value lies in its autonomy. The validity of states' acts under their own national umbrella is irrelevant for concluding whether a compensable loss has materialized. In turn, the investment regime for cross-border enterprises has legal caveats. Depending on where loss occurs, national law puts at the investor's disposal precarious remedies in equity. On top of that, investors may perceive the legislation and the judicial apparatus of certain countries as not being evenhanded. International law, on the contrary, translates at best in compensations, with no equity solution allowing for direct enforcement of rights.²³

In parallel to the difference in the results of national and international law, examining the validity of acts under the national and the international orders entails separate analyses. International law's self-sufficiency for concluding that an act in national law creates liability to the state, in that sense, resembles the autonomy of PRI.²⁴ Apart from the applicability of abstract and distinct provisions in law, practical issues arise when a loss occurs. Differently from situations where the occurrence of a loss is instantaneous and acknowledgeable, PRI situations are often circuitous. When something in the relationship between the investor and the host state goes awry, materialization of a loss can span over extended intervals. Many losses come in the aftermath of creeping takings. The calculation of its value can be difficult.²⁵

Compared to national law, international law does appeal as an informal way of insurance. In fact, scholars point to how concerns of turning the World Bank into an insurance

²³ "Article 54(1) of the ICSID Convention obliges Contracting States to enforce the pecuniary obligations arising out of an ICSID award. The corollary is that non-pecuniary obligations are not enforceable". DOUGLAS, Zachary, *The International Law of Investment Claims*, Cambridge, 2009, 101.

²⁴ "The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law." Article 3 of The United Nations' Draft Articles on Responsibility of States for Internationally Wrongful Acts.

²⁵ Creeping expropriation clauses in PRI were expected to deter governments seeking to squeeze investors locked in long-term contracts. WELLS, Louis T.; AHMED, Rafiq, *Making Foreign Investment Safe*, Oxford, 2007, 90.

scheme historically influenced the creation of a neutral arbitration machinery of the International Centre for the Settlement of Investment Disputes (ICSID).²⁶ As a development of this arbitration-led origin, scholars and tribunals circumscribe international law on foreign investment outside the territory of insurance schemes guaranteeing compensations.²⁷

Point 5: PRI compensations do not formally depend on the qualification of state acts in national or international law. Because the characterization of an insurable loss is not always straightforward, these compensations are complementary to other remedies available to investors, especially those in international law.

4. Methodological Notes on the Litigation Test for Political Risk Insurance

Twenty-one cases are quoted in this paper. The majority comes from courts in the United States and in the United Kingdom. Courts in Switzerland and France produced interesting cases too. Apart from judicial proceedings, arbitration shapes PRI case law. *Ad hoc* panels and panels sitting under the World Bank's International Centre for the Settlement of Investment Disputes have done so. These cases look at administrative, legislative and judicial acts of states in the context of a policy much as international courts assessing breaches of international law by states. But given this wide range of non-hierarchical sources, speaking of proper case law in PRI is not technically accurate.

This litigation test suffers from the same shortcomings of any case law study. Courts' decisions and arbitral awards are often incomplete on the conceivable set of relevant facts and arguments. Besides, settling complex disputes requires adjudicators to deal only in an indirect manner with certain topics. A PRI inspection is oblique in this sense. In addition, a relative scarcity of cases prevails. The probable reasons for that combine two factors. First: the relative small size of the market in comparison with the overall insurance business. Second: an

²⁶ JOHN, Taylor St., *Enriching law with political history: A case study on the creation of the ICSID Convention*, in: SCHIL; TAMS; HOFMANN (Ed.), *International Investment Law and History*, Cheltenham, 2018, 307.

²⁷ SORNARAJAH, M., *Resistance and Change in the International Law on Foreign Investment*, Cambridge, 2015, 279. See also: GUGLER, Philippe; TOMSIK, Vladimir, *General Agreement on Investment: Departure from the Investment Agreement Patchwork*, in: DUNNING; GUGLER (Ed.), *Foreign Direct Investment, Location and Competitiveness*, Oxford, 2008, 247. Since proper insurance is necessary for apt claims, an off-stage battle is reported to occur elevating the pressure on PRI activities. The British government reportedly barred the issuance of a PRI policy in the London market for business to be carried out in Zimbabwe. MADONGO, Irene, *Zimbabwe political violence: an insurance deal too far?*, *The Financial Times*, 13. Nov 2012. Retrieved from <https://www.ft.com/content/402325a2-efbe-33e1-8209-ed0e837a52c6>.

unwillingness to litigate the—after all—sensitive political issues. With few cases and many partial or deficient reasoning, PRI issues do not form a wide-ranging legal panorama.

Adverse selection reduces the importance of PRI litigation. The underwriting process is costly. It follows that risks need to be significant in probability or impact to be marketable. In tandem, the most nuanced and problematic cases make it to litigation. While many policies expire without a loss ever happening, parties process many claims amicably. Case law reflects only partially what are the legal challenges PRI practitioners face.

Nevertheless, a comprehensive investigation of case law on PRI retains practical value to the overall assessment of the product and to factor its risks. SwissRe's country risk rating, for instance, provides for adjustments “based on expert judgement, *e.g.*, when the outside indicators do not yet reflect recent events and developments or when original input data is not comprehensive enough”.²⁸ This intrinsic element of political risk weighting on a given country/project runs alongside an extrinsic component. Being a constraint for policyholders, brokers and insurers, case law potentially affects all policies in ever more expansive ways. Whereas reference to the specific body of case law in PRI is still not widespread, New York courts do strive for coherence with past rulings.²⁹ Gathering several cases in a single assessment contributes to this trend, especially considering how recent some of these cases are. Lastly, litigation can be of pertinence in PRI. The profitability is heavily dependent on recovery of the losses from the injurer party.³⁰

Point 6: A handful of jurisdictions and adjudication systems issued PRI decisions. Although case law can have a knock-on effect on the industry, the available material is still scarce to form a comprehensive body of law and is impaired by adverse selection.

²⁸ LIER, Marco, SwissRe Political Country Risk Rating, in: HABEGGER (Ed.), *International Handbook on Risk Analysis and Management*, Zurich, 2008, 182.

²⁹ Recently, the *CT Management* case was discussed and distinguished by the court in the *International Finance Corporation* case. *International Fin. Corp. v. Carrera Holdings Inc.*, Section IV. The latter brought the World Bank's entity to a project-based litigation. The case was not based on a PRI policy. The facts dealt with the duties and rights of the parties under a scenario in which a classical type of political risk materialized abroad.

³⁰ Claims outstanding in political risk in 2016 reached 4.626 billion dollars, whereas claims paid reached 269 million. Recoveries reached 5,011 billion. See *Berne Union Statistics 2012-2016*. Retrieved from <https://www.berneunion.org/DataReports>, 21- 25.

5. Benchmarks in the Case Law on Political Risk Insurance

5.1. Overview of the benchmarks

Benchmarks in case law are meant to be critical points to courts and tribunals. In PRI case law they remain scattered and, to the author's knowledge, literature does not tackle them in a comprehensive way. Yet the following subsections assert that these benchmarks account for a substantial part of the mitigation of political risks cycle. Albeit with an unavoidable degree of description, the subsections shed lights on the issue of *how to define political risks* in the context of foreign investment (5.2). One finds elements on *how to interpret* the contracts (5.3) and looks at *brokers' liability for the disclosure of risks* (5.4). A subsection pertains to the problem of *subrogation rights* in PRI (5.5). One proceeds to depict aspects of the relationship between national and international law (5.6). Because it goes beyond the objectives of this research, the last subsection merely refers to interesting aspects of PRI in the financial sector cases. (5.7).

5.2. The Definition of Political Risk Insurance

5.2.1. The Esquenazi case

Case law engenders uncertain definitions for PRI. Where the general category of PRI is mentioned, the facts usually invoke clear-cut provisions in policies themselves issued under specific circumstances. In the *Esquenazi* case, a nomenclature problem creates confusion. To characterize a contract, the Court states that the parties “sought political-risk insurance, a type of coverage that applies only when a foreign government is party to an agreement”.³¹ In fact, the Court incurred in metonymy. It referred to the *genus* (PRI) when meaning the *species* (breach of contract). The background of the case, a Foreign Corruption Practices Act (FCPA) accusation, explains why this happened.

The case involved the criminal liability of the officers of an American company doing business in Haiti. The local business partner had unclear ties to the local government. The Court had evidence of a previous application by the *company* for a “PRI” policy. It had to

³¹ UNITED STATES. United States Court of Appeals of the Eleventh Circuit. United States v. Esquenazi, 752 F. 3d 912 (2014). United States Court of Appeals, Eleventh Circuit, 917.

decide if this evidence was relevant for the following question: did the *individuals* responsible for the company know that the insured transaction involved a government instrumentality? In the Court's view, they knew. This paved the way for their conviction. By applying to a PRI, these individuals demonstrated their engagement with officials of a government instrumentality. Since the Court had elements to prove the fraudulent payments made in the context of that engagement, the PRI factor was material to concluding that the defendants bribed foreign officials within the meaning of the FCPA.

