

2024 Spring Conference

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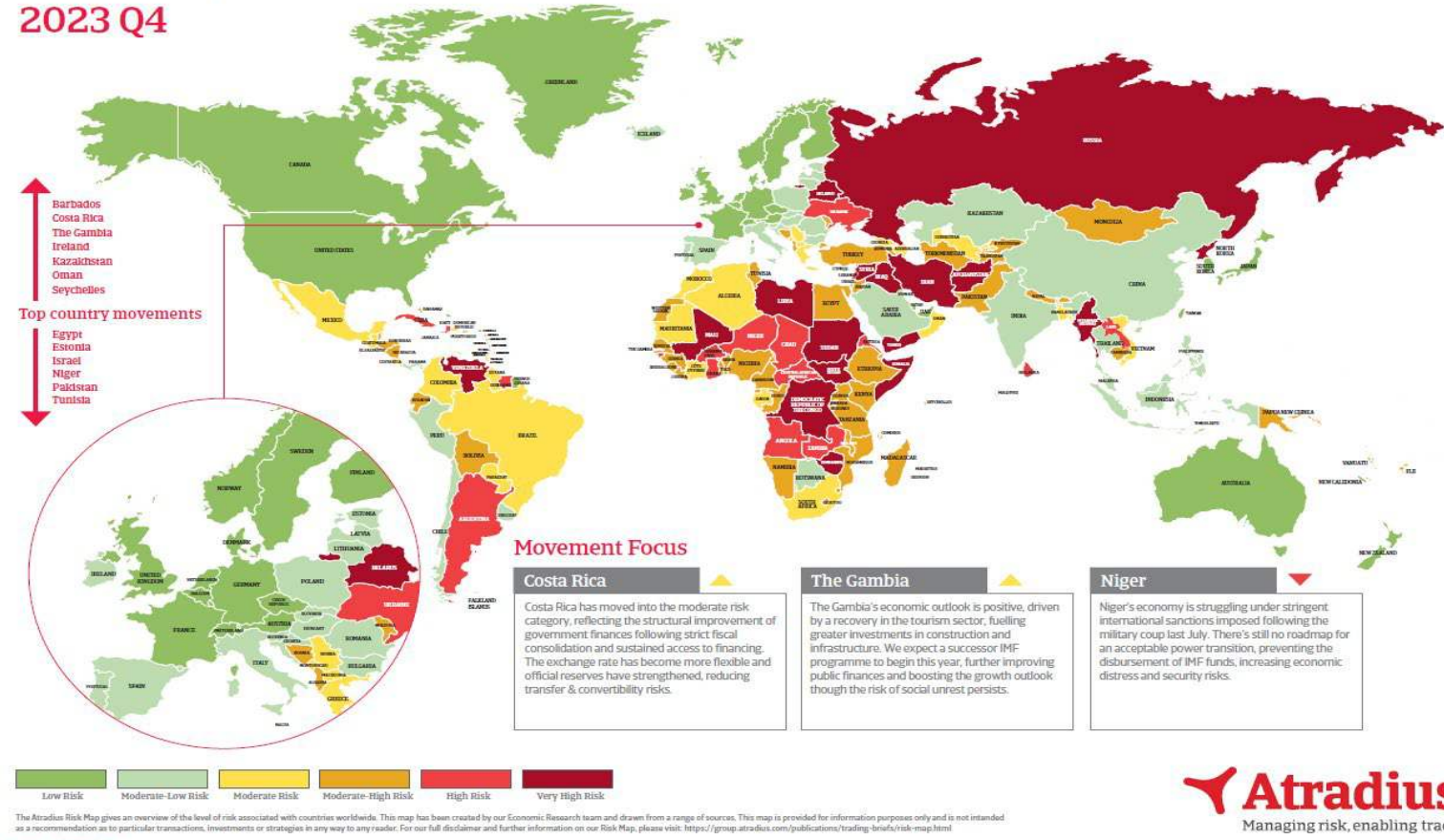


Hot Spots and Hot Policies: Political Risk Insurance in Today's Volatile World

May 2, 2024

Investor Protections in an Uncertain World: Political Risk Hot Spots

Country Risk Map 2023 Q4



The Basics

What Is Political Risk Insurance (PRI)?

