Volume I, Issue 2

October 2005

political risk insurance newsletter

robert wray PLLC 1150 connecticut avenue, nw suite 350 washington, dc 20036

Inside this Issue

Insuring Arbitration Outcomes

By Felton (Mac) Johnston and Robert T. Wray

INVESTORS who rely on international arbitration of contract disputes with sovereign counterparties must be prepared to live with the fact that under the best of circumstances arbitration can be a lengthy process -- and may have perverse results. Most investors, however, do not want to assume the risk that an award in their favor cannot be enforced or that, on account of the sovereign's intransigence or conditions in the host country, the arbitration process will be frustrated, resulting in no award. Timely enforcement even of an ICSID award is not a sure thing.

Arbitral Award Default Coverage – If the Sovereign Fails to Honor the Award

The political risk insurance (PRI) market does offer some solutions. Investors can protect themselves by purchasing Arbitral Award Default (AAD) coverage, which offers compensation in the event that the investor is unable to obtain timely enforcement of an international arbitral award arising from a contract dispute with a sovereign. AAD coverage is sometimes called "breach of contract," but "arbitral award default" is a more accurate designation.

Wordings, of course, vary greatly with the underwriter and with the degree of manuscripting (*i.e.*, contract tailoring) that goes into the individual policy, but AAD coverage usually includes these fundamentals:

- The investors (or the project company from whom they derive their interest) must receive a monetary award against the sovereign, whose obligation may be as contracting party or its guarantor. In some cases a sub-sovereign entity may be acceptable to the underwriter.
- The award must issue from an international arbitration panel.
- The award must be final, binding and non-appealable. To be "final and binding", an award must not be subject to further review by the arbitral panel that properly rendered it. The award also must not be subject to appeal to any other panel or authority. The conditions for appealing an ICSID award are very limited (even if often resorted to), but this may not be so with other forums where the courts may find rights to appeal under general conditions of international law, even if the underlying agreement pursuant to which the arbitration was initiated does not say so.
- The award must be legally enforceable in the place where it is sought to be enforced. Most nations are party to a 1957 international treaty on reciprocal enforcement of arbitrations and arbitral awards known as the "New York Convention."
- The insured must make reasonable efforts to enforce the award, but be unable to do so within some defined waiting period. Such waiting periods may vary from 30 days to as much as a year. "Reasonable efforts" calls

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Interview with Malcolm Stephens of IFC Ltd.

Malcolm Stephens, CB, is well known in trade credit and political risk insurance circles, having served as Chief Executive of the UK export credit agency ECGD, as Secretary General of the International Union of Export Credit and Investment Insurers, and in senior government and banking positions. He has also assisted in the establishment and development of ECAs in Eastern and Central Europe. Mr. Stephens is a prolific writer and speaker as well as a consultant on export and trade, project finance and export credit and investment insurance. He is Group Chairman of International Financial Consulting Ltd.

Q: To what extent do you see an erosion in the boundaries between (a) PRI and Trade Credit Insurance and (b) PRI and financial guaranties. In each case, what are the implications of this erosion?

A: It seems to me that the whole market for PRI, Trade Credit Insurance and Investment Insurance/PRI is in a state of change and flux. In an important sense, this is

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Interview with Malcolm Stephens (cont'd.)

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nothing new. However, some of the changes are so fundamental as to call into serious question the way this sector of the insurance market operates. There is an increasing overlap between what used to be called Investment Insurance but which is increasingly swept up into the category of PRI and export credit insurance, especially medium and long term facilities (MLT). In the past, investment insurance related only to equity investments but all that changed when it began to be applied on any scale to loans and especially to "free standing" project loans not associated with equity investments - a category of business which now dwarfs equity insurance facilities. The growth of project financings where the insured risks relate not to the strength of the buyer/borrower/guarantor but to the viability of the project itself made things more complicated, especially where project viability and important parts of the security package depend on undertakings etc. from host governments to do certain things and not to do other things. Any traditional boundaries of any significance were further eroded when Export Credit Agencies (ECA's) and others became willing to issue "Political Risk Only" export credit cover for project loans.

Another traditional market distinction or boundary has been between political risks and commercial risks. But here again, there is now overlap and an increasingly grey area between the two. I wonder how valuable this traditional distinction and categorisation now is. For example, it is not clear where or how risks should be categorised in the increasingly important area of exchange rate movements. Are the risks political or commercial? Or does this really matter for so long as it is clear whether they are covered or not? And what about the risks of a failure of a government or quasi-government entity to fulfill its contractual responsibilities or to meet its undertakings or default by a sub-sovereign or quasi government buyer?