Point 7: Acquiring a PRI policy is indicative of dealings with government instrumentalities.

5.2.2. The *Ace Capital* and *Sempre* cases

When the insurance relationship is the direct subject matter of a case, a Court's definition of PRI is likely to be that of the contract at hand. The contract may go a step further than the mere description of governmental actions for which protection is offered. Parties may agree on the effects that must take place because of those actions. The *Ace Capital* case is an example.³² To the detriment of a more profound scrutiny, the case poses jurisdictional rather than substantial issues. The PRI policy covered risks of governmental hindrance in a natural gas pipeline between Argentina and Chile. The Court emphasized the standard of protection in the risk clause—a standard revealing a “worst case, last resort” scenario for the entire business. The policies “covered, inter alia, Expropriatory Acts and Selective Discrimination [...], provided that those actions had certain specified effects.” The Court goes on to explain that, according to the policies, “the acts in question [should render] the foreign enterprise Economically Unviable, as defined in the Policies”.³³

The Court in the *Sempre* case followed a similar approach by validating the outcome reached in a previous arbitration.³⁴ The business operations were analogous to those of the *Ace Capital* case. To protect its gas distribution business in Argentina, *Sempre* bought insurance against confiscation, expropriation, nationalization and selective discrimination. Contrary to the *Ace Capital* case, the parties in *Sempre* did not design a “worst case, last

³² UNITED KINGDOM. England and Wales High Court (Commercial Court). *Ace Capital Ltd v. CMS Energy Corporation* [2008] EWHC 1843 (Comm) (30 July 2008) ([2008] 2 CLC 318, [2008] EWHC 1843 (Comm), [2009].

³³ *Idem*, paragraph 4.

³⁴ UNITED STATES. United States District Court of the Southern District of New York. *Sempre Energy v. Nat'l Union Fire Ins. Co.*, Dist. Court, SD New York 2006.

resort” strategy of risk mitigation to the entire business. The protection was asset-based. The Court describes the expropriatory clause as covering acts that “expressly and permanently deprive[d] the Foreign Enterprise of all or part of its fixed and/or current assets”.³⁵

Point 8: The protection in PRI can be determined according to the effects of the government action in the entire business or only in some of its assets.

5.2.3. The *Atlasnavios* and *Gard Marine* cases

Courts tackle cases in which a policy is not classified as PRI and, still, the underlying issue concerns political risk. Typical governmental actions and allegations of partisan motivations appear in other sort of insurance claims. Confiscation under war insurance in the shipping business is a good example. In the *Atlasnavios* case, Venezuelan authorities detained a ship and arrested the crew after finding three bags of cocaine in an inspection.³⁶ Other administrative and judicial actions ensued, although there was no evidence of the identity of the persons involved in the stashing of the drugs. The ship-owners claimed that malicious acts by third parties were covered by the policy and further that the Venezuelan actions were politically motivated. The insurers’ defense relied on exclusions in the policy related to the infringement of customs regulations and failure to provide security. The Court rejected the political motivation but found that the malicious acts by third parties provision in the policy applied. Even though the actions by Venezuela materialized and defined the extent of the loss, the Court ruled on the scope of the protection with no express reference to *political risk* as a category of risk.

In the same vein, courts define political risks with other ends in view. An example is the *Gard Marine* case.³⁷ A ship covered by hull insurance went aground and subsequently broke up in the Japanese coast. The vessel had been successively chartered, sub-chartered and time-chartered among different operators to load cargos in different ports. One of the questions the Court answered was: could the port where the loss occurred be considered safe? The political risk diagnosis in this context investigates issues of localized violence, war or

³⁵ *Idem*, Section I, A. The clause still required the Court to interpret its meaning within a given set of facts. See below, Section 5.2.

³⁶ UNITED KINGDOM. England and Wales Court of Appeal (Civil Division). *Atlasnavios - Navegação, LDA v. Navigators Insurance Company Ltd & Ors* [2016] EWCA Civ 808. 01 August 2016.

³⁷ UNITED KINGDOM. England and Wales Court of Appeal (Civil Division). *Gard Marine & Energy Ltd v. China National Chartering Co Ltd (Rev 1)* [2015] EWCA Civ 16. 22 January 2015.

insurrection rather than into the effects of specific legal acts.³⁸ And it does not assess the compensation for the occurrence of political risk, but rather looks at political risk as a possible exclusion of liability for a separate action (departure of the port).

Point 9: PRI is not the sole form of covering risks derived from government actions or the political situation in a country.

5.2.4. The Bayview case

Individualized government actions are recurrent in PRI. Sometimes a gray zone blurs regarding what is the insurable exposure. Certain risks require PRI (such as legal rules as in *Ace Capital* and *Sempre* cases), when in fact other situations require only asset protection. This protection often is against some, but not all sorts of governmental action. In these cases, parties exclude political risk. A direct asset confiscation in the *Bayview* case serves as a good example.³⁹ Under an “all risks” policy, insurance covered motor vehicles transported from Japan to the Dominican Republic with destination to the Turks and Caicos Islands. The vehicles were not discharged by customs authorities at the Dominican Republic. They remained in custody while the importer and the insurers undertook to clear the documentation. The cars eventually went missing, and the policyholder sued. The insurers argued three lines of defense. One, that the misappropriation had occurred under forcible possession. Two, that a lawful authority was responsible for the taking. Three, that the taking involved overpowering force.⁴⁰

One may appreciate how the insurer’s arguments in this case could lead to a classification issue. While the policy was overtly non-PRI, the insurers argued that the facts at hand were a manifestation of political risk. The Court’s approach combined the factual element that the cars had been voluntarily placed under custody, with the legal assessment that the customs officers did not act as organs of the State. The policyholder was granted a compensation.

Point 10: PRI case law is influenced by the qualification of the circumstances in which a loss occurs.

³⁸ *Idem*, paragraph 52.

³⁹ UNITED KINGDOM. England and Wales High Court (Commercial Court). *Bayview Motors Ltd. v. Mitsui Marine and Fire Insurance Company, Ltd. & Ors* [2002] EWHC 21 (Commercial). 23rd January, 2002.

⁴⁰ *Idem*, paragraph 34.

5.2.5. The Enterprise Tools and the German Insurer cases

The boundaries between PRI and credit insurance are discussed in the *Enterprise Tools* case.⁴¹ Claimant, an American company, established a commercial relationship with Petroleos Mexicanos (Pemex), a state-owned oil company. To perform its fuel transport services, Enterprise Tools used its own trucks, which the Mexican government later confiscated. The insurance policy's main object concerned credit risk. It also had a second type of coverage, encompassing transfer risk and other political risks. The Court held that only the receivables owned by Pemex to Enterprise Tools were covered, not the assets used by Enterprise Tools to perform the contract. Covered political risks, however broadly described, were related only to the default by Pemex or to other credit-related events, such as currency inconvertibility, war or expropriation.⁴²

The Federal Supreme Court of Switzerland had a similar question in a different setting. Tax authorities in Switzerland distinguished between credit insurance against economic risk and credit insurance against political risk. Classifying these two types of insurance was relevant for a tax assessment establishing the scope of an exemption whose rationale, according to the Court, “consists of maintaining the competitiveness of Swiss insurance undertakings by exempting items located abroad”.⁴³ The possible exemption concerned premiums received by the Zurich branch of a German “X” insurer.⁴⁴ The Court rejected the differentiation, but advanced an important general concept: “the object of insurance cover in both cases is the irrecoverability of the claim, which is regarded as the (incorporeal) insured property”.⁴⁵

From different perspectives, both these cases support the following contention: a political risk cover within a credit insurance implies that state acts classified as political risks give rise to compensations, but only to the extent that they affect the credit claim, not the assets. The Swiss Court clarified that political risk in a credit insurance “does not in fact refer to the object of insurance, but rather to the type of insured risk to which the insured object is exposed”.⁴⁶ This concept helps to understand how credit insurance itself can be tailored to international circumstances on the background of which political risk lies. Depending on the

⁴¹ UNITED STATES. United States Court of Appeals of the Eighth Circuit. *Enterprise Tools, Inc. v. Export-Import Bank*, 799 F. 2d 437 - Court of Appeals, 8th Circuit 1986, 441.

⁴² *Idem*, 443.

⁴³ SWITZERLAND. Schweizerisches Bundesgericht. BGE 137 II 49 S. 50.

⁴⁴ *Idem*.

⁴⁵ *Idem*. Section 1. Freely translated.

⁴⁶ *Ibidem*.

contract wording, credit insurance's broad coverage is undercut. It morphs from a coverage that triggers in many cases, including if the default is caused by political risk, into a coverage that does not trigger automatically on default, but rather only in the cases the default is caused by political risk. The "object of insurance" would not include, for instance, bankruptcy. This happened in *CT Investment Management*.⁴⁷ The Court stated that the parties' sophistication revealed that their intention was to purchase an insurance against "the risk of lending in a foreign jurisdiction" and not against the borrower's own solvency risk.

Point 11: A political risk cover within a credit insurance concerns the effects of political risk on the credit claim, not the assets.