- Insureds can be **lenders or equity** investors
- Covers actions taken by host Government or possibly others (if PV)
- Basic perils covered: **Expropriation/CEND** (including Creeping Expro), **Political Violence** (PV), **Currency Inconvertibility/Non Transfer** (CI/NT)
- **Arbitration Award Default** can be added on where a parastatal has entered into a commercial contract
- For Expropriation/CEND and CI/NT, **waiting period** usually 180 days. Zero WP for PV.
- PV may require a deductible. Programmes usually QS except large multicountry programmes are primary/excess
- **Subrogation** is key

What Are International Investment Agreements (IIAs)?

- Agreements between states set minimum standards of protections for investors, may be bilateral (BITs) or multilateral (MITs) or in free trade agreements (FTAs)
- Covers investors based on *nationality*, but only for covered “investments”
- Only covers actions by *host states and instrumentalities*
- **Basic protections:** National Treatment, Most-Favored Nation Treatment, Fair and Equitable Treatment, Full Protection and Security, Expropriation
- **Enforcement:** Investor can initiate arbitration proceedings against the state



PRI Perils

Expropriation	License Cancellation	Sabotage
Confiscation	Import & Export Embargo	Terrorism
Nationalisation	Currency inconvertibility	(Usurped Power)
Deprivation	Non transfer	Forced Abandonment
Requisition	Political Violence	Arbitration Award Default
Sequestration	War & civil war	Denial of Justice
Law, order, decree, administrative action	Insurrection, revolution, rebellion	Non certification
Selective Discrimination	Coup d'etat	Unfair Calling of Bonds
Forced Divestiture	Strikes, Riots, Civil Commotion	Fair Calling of Bonds