> "I know that some insurers—including some long standing and large ones—feel that fuzzy wording preserves their flexibility and freedom of action and some brokers also favor some degree of uncertainty to prove the value of their involvement. But I think they are wrong."

Arguably, Trade Credit Insurance will most commonly apply to credits of less than two years. This is a fairly clear area where most of the business is now done by short term (ST) credit insurers, very often by one of the "Big Three" of Atradius, Euler Hermes or Coface.

In the MLT area, especially where project financings are involved, the position is more complicated and there are a variety of insurers, both private and public. But, against the background I have mentioned earlier, I am not at all clear that any traditional boundary between PRI and other facilities is of much value to anyone. The key is surely in this area, as in so many others, a clear definition of what risks are being covered and not how they are categorised.

Q: Would more precise policy language be a benefit? If so, to whom?

A: The answer to this must be "Yes". Clearer wordings would help everyone. Whatever the conventional wisdom, my clear view is that it helps no one for there to be fudging or uncertainty or lack of clarity, deliberate or otherwise. Both insurers and insureds need to know before the issue of a facility whether a risk or situation is covered or not. The worst time to find this out or to uncover a difference of view is at the claims stage. What happened in Argentina and Indonesia is a good example of these points. I know that some insurers - including some long standing and large ones - feel that fuzzy wording preserves their flexibility and freedom of action and some brokers also favour some degree of uncertainty to prove the value of their involvement. But I think they are wrong. Even in crude marketing terms, it is very desirable for insureds to know what they are buying - "It will - probably - be all right on the night" does not seem to me to be a very good product from anyone's point of view!

A linked area is, I think, the desirability of much clearer wordings in the traditional exclusion, especially in reinsurance arrangements for credit insurance, of financial guarantees. I should like to see this exclusion much more clearly explained with examples, so that all parties know where they stand without leaving things to be sorted out by the courts or arbitrators after rejection of a claim.

Q: Can (and should) product improvements restore demand for CI and CEN products? What Improvements do you think are needed?

A: I would personally favour a rather wider or more radical approach. I should begin from the position of trying to establish in as much detail as possible what investors or lenders or exporters really want and need. Brokers could play a useful role here in teasing out and articulating this in terms of perceived risks, etc. But it could also be a very useful part of what I see as the essential dialogue between insurers (especially underwriters) and insureds. I do not believe that any refusal of underwriters to meet or talk direct to insureds is helpful to either party, whatever the traditional position may be. Such a direct dialogue - or willingness to have such a dialogue - is surely crucial to the establishment and development of mutual understanding and mutual trust.

This market research and dialogue should help to establish what insureds see as the main risks they want to be covered. Insurers can then better consider whether they are willing to provide such insurance.

Such a process would seem to me to be much more likely to lead to relevant new products and clarity of wordings than simply tinkering with traditional products, however popular this may have been in the past. At the risk of caricaturing the position, I sometimes see the painful step by painful step approach of "widening" the creeping expropriation area of an example of what not to do.

Q: What is the future market for conventional PRI, especially since CI and CEN seem to have diminished?

A: Insurance is a cyclical business and so is demand for some insurance products. As I have said earlier, the whole area of inconvertibility and exchange rate movements has caused problems and disillusion amongst insureds. This will continue until wordings are clarified and insurers decide in more detail what risks they are and are not prepared to underwrite in this complex area. In my view, insurers would do well to steer well clear of underwriting future exchange rate movements per se. Better leave this to the banks and their forward exchange products. Similarly I would avoid trying to compete with the more esoteric options products.

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Interview with Malcolm Stephens (cont'd.)

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As for CEN, I agree that most investors seem to have decided that they are not concerned about confiscation or nationalisation risks. Personally, I think they are wrong. And I thought this long before Yukos.

Q: What future role do you see for public sector political risk insurers?

A: This is fascinating, especially for me. As I have said earlier, fashions and the market change and insurance is a cyclical business. And this is an area where myth abounds. For example the whole raft of assertions that "Only public or government insurers will do....". This is, for example, very often said of facilities for small exporters.