5.3. Contract Interpretation

5.3.1. The CT Investment Management case

Insurance contract interpretation plays a more prominent role in PRI than general contracts principles and, notably, than political risk and international law specifics. The *CT Investment Management* is a case in point.⁴⁸ A PRI policy was attached to a loan granted in the United States to fund the operation of timeshares at resort properties in Mexico. The political risk matter emerged when the borrower in the loan initiated a voluntary bankruptcy proceeding in accordance to Mexican law. The Court interpreted the exclusion clause. It rejected the argument that the mere disagreement of the parties as to its interpretation was sufficient to consider the clause ambiguous. For that reason, the policy would not have to be construed in favor of the insured.

The Court asserted that the Mexican bankruptcy regime was not in itself an expropriatory action, nor an expropriation as defined in the policy. In the Court's view, the unfavorable outcome to the insured of the bankruptcy proceeding was not "analogous to the passing of a new law by a foreign legislative body or the nationalization of a private company by the executive."⁴⁹ The Court further explained that a judicial order freezing an account of a failing legal entity, within a bankruptcy proceeding, did not equate to an official act prohibiting the transfer of funds.

⁴⁷ UNITED STATES. New York Appellate Division. *CT Inv. v. Chartis Specialty 130 AD 3d 1 - NY_ Appellate Div., 1st Dept.* 2015. For a more detailed explanation on the facts, see below 5.2.

⁴⁸ *Ibidem.*

⁴⁹ UNITED STATES. New York Appellate Division. *CT Inv. v. Chartis Specialty 130 AD 3d 1 - NY_ Appellate Div., 1st Dept.* 2015, 7.

Point 12: The lack of protection within the legal framework of a country is not, by itself, an insurable risk.

5.3.2. The Enterprise Tools case

As opposed to answering if a certain situation falls into the policy scope of protection, as the in the *CT Investment Management* case, the *Enterprise Tools* case established a premium-based test to determine the extent of the coverage.⁵⁰ In dispute was the coverage of a *credit* insurance policy with ambiguous provisions. Claimant tried to classify the policy as PRI. It argued that losses in the assets used to perform the obligation originating the insured receivables, which were confiscated, would be covered. Because the language in the contract was ambiguous, the Court proceeded to a value-test. Since the premium paid by the parties was considerably lower than that which would be due under a PRI policy with clear language, no principle of protection of the insured could have been applicable to its favor and therefore the policy could not have been interpreted as a PRI policy covering the confiscated assets.⁵¹

Point 13: The determination whether the object of a contract conforms to a PRI framework can be made through a premium-value analysis.

5.3.3. The Sempra case

In the *Sempra* case, a gas distribution business in Argentina was covered by PRI.⁵² The Court had to answer which of the policyholder's assets, among those affected by the government action, were covered. As seen in Section 5.2, one of the benchmarks in PRI definition is the prominence of contractual definitions over any general principle. The *Sempra* case illustrates how PRI policies have few pre-established settings and how courts have a role in determining the scope of the contract. In the opinion of the court, a contractual basis

⁵⁰ UNITED STATES. United States Court of Appeals of the Eighth Circuit. *Enterprise Tools, Inc. v. Export-Import Bank*, 799 F. 2d 437 - Court of Appeals, 8th Circuit 1986.

⁵¹ *Idem*, 441-442.

⁵² UNITED STATES. United States District Court of the Southern District of New York. *Sempra Energy v. Nat'l Union Fire Ins. Co.*, Dist. Court, SD New York 2006.

excluded from the expropriation coverage “intangible assets” and also “currency fluctuation or devaluation.”⁵³

Point 14: Courts can interpret policies on the categories of covered risks, and on the extent of the covered assets.

5.3.4. The Bechtel case

In the *Bechtel* case, a new wording on the coverage was introduced during the renewal of the contract and later disputed by the parties.⁵⁴ The way the *policy* was understood modulated not only the understanding the parties had of the corresponding *claim*, but also the understanding of how disputes with the government on the underlying project would be categorized as a *loss*. By request of Overseas Private Investment Corporation (OPIC), the insurer, a provision was added to policy: the insureds interpreted such provision as possibly limiting the payment of compensation for creeping expropriation but received OPIC’s confirmation that coverage was granted. OPIC, on the other hand, “interpreted the expropriation coverage of the Policy to mean that OPIC had assumed only the risk of nonpayment by the Indian government of *a confirmed arbitration award*.”

Point 15: The triggering event in a policy is not necessarily the loss suffered by the policyholder—it can be the negative outcome in a dispute between the investor and the host state.

5.3.5. The Big Sky Juice case

Disputes in PRI involve distinct types of breach or non-compliance with contractual obligations. An example is found in *Big Sky Juice*.⁵⁵ Claimant acquired a PRI policy from OPIC to protect its stake in an industrial business in Afghanistan. It submitted a claim for compensation under the political violence and permanent abandonment clauses of the contract. OPIC rejected the compensation on two grounds: (i) the insured failed to comply

⁵³ *Idem*, Section III, A and B.

⁵⁴ INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION. *Bechtel Enterprises International Ltd, Ben Dabhol Holdings Ltd, and Capital India Power Mauritius I v. Overseas Private Investment Corporation*. American Arbitration Association. AAA Case No. 50 T195 0050902.

⁵⁵ INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION. *Big Sky Juice, LLC, dba Afghanistan Natural Beverage v. Overseas Private Investment Corporation*. ICDR Case No. 50 195 T 00233 12. Partial Final Award.

with the contract, notably due to accounting problems with how the parent company and the local subsidiary booked the interest accruing from the investment; (ii) the events at hand did not trigger the protection. The sole Arbitrator found that the non-compliance defense sufficed to reject the policyholder's claim.

Whereas no detailed ruling was given on the definition of the trigger for insurance protection, the first point closely relates to the principles of international law on foreign investment. One can formulate it as follows: should the investment bear any intrinsic nature or follow any specific rule to enjoy—treaty and or insurance—protection?⁵⁶ In investment law the answer is affirmative in terms of a preconditioned nature of the investment.⁵⁷ In the *Big Sky Juice* case, parties diverged on the rule aspect of the question. OPIC raised the question that Big Sky did not demonstrate that the investment had been made in accordance to the *insurance contract*. Big Sky argued it followed the *law in the United States*. The Court gave reason to OPIC. The award established that the “fact that Big Sky and ANB may be consolidated for tax and accounting purposes does not alter the contractual obligation in the insurance contract”.

Point 16: The definition of investment is relevant to PRI. In defining it, courts look at the contract and not at general definitions of national or international law.

5.4. Brokers' liability for the disclosure of risks

As with other types of insurance, a significant portion of disputes on parties' liabilities concerns the disclosure of material facts regarding risks. In PRI, the amplitude of materiality is consequential. Specialists recommend that a company and its advisors be prepared to disclose information on the business, “including its foreign investment, trade contracts, foreign assets, and the current or recent political environment in the [host] country”.⁵⁸ It is also prescribed that companies consult with brokers and disclose “any and all issues or potential

⁵⁶ *Idem*, 3-4

⁵⁷ Drawing from several investment awards, scholars point to the following features: a certain duration, a regularity of profit and return, the presence of a risk factor, and a substantial commitment. SCHREUER, Christoph H.; MALINTOPPI, Loretta; REINISCH, August; SINCLAIR Anthony, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, Second Edition, Cambridge, 2009, 128.

⁵⁸ THAYER, Sandra Smith, *Political Risk Insurance: Coverage for Your International Investment*, in: *International Insurance Law Client Strategies: Leading Lawyers on Developing Purchase Strategies and Overcoming Regulatory Challenges*, Inside the Minds, 2015, 39.

issues no matter how small and insignificant”.⁵⁹ Finally, one could argue whether PRI imposes a duty of disclosure on the insurer. PRI seems to be one of the rare situations in which this can arise. Scholars point to two factors: the nature of the risk diminishes the ability of the insured to alleviate with the loss and the circumstances can be such that the insurer has more information than the insured.⁶⁰ This is a probable scenario when the policyholder is about to start business in a country where the insurer has ample experience.

Point 17: Policyholders in PRI make ample use of brokers and disclose meaningful information on their business. It is arguable that they should expect reciprocity from insurers.

5.4.1. The Landoil case

Brokers are exposed to litigation due to their role in advancing complex PRI products. In their intermediary role, brokers have duties and liabilities towards both insureds and insurers. The *Landoil* case involved a network of brokers.⁶¹ Third parties were hired by the “first” brokers of a PRI policy to negotiate with the underwriters the reinstatement of a contract which had been previously entered into and subsequently voided *ab initio*. The insured company sued their PRI brokers for an alleged failure to “make adequate disclosures to the underwriters on its behalf, and that it failed to advise Landoil [the insured] of certain material facts that had to be disclosed.”⁶²

A third-party claim was filed against the “second” brokers for their role in the transaction. Whereas such allegations would fit other non-PRI fields of insurance, Landoil based its case also on the fact that the “first” brokers “misrepresented [their] competence and expertise as insurer brokers in the field of political risk insurance”.⁶³ The Court did not rule on the merits and the question of whether PRI brokers are required to have any special competence and expertise remains open.⁶⁴

⁵⁹ *Idem*, 38-39

⁶⁰ PARK, Semin, *The Duty of Disclosure in Insurance Contract Law*, Aldershot, 1996, 181-182.