Size and Growth of PRI Market

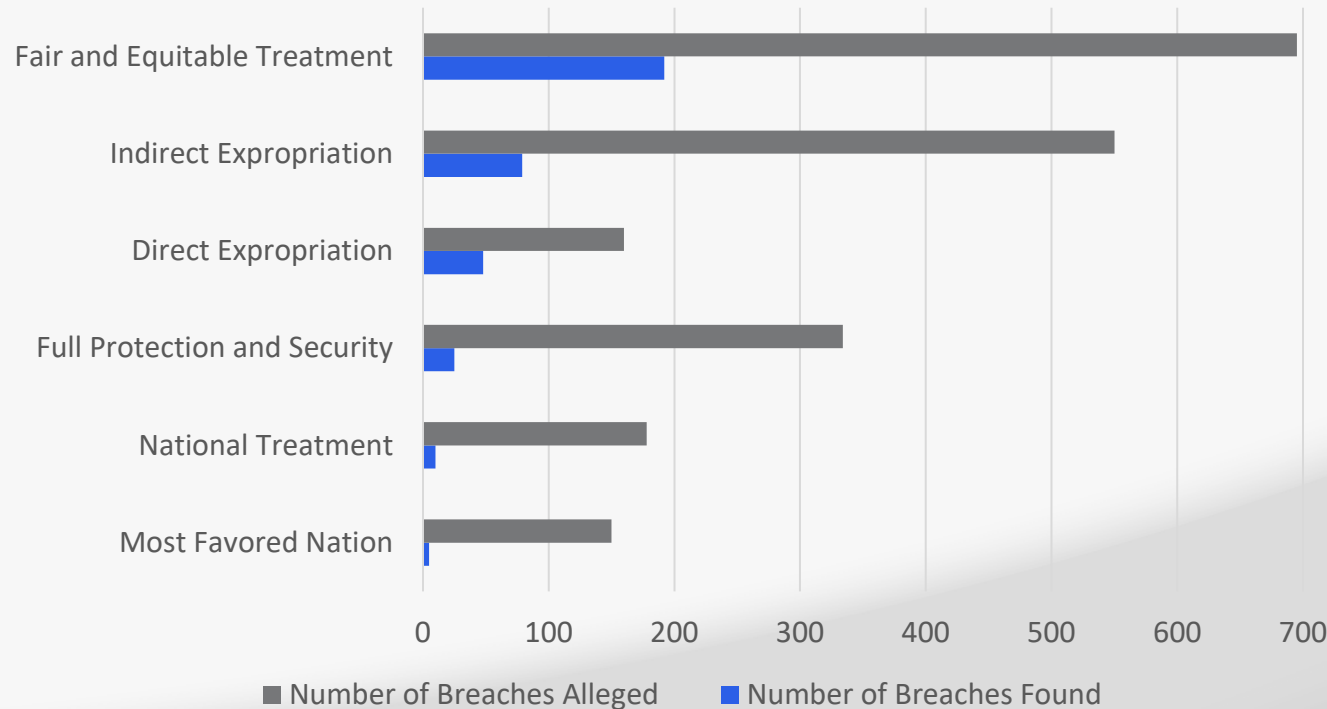


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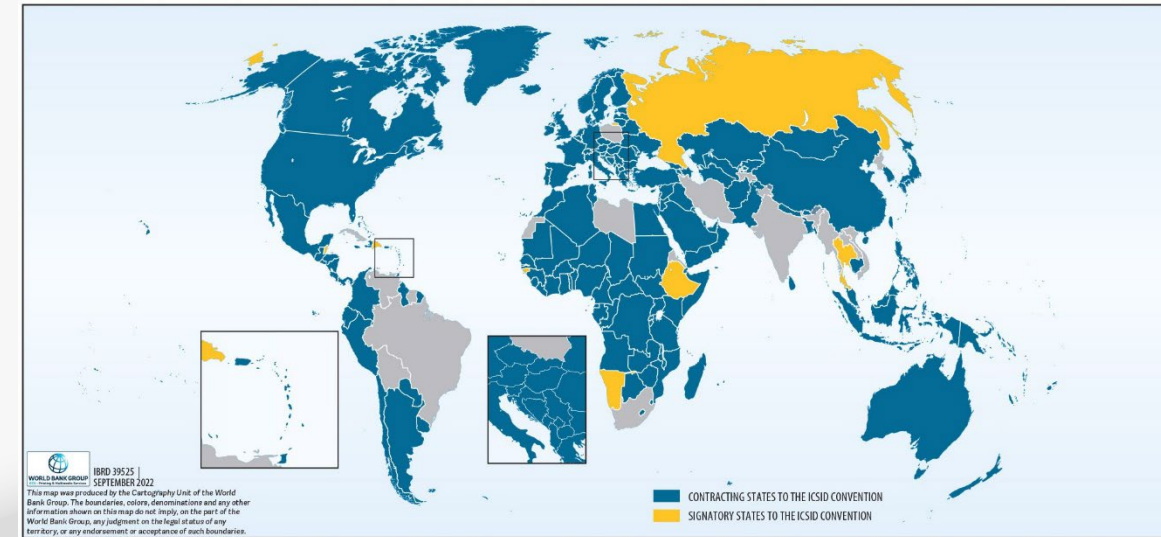


Investment Treaty Protections

Investment Treaty Breaches Through December 31, 2023 – Alleged and Found (Source: UNCTAD)



States Party to the ICSID Convention



Expropriation / CEND

Political Risk Insurance

- Slight differences between **Confiscation** (physical taking), **Expropriation** (property rights), **Nationalization** (by exec or legislative order)
- Permanent deprivation
- **Deprivation:** denied the possession of whole or part of (mobile) assets
- **Selective Discrimination, Forced Divestiture**
- **License Cancellation**
- **Import/Export Embargo**
- **Non-certification** (of invoices or documentation)
- **Creeping Expropriation** – term used for cumulative effect of many smaller government actions