Usually these assertions are half truths or just plain untrue. And you do not need to be a total cynic to sense that some public insurers are looking for a "new" role or seeking to prove that in some areas they have or need to have a monopoly, given the significant growth of private sector activities and capacity.

Public insurers continue to face serious problems, especially when - in theory at least - they are precluded from competing with private insurers. And as their financial objectives are tightened, their accounting arrangements made more open and transparent and as they are told to be "more commercial", so they face what I have long seen as the sheer impossibility of achieving both of the twin objectives of breaking even/not making losses and accumulating reserves/provisions whilst not competing with private insurers. The key here is whether or not in the real world there is a sufficient volume of "non-loss making" business which the private sector is unable/unwilling to do so as to provide the public insurers with sufficient premium income not only to the meet claims and losses but also to pay their overheads and administration costs.

In my view, in the ST trade finance area, sooner or later the only role for the public sector will be to provide contingent reinsurance against the possible severe contraction of the private reinsurance market. Apart from all else, very few public insurers now have the IT power or buyer status records or economies of scale or the credit limit expertise to produce or operate world class and internationally competitive ST facilities, including for small exporters

The MLT area is more complex, difficult and sensitive. Cases often have a very high value and very long horizons of risk. However, for insurers to be able to offer an efficient and valuable service to exporters and lenders, they would need to be handling cases on a day to day basis. Only then will staff have the necessary up to date market knowledge and relevant current technical expertise. This is not a theoretical area. You need to be in the market or out of it. Insurers can't be mothballed and brought back into fully operative and efficient life by the kiss of some prince!

> "...the whole area of inconvertibility and exchange rate movements has caused problems and disillusion amongst insureds. This will continue until wordings are clarified and insurers decide in more detail what risks they are and are not prepared to underwrite in this complex area."

For the future, I confess to increasingly holding the view that for MLT business, the medium and long term role of the public sector may best be to leave the fronting and processing of business to private insurers and for the public contribution to be as providers of capacity or reinsurers. MIGA, as a multilateral IFI, may be the exception for various reasons.

I appreciate of course that this view may not be universally welcomed but it is surely better than death by a thousand cuts or "reviews". Many of my former colleagues may strongly disagree with me, but I cannot escape the feeling that a reinsurance/capacity provider role begins to have a certain inevitability about it. ■

Insuring Arbitration Outcomes (cont'd.)

(Continued from page 1)

for the insured to seek enforcement in the local courts, and depending on the circumstances may also require the insured to seek enforcement elsewhere.

- Compensation is typically limited to the insured investor's (or lender's) share of the award. One insurer places a "book value" limitation on compensation, which could be problematical, especially if the book value calculation is determined as of the date of the award, or the end of the waiting period, by which time the events giving rise to the arbitration might have severely degraded the value of the enterprise. It may be possible for investors to negotiate more favorable wordings.

Insurance protection equivalent to AAD might arguably be implied in an insurer's expropriation coverage wordings that refer to deprivation of the investor's fundamental rights, to creditors' rights, or to the host government's violation of international law. There is a case to be made for policy language that is broad and embracing, in order to capture things that a more precise enumeration of the circumstances of expropriation might miss. But most investors seeking AAD protection will be unwilling to assume that there is sufficient safety in such generalities, and will want explicit AAD coverage instead (or in addition).

Explicitly worded AAD coverage is sometimes embedded in the policy's expropriation section, rather than being set out as a separate coverage. This can be a bad idea because exclusions and limitations appropriate to standard expropriation coverage may confound effective AAD coverage or confuse its meaning. And whether part of expropriation coverage or not, AAD wordings that include limiting or opaque terms such as exclusions for loss due to "financial causes" or requirements that the sovereign's refusal to pay to be "arbitrary and discriminatory" or "a violation of international law" deserve special scrutiny.

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Insuring Arbitration Outcomes (cont'd.)

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Investors will want to know if compensation may be denied simply because the sovereign is insolvent, or because it is defaulting generally.

Denial of Justice Coverage – If the Arbitration Procedure is Thwarted

The very best AAD coverage will be of no avail if no award is issued, and investors can reasonably be concerned that a sovereign might thwart or indefinitely prolong a panel's workings through delaying tactics or outright obstruction. A case can be made that in such event investors have protection in standard expropriation wordings that refer to denial of fundamental rights and/or to the host government's violations of international law. But more certain and explicit protection may be available from insurers in the form of what is often called "Denial of Justice" (DOJ) coverage, which is usually offered in combination with AAD coverage. DOJ coverage is not nearly as readily available as AAD coverage, and terms and wordings vary greatly among underwriters, often emerging only after arduous negotiations.