⁶¹ UNITED STATES. United States Court of Appeals of the Second Circuit. *Landoil Resources v. Alexander & Alexander Serv.*, 918 F. 2d 1039 - Court of Appeals, 2nd Circuit 1990.

⁶² *Ibidem*, 1041.

⁶³ *Idem*.

⁶⁴ In the American market, an expert lawyer contends “a company would be wise to work with one the insurance brokers who specializes in this area of coverage: Willis, Aon, or Marsh”. THAYER, Sandra Smith, *Political Risk Insurance: Coverage for Your International Investment*, in: *International Insurance Law Client Strategies: Leading Lawyers on Developing Purchase Strategies and Overcoming Regulatory Challenges*, Inside the Minds, 2015, 39.

Point 18: The PRI market for brokers is dominated by specialized players. It is not current law that brokers bear differentiated liability according to their lack of specialization.

5.4.2. The *André et Compagnie* case

In the *André et Compagnie* case, the background involved a credit/PRI policy covering the sale made by the claimant to the government of Albania.⁶⁵ *André et Compagnie* suffered a loss in the contract and sued its broker and the insurer. The French *Court de Cassation* relied on two facts to reject the claim. The first test was contract-based, while the second one was contextual. The Court dealt with the burden of the parties in an insurance contract to disclose relevant information. *André et Compagnie* argued that the broker, SGAC Bellan, failed in its duties of advisory and information. The Court emphasized, however, the claimant's duty to provide "sincere information" about the risks. Furthermore, the Court stressed the factual context in which the company gave inexact and dissimulate information. In the Court's view, the company "did not ignore that [the country] was notoriously insolvent and that it faced a period of quasi-insurrection".

Point 19: The notoriety of political risk in a country can be a criterion to determine the legitimacy of expectations parties have about a PRI policy.

5.5. Subrogation rights

Subrogation in insurance contracts enables the insurer to pursue rights the insured would be entitled to pursue against those who caused the loss.⁶⁶ In public PRI, once a private investor is compensated for a loss, subrogation ignites a classical international law dispute among sovereign states.⁶⁷ Acts attributable to the host state are the ultimate basis for a claim, but the immediate grounds consist of the payment made to the investor.⁶⁸ How and under

⁶⁵ FRANCE. Cour de Cassation. *André et Compagnie vs. Société Assurances Générales de France (AGF-IART) et à la Société SGAC Bellan*. Chambre Civile 1. Audience publique du 13 janvier 2004. N° de pourvoi: 01-03445.

⁶⁶ PADFIELD, Alison, *Insurance Claims*, Haywards Heath, 2016, 287.

⁶⁷ In bilateral treaties, subrogated rights derive from "guarantee, indemnity or contract of insurance in respect of an investment." CORREA, Carlos M.; KUMAR, Nagesh, *Protecting Foreign Investment, Implication of a WTO Regime and Policy Options*, New Delhi, 2003, 116.

⁶⁸ Scholars explain that subrogation normally does not imply the host incurred in a delictual conduct. MUCHLINSKI, Peter, *The Framework of Investment Protection: The Content of BITs*, in: SAUVANT; SACHS (Ed.), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation*

which procedure the payment occurs is not, in principle, a material question. But international politics have a hand in the outcome of subrogation disputes.

5.5.1. The United States v. India case

Following the Dabhol project disputes, the United States initiated an arbitration against the government of India based on an investment incentive agreement. It sued for compensation for the losses emerging from the payment under the PRI program offered by OPIC. The strong elements of the attributability of the actions to the Government of India did not depoliticize the dispute. It is telling how the Americans legitimized their claims from a strategic point of view. In the request to arbitration, they informed how OPIC “delayed [the investor’s] claims until [the companies] had obtained a decision from a distinguished American Arbitration Association (‘AAA’) panel.”⁶⁹ The US also negotiated with India prior to the arbitration request, the case eventually being settled.⁷⁰

Point 20: In public PRI subrogation rights do not frustrate politically acceptable means of exercise.

5.5.2. The Hochtief case

The *Hochtief* case discussed political risk in the backdrop of the commercial balance in a concession agreement in the utility sector.⁷¹ It also examined the Argentinean crisis following the pesification of its economy after years of the national currency being pegged to the American dollar. The tribunal construed a subrogation clause in a BIT as creating a possibility of a subrogation. Upon payment of compensation under a PRI policy, the home state of the investor, Germany, would be allowed to exercise the rights against the host state, Argentina. The tribunal found this was not an obligation for Germany, but rather an obligation for Argentina. This obligation consisted of recognizing or admitting “such a

Treaties, and Investment Flows, Oxford, 2009, 66-67.

⁶⁹ *Request for Arbitration Under the Investment Incentive Agreement Between the Government of the United States of America and the Government of India*, 19 November 1997. Retrieved from <https://www.opic.gov/sites/default/files/docs/GOI110804.pdf>, paragraph 34.

⁷⁰ *Idem*, paragraph 9. KUNDRA, Peetri, Looking Beyond the Dabhol Debacle: Examining its Causes and Understanding its Lessons, *Vanderbilt Journal of Transnational Law*, 41, 2008 III, 908.

⁷¹ INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES. *Hochtief AG and Argentine Republic*. ICSID Case No. ARB/07/31.

transfer of rights if and when the transfer is in fact effected by provision of law or by a legal act".⁷² The tribunal expressly rejected Argentina's argument that the fact that a PRI policy was in place and was paid would be sufficient to dismiss or be deducted from the claim the investor had, under the treaty, on similar grounds.

Point 21: A subrogation clause in an investment treaty creates a duty on the host state, not on the home state. Subrogation rights of the insurance compensation do not comprehend a dismissal or a deduction of the investment compensation.

5.5.3. The *Karaha Bodas* cases

The *Karaha Bodas* cases originate from a geothermal energy project in Indonesia. A joint venture between foreign investors and Indonesian state-owned firms built and operated a power plant. In parallel, they sold the produced electricity to another state-owned firm. Political risk materialized in subsequent government decrees disrupting the state-owned parties' ability to perform their obligations. This case exhibits the trace of international investment law: the foreign investors were first awarded a compensation in a Swiss arbitration proceeding. The issue of PRI appeared in the enforcement. The decisions rendered chronologically in Hong Kong, Canada and in the USA, in the respective enforcement proceedings, reached similar conclusions. They separately refer and clarify points on Indonesia's argument that the existence and lack of disclosure of PRI policy were an impediment to the enforcement. For simplification, those points are convened here in a synthesis.

The case deals with risk allocation among parties. The Indonesian state-owned firms contended they could not pay compensation for merely complying with the – newly-enacted – applicable national law. To deny the request for setting aside the award, it was pointed out that the contract did not operate a forceful disregard for national law onto the Indonesian companies: it merely allocated the risk in a very typical way for contracts.

A question that ensues is whether PRI is sufficient, by itself, to change the risk allocation reached by parties in the underlying contract. The courts rejected such argument by clearly establishing an insurance's intent of being an autonomous obligation. Such approach is consistent with the discrete function of PRI of fostering foreign investment in all forms. Regardless of the existence of a direct and contractual relationship between the foreign

⁷² *Idem*, 43-44.

investor and the host state, international protection may be applicable.⁷³ With stronger reason, PRI should be assessed and enforced autonomously from any underlying contract.⁷⁴ Like in the *Hochtief* case, the *Karaha Bodas* courts also held that the insurance proceeds could not be mixed with the calculation of damages due on the underlying relationship.

In addition to the (lack of) effect of PRI in risk allocation, the *Karaha Bodas* cases raise the issue of disclosure. Two correlated matters can be logically separated in this note. On the one hand, one must decide whether the disclosure of the PRI is an obligation the failure of which bears any consequence. A second analysis relates to whether an arbitral award based on such non-disclosure violates public policy within the meaning of the New York Convention.⁷⁵ The New Court hinted on a negative answer to the first question. It tested the second matter by assessing whether “the prevailing party furnished perjured evidence to the tribunal or if the award was procured by fraud”.⁷⁶ However, during the arbitration proceedings, the Indonesian parties had an opportunity to discuss and request discovery evidence on the existence of the policy.⁷⁷ This sufficed to reject the argument of fraud and to overlook the more general inquiry of whether disclosure was necessary in the first place.⁷⁸

Point 22: PRI does not alter the risk allocation agreed by the parties in insured projects. It is not current law whether a PRI should be disclosed, or not, to a host state in the context of a collaborative project.

⁷³ International protection, under BITS, is referred by scholars as “arbitration without privity.” It refers to the possibility of investors seeking arbitration against the host state without a contractual basis for their relationship and/or without an arbitration clause in their contractual relationship. SCHREUER, Christoph H.; MALINTOPPI, Loretta; REINISCH, August; SINCLAIR Anthony, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, Second Edition, Cambridge, 2009, 191.