International Investment Agreements

- A host state cannot **expropriate** an investor's property unless the expropriation is:
 - (1) for a public purpose;
 - (2) non-discriminatory;
 - (3) accompanied by “prompt, adequate, and effective compensation”; and
 - (4) carried out in accordance with due process of law.
- Expropriation may be “direct” or “indirect”



Expropriation/CEND

Case Studies

Agroinsumos Ibero-Americanos v. Venezuela (2016)

- Spanish agricultural firm owned 59 stores across Venezuela and employed 2,000 workers.
- The government under Hugo Chavez carried out a series of judicial and administrative measures that effectively transferred control of the business to the state.
- Agroinsumos alleged the government actions amounted to direct expropriation

Clorox v. Venezuela (2015-2023)

- Clorox Venezuela, a subsidiary of Clorox Spain, had been operating in Venezuela since the 1990s.
- The Maduro government implemented various measures that affected Clorox's ability to do business, including setting mandatory price controls below Clorox's the cost of production and limiting its ability to access to foreign currency.
- These measures ultimately caused Clorox Venezuela to shut down operations. After Clorox shut down, the government moved into its factories and began manufacturing "Clorox" products, which it sold domestically.



Discrimination

Political Risk Insurance

- “The imposition of any law, order, decree, regulation or import/export restriction selectively and discriminately imposed specifically against the Foreign Enterprise within the Policy Period by the Government of the Host Country which, in circumstances beyond the control of the Insured expressly and selectively prevents the operation of the Foreign Enterprise so as to cause the permanent and total cessation of the Foreign Enterprise's Activities.”

International Investment Agreements

- These types of measures may violate:
 - **Expropriation**
 - **Fair and Equitable Treatment**: State action that is arbitrary, abusive, or amounts to a denial of justice
 - **National Treatment**: Host state must treat foreign investors no less favorably than domestic investors
 - **Most Favored Nation Treatment**: Host state must treat foreign investor subject to treaty no less favorably than investors from any third state



Discrimination

Case Studies

Total v. Argentina (2011)

- Total owns gas distribution and electricity generation investments in Argentina.
- Argentina freezes gas tariffs and then introduces price and volume controls; rewrites the regulatory regime for electricity generation and dispatch
- Total forced to sell its assets and leave the country
- ICSID tribunal finds measures inconsistent with Total's legitimate expectations and breach of duty of fair and equitable treatment; no state of necessity

Lemire v. Ukraine (2013)

- U.S. investor in Ukraine radio frequencies sought to expand business, but denied the opportunity to purchase additional radio frequencies, where local companies received preferential treatment.
- ICSID tribunal found breach of fair and equitable treatment, including test for discrimination
- Also found denial of justice in failure to protect rights in local courts.



Currency Inconvertibility/Non-Transfer

Political Risk Insurance

- Inability to convert local currency into hard currency (convertibility)
- Inability to transfer hard currency out of host country
- Insurer is subrogated to the local or foreign currency in host country
- Value of recoveries improve over time as economy improved
- Devaluation NOT covered.
- Shareholder loans / dividends / foreign bank loan repayments

International Investment Agreements

- These types of measures may violate:
 - **Expropriation**
 - **Fair and Equitable Treatment**: State action that is arbitrary, abusive, or amounts to a denial of justice.