⁷⁴ A circumstantial argument before the Hong Kong court concerned one of the investors’ allegations during the arbitration. The government actions were reputed to hinder the investors’ ability to generate cash with the investment and therefore reinvest the proceeds in the project. The Indonesian parties considered this argument to be inconsistent with the fact that some of the investors had been granted a PRI compensation. To dismiss this line of argument, the court reasoned that “it seems to be another example of significance being attached to an issue, after the event.” *Karaha Bodas Co LLC v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, paragraph 65.

⁷⁵ The Hong Kong court refers to the New York Convention language in which the grounds for setting aside an award require the award to be “contrary to the fundamental conceptions of morality and justice of the forum”, *Karaha Bodas Co LLC v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, paragraph 60.

⁷⁶ *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak*, 306.

⁷⁷ *Karaha Boda Company, L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, paragraphs 46-49.

⁷⁸ *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak*, 364 F. 3d 274 - Court of Appeals, 5th Circuit 2004, 307.

5.6. International Law and National Law

5.6.1. The CT Investment case

The theory of state responsibility is one of the most developed, if controversial, fields of international law.⁷⁹ From a practical standpoint, there is no strict parallelism between the classical state responsibility doctrine and case law on the issues of insurable political risk. Actions trigger a policy even if deemed to be in accordance to international standards. In the *CT Investment* case, reference to “violations of international law” to define the occurrence of an expropriatory act were made only by operation of the insurance policy, not by any intrinsic and necessary applicability of international law.⁸⁰ One point of convergence arises between those two fields in the analytical process of factual and legal issues. State activities under national law are considered facts under international law according to the International Court of Justice. This includes administrative measures, legal decisions and municipal laws.⁸¹ State activities in those three domains are also discussed as a matter of fact in the PRI litigation.

Point 23: A contractual provision is necessary for international law to be applicable as reference for the qualification of an insurable risk.

5.6.2. The Metlife and Bayview cases

In the *Metlife* case, the England and Wales Court of Appeal had to decide on the impact on a contractual obligation of the alleged mischiefs of the Argentinean government on the activities of the agency responsible for measuring inflation. The Court pointed out that the findings of fact of the case supported the conclusion that the measurement had become not only unreliable, but dishonest.⁸² In *Bayview*, the insurance claim involved the consequences of the confiscation by Dominican custom authorities of shipped motor vehicles. The Court not only

⁷⁹ The United Nations’ Draft Articles on Responsibility of States for Internationally Wrongful Acts is sharply criticized. It is argued that the Articles destroyed the unity of international law, by eliminating damage as a necessary condition for a state act to be considered wrongful. PELLET, Allain, *The definition of responsibility in International Law*, in: CRAWFORD; PELLET; OLLESON (Ed.), Oxford, 2010, 11.

⁸⁰ UNITED STATES. New York Appellate Division. *CT Inv. v. Chartis Specialty 130 AD 3d 1 - NY_ Appellate Div.*, 1st Dept. 2015, 4.

⁸¹ SPIERMANN, Ole, *International Legal Argument in the Permanent Court of International Justice: The Rise of the International Judiciary*, Cambridge, 2004, 277-278.

⁸² UNITED KINGDOM. England and Wales Court of Appeal (Civil Division). *Metlife Seguros De Retiro S.A. v. JPMorgan Chase Bank, National Association* [2016] EWCA Civ 1248 (07 December 2016) ([2016] EWCA Civ 1248; From England and Wales Court of Appeal (Civil Division) Decisions, paragraph 83.

pointed to the fact that it was common ground for the parties that the confiscation lacked legal basis. It expressly rejected the argument of the defendant that such action was “simply a mistake about the lawfulness of effecting a confiscation”. In rather harsh language, the Court went on to contend that the authorities’ justification of their acts was “transparently bogus”.⁸³

Point 24: Although it is not a necessary step in handling a PRI claim, courts do not refrain from establishing the illegality of states’ acts as a factual basis for compensations.

5.7. PRI and the financial sector

It would go beyond the purposes of this research to expand comments to the group of cases dealing with PRI as a tool in the financial sector. Acknowledging those cases, however, is useful to illustrate the variety of scenarios in which adjudicators can shape the product. The *Braspetro* case exemplifies how being a policyholder in PRI influences interest rates a company pays in the bond market and in bank loans.⁸⁴ The *Oxus* case shows how relevant stakeholders refrain from allowing a company to pursue a business opportunity unless a PRI policy is obtained.⁸⁵ In the *Metlife* case, the scope of PRI is raised by means of a negative determination: a borrower argues that a certain interpretation of a contract should prevail since the bank could get around its excessive cost purchasing PRI.⁸⁶ The *Parmalat* case discussed fraud in the capital markets, in the context of PRI being bought from an inept insurer to allow the policyholder’s officer to perpetrate embezzlement.⁸⁷ Finally, one can briefly refer to an undiscussed issue of the *Bechtel* case.⁸⁸ OPIC’s dual position as an insurer and a lender allowed it to tamper with how the investor handled its legal alternatives in the

⁸³ UNITED KINGDOM. England and Wales High Court (Commercial Court). *Bayview Motors Ltd. v. Mitsui Marine and Fire Insurance Company, Ltd. & Ors* [2002] EWHC 21 (Commercial). 23rd January, 2002, paragraph 30.

⁸⁴ UNITED KINGDOM. England and Wales High Court (Commercial Court). *Braspetro Oil Services Co & Anor v. FPSO Construction Inc & Anor* [2007] EWHC 1359 (Comm) 12 June 2007, paragraph 303.

⁸⁵ UNITED KINGDOM. England and Wales High Court (Commercial Court). *Oxus Gold Plc (Formerly Oxus Mining Plc) & Anor v. Templeton Insurance Ltd* [2006] EWHC 864 (Comm) 27 April 2006, paragraphs 157, 228, and 295.

⁸⁶ UNITED KINGDOM. England and Wales Court of Appeal (Civil Division). *Metlife Seguros De Retiro S.A. v. JPMorgan Chase Bank, National Association* [2016] EWCA Civ 1248 (07 December 2016) ([2016] EWCA Civ 1248; From England and Wales Court of Appeal (Civil Division) Decisions, paragraph 68.

⁸⁷ UNITED STATES. United States District Court of the Southern District of New York. *In re Parmalat Securities Litigation*, 414 F. Supp. 2d 428 - Dist. Court, SD New York 2006.

⁸⁸ INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION. *Bechtel Enterprises International Ltd, Ben Dabhol Holdings Ltd, and Capital India Power Mauritius I v. Overseas Private Investment Corporation*. American Arbitration Association. AAA Case No. 50 T195 0050902.

project. With liability stemming from a duty to compensate in case of a loss. OPIC used its prerogative as a lender not to authorize the termination of the contract.

Point 25: PRI can be an instrument of financial planning.

6. Policy considerations in the Litigation Test

6.1. Overview

This chapter advances three main recommendations on policy themes in PRI. They read as follows: (1) *adequate boundaries between national and international law should be in place*, (2) *parties should enjoy autonomy to determine the scope of protection*; (3) *subrogation rights should be enforced*. To avoid misunderstandings, one stresses that “policy”, in this chapter, does not refer to the document of the insurance contract. It denotes a concern with the function of PRI. In other words, policy considerations establish how this product should be treated by adjudicators so that it better achieves the objectives entrenched in that function.

The three themes are latent in many of the cases discussed in the previous section. Directly or indirectly, they also crop up in the twenty-five points summarizing the argumentative path followed in this research. By no means these themes exhaust the considerations on if and how to regulate PRI as a discrete sort of insurance. Likewise, they do not allude to supervisory concerns on how authorities should use their powers to make sure the business of PRI is carried out with due respect to all stakeholders connected to PRI’s function.

6.2. Discussion

6.2.1. Adequate boundaries between national law and international law

a. PRI issues governed by national law and international law

At least in one dimension, the impact of PRI on states is straightforward. Host countries take PRI premiums as a measure of how business-friendly they are perceived to

be.⁸⁹ The pursuit of lower PRI costs originates many governmental initiatives on the national front, as well as in the international arena. In that respect, ratifying bilateral investment treaties is one of the most salient.⁹⁰ While the “obsolescing bargain” theory and the “institutional analysis” of political risk explain the theoretical interplay of national law and international law in foreign investment, one presents here a table with specific issues of PRI and the respective governing law. This is a good moment to do so. The nuances and dimension of the issues can now be better appreciated by reference to the benchmarks of the litigation test. What is more, such conceptual premise is crucial in advancing party autonomy to insured risks and the proper enforcement of subrogation rights.

a.1. Elements of the classification

There are two sources of law (national and international) and three categories of players (states, investors and insurers). The table draws an overview of the applicability of these two layers on PRI-related activities.⁹¹ The first layer (national law) represents vehicles through which political risk manifests itself. The second layer (international law) consists of constraints to political risks. The visual representation of those layers starts in the left and moves forward to the right of the table. They start with the state (main agent of national and international law), and advance to cover the activities of investors (main agent of investment) and insurers (main agent of insurance).

a.2. The perspective of the state

The manifestation of political risk through national law relates to typical state activities. While different classifications have been proposed, here one focuses on general areas of state activities.⁹² They encompass rules and practices (acts and omissions) in four areas: (i) the flow of investment; (ii) on-going regulations of business activities; (iii) contractual relationships between the state and the investor; (iv) protection in situations of

⁸⁹ Besides premiums for PRI, scholars point to two other market mechanisms to value risk: “implied risk spreads on international loan instruments” and derivatives. WHITE, Colin; FAN, Miao, *Risk and Foreign Direct Investment*, Basingstoke, 2006, 130.

⁹⁰ LAPPER, Richard, South Africa to sign deal with Zimbabwe, *The Financial Times*, 6. Nov 2009. Retrieved from <https://www.ft.com/content/83e07228-caf6-11de-97e0-00144feabdc0>. See also: MONTT, Santiago, *State Liability in Investment Treaty Arbitration, Global Constitutional and Administrative Law in the BIT Generation*, Oxford and Portland, 2009, 115.

⁹¹ See Annex, Table “PRI issues governed by national and international law”.

⁹² See Section 3.1.

physical danger. The table displays self-explanatory examples within each category. Investors and insurers operate in the receiving end of these activities. One should construe the respective columns as though they also listed these four elements. In turn, international law constrains state actions by creating obligations aimed at limiting political risk. PRI relates to the international law on foreign investment, its standards and mechanisms of settling disputes, but also to other areas of international law, notably those related to protection.

a.3. The perspective of the investor

National law is relevant to investors in two areas of action: (i) handling the direct consequences of political risk; (ii) outlining the main elements of the insurance product. Those actions have a common origin in the manifestation of political risk but pose different legal questions. There are two factors at play. Firstly, PRI compensations do not hinge on a state act being valid or invalid under the state's own law. Instead, they depend on the contract wording. Secondly, the PRI contract must be valid under the law where the interested party seeks enforcement, but that does not have to be the law where the risk lies, nor the law of the home state of the investor.

In the first area of action, national law allows the investor to sue the government for acts falling under the umbrella of political risk. In many cases, investors have remedies in equity to force changes, annul acts or otherwise directly impact sources of political risk. They are bound, in that respect, by the state's apparatus of law and justice. The second area of action relates to the insurance contract. National law is the basis for the autonomy to define the insured risk, the scope and the degree of compensation, among other issues. It is also the basis for the core of the "litigation test" carried out in this paper of cases among policyholders, insurers and brokers.

International law comes to the fore when the investor brings a dispute with the state to international arbitration. Ruling on the merits of these disputes, tribunals take matters of national law with a factual approach. Awards grant compensations but are inept to create effects in the national law. It follows that they do not force changes, annul acts or otherwise directly impact sources of political risk. On the other hand, subrogation rights play a decisive role in PRI and they have been discussed by investment tribunals and national courts. Although courts and tribunals do not favor the notion that the investment compensation should be dismissed or deducted by the insurance compensation, the table indicates subrogation rights as a relevant topic in both layers.

a.4. The perspective of the insurer

National law and international law jointly impact all three modalities of insurers (private, public and multilateral). On the risk perspective, the object of insurance is always conceptually linked to national law. Private and public insurers have additional touchpoints to it. To private insurers, national law governs regulatory and supervisory aspects of the insurance business.⁹³ On the policy perspective, national law governs the contractual and litigation issues with policyholders. Private insurers can be subject to international law in the context of subrogation rights, as public and multilateral insurers often are.

Public and multilateral insurers do not operate on a purely commercial basis. Their mandates are set in national and international law with rules on how they market their products. Finally, the table indicates that multilateral insurers are bound by international law in their contractual issues with policyholders.⁹⁴

b. Critical analysis of the proposed classification

PRI case law should conform to, not subvert, general principles of international law on foreign investment. By doing that PRI case law incorporates ground principles on how to deal with the boundaries of international standards of alien protection and national manifestations of sovereignty by states. Negotiated legal structures between investors and states, in fact, combining the two spheres of law, constitute the background for many political risk-associated disputes.⁹⁵ And international rules themselves carve out spaces in which investor-states disputes are settled on the premise that states maintain ample maneuvers under their national law.⁹⁶ On the other hand, from a more practical standpoint, PRI activities create connecting factors with several jurisdictions. A foreign investor in a given country can seek a

⁹³ This statement simplifies the multi-level regulatory dynamics of insurance. At least three planes concur in insurance regulation: the G20 and the Financial Stability Board; standard setters like the International Association of Insurance Regulation; and national regulators and supervisors. The European Union qualifies as a fourth plane. MÄCHLER, Monica, *Insurance Regulation and Supervision*, Material for the LL.M International Business Law, Specialization International Banking and Finance Law, University of Zurich, 2017/2018, 22.

⁹⁴ Where the contract and the Convention Establishing the Multilateral Investment Guarantee Agency [MIGA] do not cover the issue at dispute, general principles of law are applicable. Art. 14 of the “Contract of Guarantee for Equity Investment”. Retrieved from <https://www.miga.org/Documents/Contract%20of%20Guarantee%20for%20Equity%20Investment.pdf>.

⁹⁵ DOLZER, Rudolph; SCHREUER Christoph, *Principles of International Investment Law*, Oxford, 2008, 74.

⁹⁶ Art. 42 of the ICSID Convention.

broker in a third jurisdiction and eventually be insured by a carrier in a fourth location. The contract can be governed by the law of a fifth jurisdiction and the case be heard by the courts of yet another country.

A misguided understanding of these boundaries would lead to several problems. An obvious one is to admit that policies can be enforced only if the act from which the loss stems is qualified as an expropriatory act under national law. Overcoming this condition is one of the main factors for PRI. But rejecting instances of national law does not mean that international law conceptions are to be binding to PRI contracts. Foreign direct investment is normally linked to long-term projects, and some investor-state tribunals narrow the concept of investment for treaty protection to a certain duration.⁹⁷ From a contractual standpoint, however, no intrinsic restriction exists in respect of how seasoned or long-term oriented a project must be to gain eligibility to PRI. A coverage's duration is independent from the international law concept of investment. Another example would be to condition the payment of the compensation for political violence—as a matter of law and not as a matter of contract wording—to an international act recognizing the liability of the state for violations of human rights.

Since private, public and multilateral insurers in PRI are creatures of different types of law, it is worth mentioning how adjudicators have expressed concern with a level playing field in the market. Case law suggests how a shift occurred in the market regarding access to private and public insurers. The Federal Supreme Court of Switzerland laid down an explanation for why public insurers used to dominate PRI: “poor calculability and therefore lack of marketability of political risk”.⁹⁸ In turn, the England and Wales High Court mentioned a document by OPIC in which the American agency informed a potential client one of the requirements for policy to be issued. PRI would be offered only if investors “investigated the possibility of private political risk insurance with at least two insurers and insurance was not available on terms sufficient to make the investment viable.”⁹⁹

⁹⁷ DOLZER, Rudolph; SCHREUER Christoph, *Principles of International Investment Law*, Oxford, 2008, 60. SCHREUER, Christoph H.; MALINTOPPI, Loretta; REINISCH, August; SINCLAIR Anthony, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, Second Edition, Cambridge, 2009, 128.

⁹⁸ SWITZERLAND. Schweizerisches Bundesgericht. BGE 137 II 49 S. 50. The Court refers to the following work: BOEMLE UND AND ANDERE, *Money, Banking and Financial Market Dictionary of Switzerland*, 2002, p. 695

⁹⁹ UNITED KINGDOM. England and Wales High Court (Commercial Court). *Excalibur Ventures LLC v. Texas Keystone Inc & Ors* (Rev 1) [2013] EWHC 2767 (Comm) 13 December 2013, paragraph 130.

As a result, from being the only path to PRI, public insurers started taking a mandatorily residual market share. Bound by the same standards of law, if not by the same economic and political clout, public and private insurers shall compete on equal footing.¹⁰⁰

6.2.2. Party autonomy to determine the scope of protection

a. The idiosyncrasy of the risk

Standardization in PRI policies is hard to achieve.¹⁰¹ A continued business relationship between insurer and policyholder would not, by itself, change that. Two policies to protect similar projects in different jurisdictions tend to look completely distinct. Two projects in a single country bear diverse risk profiles, according to the risks' nature and to how they are allocated. Scholars acknowledge this circumstance. Political risk is idiosyncratic. It can be correlated to other manifestations in the same country or region, but its insurance cannot be decocted to the traditional elements of assessability, randomness and mutuality.¹⁰² Players pursue “individualized covers” and “unconventional risks”.¹⁰³

b. Autonomy as a response to adverse selection

Party autonomy copes with adverse selection in PRI. This sort of insurance is only advantageous when and to the extent that other mechanisms of risk mitigation fail or are inept. The province of PRI is not the starting point of a risk mitigation strategy. It is located rather at its end. Before getting insurance, a company first devises multiple strategies of business

¹⁰⁰ The Federal Supreme Court of Switzerland, deciding on how to interpret tax exemptions on the activities of credit insurance for political risks and PRI, argued, inter alia, that “there is no reason to treat privately offered credit insurance for political risks differently, even from the point of view of competition and equal treatment”. SWITZERLAND. Schweizerisches Bundesgericht. BGE 137 II 49 S. 50, Section 5.4. Freely translated.