Political Violence

Political Risk Insurance

- Covers **physical/property damage** caused by political violence
- **Forced abandonment (FA)**: insured is formally required to abandon foreign assets/evacuate staff due to unsafe environment. **Not necessarily property damage**
- Usually has a deductible (except when a lender is insured)
- **Business interruption** following PV as an add on

International Investment Agreements

- May violate host state's obligation to provide investment with "**full protection and security.**"
 - Host state may not directly harm investors/investments through force or military action
 - Host state must take active measures to protect investors and investments against harm inflicted by non-state actors



Political Violence

Case Studies

Coca Cola v. Certain Underwriters at Lloyd's, 2017 WL 1282159 (N.D. Ga. 2017)

- Coca Cola owned a bottling plant in Nepal. It relied on trade across the India/Nepal border to import materials and export product.
- In 2015, the Nepalese Government implemented a new constitution that discriminated against a minority group, the Madhesi.
- The Madhesi began widespread protests, including blockading the India/Nepal border.
- As a result, Coca Cola had to shut down its bottling operations for 6 months.

Ampal-American Israel Corp. v. Egypt (2012)

- U.S. incorporated companies were shareholders in Egyptian company that owned a natural gas pipeline.
- Pipeline was attacked 14 times by terrorists during the Arab Spring uprising.
- Egyptian government failed to protect pipeline from attacks even though previous attacks showed pipeline was susceptible



Exclusions

Political Risk Insurance

- **Host Government as a counter party**
- Possibly **5 Great Powers** (though less common now)
- **Bona fide** government actions (environmental protection very topical. Covid lockdowns also good example)
- Corruption / **illegal acts** by Insured
- **Cyber actions** (for PV only, which is a Lloyds requirement)

Also note that policies are **CONFIDENTIAL** and existence cannot be disclosed

International Investment Agreements

- **“Right to Regulate”/Public Policy Exceptions:** Measures by host government necessary to protect human/environmental health, conservation of natural resources
- **Security Exceptions:** Measures by host government necessary for maintenance of public order



Quantum/Damages

Political Risk Insurance

Loss calculations are prescriptive.

- For CEN, Selective Discrimination and Forced Abandonment, usual calculation of loss is **Net Investment Value**
- For Deprivation: **Book Value**
- Forced Divestiture: **Net Investment Value less salvage from selling shares**
- PV: **repair for damage or Book Value**
- Licence Cancellation: **Net Investment Value**

Net Investment Value example: equity + pro rata RE + shareholder loans + bank loans + A/P less A/R from insured [+equipment carried on foreign enterprise's books].

International Investment Agreements

- Treaties usually silent on methods of valuation
- Common approaches:
 - **Fair Market Value**: What a willing buyer would pay to a willing seller prior to state's wrongful act
 - **Discounted Cash Flow Analysis/“But for” counterfactual**: value of investment “but for” state's wrongful act
- Modern approach is to award compound interest



Hot Topic 1: Russia/Ukraine

- **PV Ukraine** claims under multi-country policies although many markets weren't writing Ukraine since 2014
- **CI/NT Russia** claims (non convertibility of dividends, shareholder loans or share sales)
- Is leaving Russia as a “good corporate citizen” **Forced Divestiture?**
- Other **Expropriations?**
- **Political events** have also triggered losses under Credit Insurance Policies
 - Commercial loans have defaulted due to non receipt of USD/EUR from a sanctioned entity
 - Sales of loans into the secondary market have crystallized losses for the haircut amount
- **What about IIA claims?**



Hot Topic 2: Sovereign Debt Defaults

- Not covered by PRI but covered by **Contract Frustration (CF) cover**
- Recent sovereign debt defaults highlight volatility of emerging markets for lenders and contractors (Sri Lanka, Zambia, Suriname, Ghana, Congo, Ethiopia)
- Sovereigns may trigger a non payment event covered by a CF policy either via a wholesale debt restructuring or selective default under specific contracts
- Purpose of obligation (lending vs wheat importation) and prioritization are key

- **What about IIA claims?**



Two Sides of the Same Coin: Effective Risk Management Through PRI & IIA Rights

- PRI provides comparatively rapid relief, provides investor “breathing room” to pursue investment claims as required under any insurance compensation
- Recovery under both PRI and IIAs possible but need to be careful
- Differing standards of protection may allow investor protection where coverage is barred under the other
- Differing standards of compensation: Full value + interest vs. policy limits



Questions?