¹⁰¹ As found, for instance, in the *United Nations Conference on Trade and Development Model Clause on Marine Hull and Cargo Insurance*. Retrieved from http://unctad.org/en/PublicationsLibrary/c4isl50rev.1_en.pdf.

¹⁰² This deviation is explained by the materials gathered in SCHEFER, Krista Nadakavukaren, *International Investment Law, Text, Cases and Materials*, Cheltenham, 2013, 512-513. These materials are quoted by the author as follows: OECD Insurance Committee, OECD Checklist of Criteria to Define Terrorism for the Purpose of Compensation: Recommendation of the Council (Dec. 15, 2004) and GORDON KATHRYN, Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development, in: OECD Investment Policy Perspectives 91-122, 93 (2008). Retrieved from: <http://www.oecd.org/finance/insurance/44230805.pdf>.

¹⁰³ Aon *Political Risk Insurance*. Retrieved from <http://www.aon.com/middle-east/risk-solutions/political-risk-insurance.jsp>.

development already imbedded with risk mitigation. But a PRI policy is no afterthought. Literature and case law show how insurers evaluate, monitor and sometimes interfere in the legal order of host countries. This happens when a policy is about to be issued, when a loss occurs, and even before, when the deal is being arranged.¹⁰⁴ Nevertheless, the tailoring of a policy is the counterpoint of the risk outlook in the final stages of a project architecture. An inflexible product that assuming static definitions of risk and reduces the ability of parties to strike individual risk-sharing deals. Curtailing party autonomy, on behalf of policyholder protection, would disfigure PRI into a luxurious item for extremely risk adverse companies, as opposed to an effective tool for companies of different sizes, budgets and risk profiles.

c. Difference in criteria between investment arbitration and PRI

Literature discusses PRI's granularity by focusing on expropriation clauses. The variety of criteria for the definition of expropriations in PRI litigation mirrors a variety of criteria for such definition in investment arbitration. Some scholars identify a mismatch in awards granting compensation to investors for losses caused by government takings. Instead of grounding such compensation in the classical principles that constrain expropriation, many awards ground compensations on the principle of fair and equitable treatment.¹⁰⁵ Termed as "the eclipse of expropriation", this phenomenon is considered to undermine secondary markets, such as that of PRI, which rely on the concept of expropriation.¹⁰⁶ But another way of putting it would be to advance, as some scholars do, that "an investor may have additional protection in a BIT as a result of the fair and equitable treatment standard".¹⁰⁷

¹⁰⁴ TAN, Celine, Risky Business: Political Risk Insurance and the Law and Governance of Natural Resources (May 18, 2015), *International Journal of Law in Context*, Special Issue on International Economic Law, Natural Resources and Sustainable Development, Volume 11, n. 2, June 2015. *Warwick School of Law Research Paper*, n. 2016/06. Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2607535, 10. See also a direct report from an English Court in the *Republic of Djibouti* case. "In the absence of any evidence from the banks themselves, it is not possible to say which particular provisions in the Joint Venture Agreement they required. What can be said with confidence, however, is that both the banks and MIGA, the political risks insurers, required the management of the DCT to be in the control of DP World, without the possibility of any interference from the Government." UNITED KINGDOM. England and Wales High Court (Commercial Court). *Republic of Djibouti & Ors v. Boreh & Ors* [2016] EWHC 405 (Comm) 02 March 2016, paragraph 648.

¹⁰⁵ States' rights to expropriate foreigners' property is subject to four conditions. The expropriation must be carried out in furtherance of a public purpose and in a non-discriminatory fashion. Due process of law and a compensation must be granted. KLÄGER, Roland, "Fair and Equitable Treatment" in *International Investment Law*, Cambridge, 2011, 295.

¹⁰⁶ REISMAN, Michael W.; DIGÓN, Rocío, Eclipse of Expropriation?, in: ROVINE (Ed.), *Contemporary Issues on Arbitration and Mediation, The Fordham Papers 2007*, Leiden, 2008, 45.

¹⁰⁷ HOBÉR, Kaj; FELLEBAUM, Joshua, Political Risk Insurance and Investment Treaty Protection, in: BUNGENBERG; GRIEBEL; HOBE; REINISCH (Ed.), *International Investment Law: A Handbook*, Baden-

Meanwhile, the fact that investment arbitration case law is not referred as authority, in PRI litigation, to define expropriation, does not prevent the outcome of specific arbitration awards from being confirmed in PRI disputes. This happened in the *Sempra* case. Further, the litigation test for PRI shows that courts have enforced very different levels of protection in expropriation policies based mostly in contract wording. The dissimilarities in PRI policies are not robust only in the definition of the risk of expropriation. They pertain to the effects risks have on the business, which translates into the degree of protection set in the amount of compensation. In the *Ace Capital* case, for instance, the policy was meant to kick in only if state actions made the protected enterprise “economically unviable”. In different circumstances, an asset-based policy will respond better to the needs of the parties. Finally, even though the contract wording was not clear, the *Bechtel* case shows that parties can use their autonomy to establish a specific triggering event. Instead of the loss *per se*, parties can agree that the claim hinges on a negative outcome in a dispute between the investor and the host state on the reparation for a loss.

6.2.3. Enforcement of subrogation rights

a. The interest in subrogation

In contrast to catastrophe insurance, losses a policyholder in PRI suffers can be directly or indirectly attributed to an identifiable legal entity. These legal entities are not always a state with the attributes of international legal personality. However, they tend to have perpetual succession and enough assets to cover their liabilities. In joint ventures and concession agreements, they are even backed by discrete legal arrangements and assets. In fact, the necessity to litigate against the government is an argument insurers use in their defense. In the *Bayview*, the Court rejected the argument that, before receiving his insurance compensation, the policyholder should have initiated a legal action against the Dominican authorities who caused the loss.¹⁰⁸

Baden, 2015, 1548.

¹⁰⁸ UNITED KINGDOM. England and Wales High Court (Commercial Court). *Bayview Motors Ltd. v. Mitsui Marine and Fire Insurance Company, Ltd. & Ors* [2002] EWHC 21 (Commercial). 23rd January, 2002, paragraph 34.

In tandem to this overall interest in subrogation, PRI counters the criticism that subrogation rights are only useful if the injurer is also covered by insurance.¹⁰⁹ No such scheme exists in PRI. Another pertinent criticism on subrogation rights relates to a long-term neutrality of its economic benefits. It rests on the assumption that “insurers who recoup their losses today will be paying out tomorrow to cover the liabilities of wrongdoers whom they insure”.¹¹⁰ Because the wrongdoers in this scenario, the states, are outside the pool of insureds, this observation does not hold true to PRI.

b. Economic analysis of subrogation

Bearing in mind the function of PRI, a general policy proposition suggests subrogation rights should be enforced so that satisfactory means of recovery drive costs of transaction down. The economic literature on insurance demonstrates the positive effects of subrogation rights.¹¹¹ PRI scenarios with subrogation rights are a case in point of optimal insurance contracts. For investors seeking PRI, the product is beneficial not only for the compensation; it eliminates the risk of litigation itself. In many cases litigation with government entities bears reputational consequences investors want to dodge. More important is preserving a good relationship that enable business to be resumed once a dispute arises.

Acceptance of subrogation rights in a PRI context has other benefits. As seen in the *Hochtief* and *Karaha Bodas* cases, both investment tribunals and national courts hold that insurance proceeds are not prejudicial to the investor’s claim against the injurer state. The argument that this helps shaping optimal subrogation provisions in general is also applicable to PRI.¹¹² Companies adopt risk-mitigating strategies in parallel to buying PRI. They generally take deductibles and do not buy coverage for the entire value of their assets in a given country.¹¹³ Pollinski and Shavell argue that, because of subrogation rights, “the receipt

¹⁰⁹ LOWRY, John; RAWLINGS, Philip, *Cases and Materials on Insurance Law*, Portland, 2004, 621.

¹¹⁰ *Ibidem*.

¹¹¹ POLINSKY, Mitchell A.; SHAVELL, Steven, Subrogation and the Theory of Insurance: When Suits Can Be Brought for Losses Suffered (March 9, 2017), *Stanford Law and Economics Olin Working Paper*, n. 506; *Journal of Law, Economics, & Organization*, Forthcoming; *Harvard Public Law Working Paper*, n. 17-04. Retrieved from <https://ssrn.com/abstract=2942448>, 3.

¹¹² *Idem*, 4.

¹¹³ Public and multilateral insurers have limits on the value of political risks they underwrite. For instance, “MIGA may insure up to \$250 million per project, and if necessary more can be arranged through syndication of insurance.” Retrieved from <https://www.miga.org/investment-guarantees/overview/terms-and-conditions/>. The *Ace Capital* case outlines that, in the private market, partial cover is common even if syndicates of several underwriters are in place. England and Wales High Court (Commercial Court). *Ace Capital Ltd v. CMS Energy*

of a share of damages by the insured will help to offset the portion of the loss not covered by insurance”.¹¹⁴ The authors also address moral hazard in a fashion that is relevant for PRI.¹¹⁵ Investors’ interest in eluding political risks translates into an enhanced compliance with the host state’s legal order. They do it because subrogation’s rights will not come to fruition if a court or arbitral tribunal finds that the investor took actions in clear disregard of the host state’s applicable law.

c. *The Halo Effect*

In public PRI, scholars mention the so-called halo effect. They suggest that “if a host knows that its political actions will harm an investor that is insured by the home state, the host may be less willing to engage in such action to preserve its political capital”.¹¹⁶ An empirical demonstration of this probably relative effect would have to control several variables among a wide range of projects with and without PRI. While this is not available, the litigation test shows that public PRI is not an absolute means of deterrence.¹¹⁷ The *Hochtief* and *Karaha Bodas* projects were backed by public PRI. That did not prevent the investors from suffering losses. In turn, subrogation rights of public insurers can lead to fully fledged disputes between sovereigns.¹¹⁸

Bilateral investment treaties frequently establish an explicit subrogation clause for payments made by the contracting states in public PRI. Scholars point to a limitation in these

Corporation [2008] EWHC 1843 (Comm) (30 July 2008) ([2008] 2 CLC 318, [2008] EWHC 1843 (Comm), [2009], paragraph. 4. See also: SCHEFER, Krista Nadakavukaren, *International Investment Law, Text, Cases and Materials*, Cheltenham, 2013, 514.

¹¹⁴ POLINSKY, Mitchell A.; SHAVELL, Steven, Subrogation and the Theory of Insurance: When Suits Can Be Brought for Losses Suffered (March 9, 2017), *Stanford Law and Economics Olin Working Paper*, n. 506; *Journal of Law, Economics, & Organization*, Forthcoming; *Harvard Public Law Working Paper*, n. 17-04. Retrieved from <https://ssrn.com/abstract=2942448>, 5.

¹¹⁵ *Ibidem*.

¹¹⁶ SCHEFER, Krista Nadakavukaren, *International Investment Law, Text, Cases and Materials*, Cheltenham, 2013, 532.

¹¹⁷ Scholars compare the role of public insurers in the “deterrence against the prospect of suffering loss” to services providers who not only would install lightning rods, but would also attempt to influence the weather. MORAN, Theodore H., *Foreign Direct Investment and Development: The New Policy Agenda for Developing Countries and Economies in Transition*, Washington, 1998, 147-148. The coverage of “creeping expropriation” by public insurers is considered another example of this deterrence, as “no host country, many investors reasoned, would squeeze a project that involved money or insurance from the World Bank and aid donors”. WELLS, Louis T.; AHMED, Rafiq, *Making Foreign Investment Safe*, Oxford, 2007, 90.

¹¹⁸ *Request for Arbitration Under the Investment Incentive Agreement Between the Government of the United States of America and the Government of India*, 19 November 1997. Retrieved from <https://www.opic.gov/sites/default/files/docs/GOI110804.pdf>. Some insurance schemes, although backed by governmental agencies, do not target PRI as such. Credit insurance in the context of exports comprise one such scheme. They too entail litigation as seen in the *Enterprise Tools* case.

clauses: they allow for a subrogation of rights, but not for access of the subrogated state to the dispute settlement of the ICSID. As a result, no State-State investment arbitration takes place under the ICSID.¹¹⁹

d. Subrogation and disclosure

Companies sometimes have an interest in not disclosing a PRI coverage to their own subsidiaries. The rationale for that lies in obviating that subsidiaries incur in unnecessary risk created by moral hazard.¹²⁰ Scholars suggest that host states themselves are subject to moral hazard. If states assume insured foreign investors can cope well with losses, they might behave in a way that “indirectly harms the international community’s interest in accountable, rule-of-law-abiding states”.¹²¹

What is more, the necessary disclosure of the coverage to the state begs the question of when this disclosure should be done. The spectrum for possible occasions is wide. Would it be from the moment negotiations with a broker start? Could it be when a policy is underwritten? Other possibilities would be when the dispute arises or when the litigation starts. The absence of a generally accepted standard renders the disclosure analysis one with variations on a case-by-case basis. This is critical in an industry in which letters of commitment may be subscribed by insurers to reserve capacity and, yet, no deal and no policy ever be issued.¹²² Since different policies have different triggering events, it is highly speculative to pin down a specific moment in time in which disclosing makes sense.

¹¹⁹ Three main reasons are: a strict interpretation of the ICSID Convention, which provides for the settlement of disputes between States and nationals of other States; the Convention’s aim of depoliticizing disputes; the option of excluding states as claimants stated in the *travaux préparatoires* of the Convention. SCHREUER, Christoph H.; MALINTOPPI, Loretta; REINISCH, August; SINCLAIR Anthony, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, Second Edition, Cambridge, 2009, 187.

¹²⁰ DUNNING, John H.; LUNDAN, Sarianna M., *Multinational Enterprises and the Global Economy*. Second Edition, Cheltenham, 2008, 237. Scholars also use the term “moral hazard” to refer to the situation in which the insurer has less information on the risk factors than the insured. The insured would not have an incentive to adopt risk-mitigating actions, as the gains from such mitigation will be enjoyed by the insurer. WHITE, Colin; FAN, Miao, *Risk and Foreign Direct Investment*, Basingstoke, 2006, 18.

¹²¹ SCHEFER, Krista Nadakavukaren, *International Investment Law, Text, Cases and Materials*, Cheltenham, 2013, 532.

¹²² UNITED KINGDOM. England and Wales High Court (Commercial Court). *Excalibur Ventures LLC v. Texas Keystone Inc & Ors* (Rev 1) [2013] EWHC 2767 (Comm) 13 December 2013, paragraph 109.

7. Conclusion

The political risk connection to several fields trickles down to a complex underwriting process adaptable to different historical and economic settings. Its definitions can encompass any non-business alterations in a company's realm of activity, but PRI assumes the officiality of the causative agent. The categories in this class of risk vary in accordance to how different businesses work, and to macro and micro magnitudes. Developed in the scholarship of the international law on foreign investment, the obsolescing bargain theory and the institutional analysis lay the foundations for insurance strategies that optimize the moment and the duration of coverage. PRI compensations do not formally depend on the qualification of state acts in national or international law. They are complementary to other remedies available to investors, especially those in international law.

If taken as one coherent piece of law, the cases assessed in this paper support a detailed delineation. The protection in PRI can be determined according to the effects of the government action in the entire business or only in some of its assets, as well as that PRI is not the sole form of covering risks derived from government actions or the political situation in a country. A political risk cover within a credit insurance concerns the effects of political risk on the credit claim, not the assets. The lack of protection within the legal framework of a country is not, by itself, an insurable risk. The determination whether the object of a contract conforms to a PRI framework can be made through a premium-value analysis. Courts can interpret policies on the categories of covered risks, and on the extent of the covered assets. The triggering event in a policy is not necessarily the loss suffered by the policyholder—it can be the negative outcome in a dispute between the investor and the host state. The definition of investment is relevant to PRI. In defining it, courts look at the contract and not at general definitions of national or international law. The notoriety of political risk in a country can be a criterion to determine the legitimacy of expectations parties have about a PRI policy. On subrogation rights, the cases point to the fact that they do not frustrate politically acceptable means of exercise by sovereign states; and that a subrogation clause in an investment treaty creates a duty on the host state, not on the home state. Courts hold that insurance compensation does not comprehend a dismissal or a deduction of the investment compensation and that PRI does not alter the risk allocation agreed by the parties in insured projects.

From a deep-dive in the practical determinants of PRI case law, the paper advances three recommendations. First: adequate boundaries between national and international law should exist, so that PRI supports the legal framework of foreign investment.

Second: party autonomy to determine the scope of protection should allow parties to create tailor-made coverages. Third: subrogation rights should be enforced, so that policyholders and insurers can extract the full economic benefits of insurance contracts.

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Annex

Table 1, PRI issues governed by national law and international law

Law/Agent	States	Investors	Insurers
National	<ul style="list-style-type: none"> Flow of investment <i>Currency conversion and transfer of funds</i> On-going regulation <i>Public policies and specific measures (direct and creeping expropriation)</i> Contractual relationship <i>On-going regulations and contractual breaches</i> Protection <i>Violence, War and Terrorism</i> 	<ul style="list-style-type: none"> Consequences of risk <i>Legal actions against the state with remedies in equity</i> Insurance product <i>Definition of risk, scope and degree of compensation</i> <i>Distinction from other types of insurance</i> <i>Legal actions against insurer and broker</i> 	<ul style="list-style-type: none"> Private Insurers <i>Regulatory and supervisory aspects</i> <i>Contractual issues</i> Public Insurers <i>Mandate</i> <i>Contract</i>
International	<ul style="list-style-type: none"> International Law on Foreign Investment <i>International standards of treatment and dispute resolution</i> International Law on issues of protection <i>General International Law on issues of protection</i> 	<ul style="list-style-type: none"> Investor state disputes <i>Matters of national law qualified as facts</i> <i>International standards limited to the right of compensation, with dismissal or deduction of insurance compensation</i> 	<ul style="list-style-type: none"> Public, Private and Multilateral <i>Subrogation rights</i> Multilateral Insurers <i>Mandate and contract</i>

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