In general, however, explicit DOJ coverage typically includes these elements:

- The sovereign refuses to cooperate in the initiation of the arbitration process, in spite of the insured's diligent efforts to get it underway.
- Or, in spite of the insured's diligent pursuit of the process, the sovereign, through action or inaction, thwarts its completion.
- Or, as a result of conditions in the country not extant when the policy was issued, pursuit of the process is rendered futile, impracticable, or hazardous.
- And such circumstances exist for some stipulated period of time, often required to be "continuous".

It takes little imagination to see that lurking in these simple concepts are a host of thorny issues and drafting challenges for investors and underwriters. Here are just a few:

- How does one allocate responsibility between the investor (or project company) and the sovereign for delays? Arbitrations are commonly replete with disputes between the parties over evidentiary and procedural matters, and it may be difficult to pin the responsibility for delay on one party alone.
- How is the distinction made between deliberate efforts to thwart the procedure and the actions that litigators routinely engage in to harass and discourage their opponents?
- What constitutes an act of the sovereign? Are actions of its courts included? What if a private party uses the sovereign's courts to thwart the process?
- What if the sovereign's delaying tactics are episodic and cumulative, rather than occurring continuously over a prolonged period?
- What kinds of conditions in the country that render the process fruitless are included? Must they be the result of deliberate acts of the sovereign? If essential local witnesses are prevented from appearing because of a civil war, or an epidemic, should that be the basis of a claim?
- Given the sluggish pace of international arbitration to begin with, what is an appropriate "waiting period" during which the process is thwarted, before a claim can be made?
- What compensation should be paid? The amount claimed in arbitration? The project's book value or (as the case may be) the lender's outstanding balance? If book value, calculated as of what date?

Merely getting agreement between investor and underwriter on what they intend DOJ coverage to do can be difficult. Worse, the best efforts of underwriters, investors, and their advisors to capture DOJ coverage intentions in policy language will invariably still leave room for interpretation.

Given these problems it is no wonder that underwriters approach DOJ coverage so warily. Another reason for caution is uncertainty of salvage for the insurer. Even salvage from AAD coverage claims payments is problematical, since the reason claims are paid in the first place is that the sovereign has already refused to pay, and may simply be unable to do so. Now the insurer in a salvage position may fall among a pool of creditors whose debts the sovereign wants to reschedule, perhaps with a haircut.

> "…it may be worth exploring DOJ wordings that rely less on abstraction and more on objective and impartial factors."

If getting the sovereign to make good on a non-honoring default or arbitration award that it is legally obligated to pay is no sure thing, recovery from the sovereign is likely to be far more difficult when the origin of the "obligation" is a third-party insurance policy payment. For this reason, private insurers may be especially keen to offer the coverage in cooperation with, or with reinsurance from, some powerful public sector underwriter that can exercise treaty rights and national or multilateral clout to achieve a recovery.

Narrowing the Scope for Interpretation

Earnest efforts to overcome the daunting problems of negotiating and drafting DOJ coverage produce wordings that, however exhaustive, still call for interpretation in the light of real events. So it may be worth exploring DOJ wordings that rely less on abstraction and more on objective and impartial factors. If such factors were present and other policy conditions were satisfied, the investor would be compensated but still be obligated to exercise all reasonable efforts on behalf of the insuring party who succeeds to its interests. If the process eventually did produce an award in the insured's favor the underwriter would be the first to benefit.

It is probably not feasible or desirable to trigger DOJ compensation exclusively on the basis of mechanical tests or proxy conditions, but it should be possible and beneficial to all parties to develop factual and measurable standards that narrow the scope for interpretation. At the sacrifice of some opportunities for discretion and judgment in the claims process, underwriters and investors might both enjoy greater confidence in the insurance product and leave less scope for vagaries in its interpretation by arbitrators. ■

INSTITUTIONAL PROFILE:

International Centre for Settlement of Investment Disputes (ICSID)

AMONG eligible parties, ICSID arbitration is now the premier foreign investment dispute resolution mechanism. Its jurisdiction has been consented to by investment host country governments in more than 900 Bilateral Investment Treaties and several multilateral investment treaties. In recent years, foreign investors seem to be choosing ICSID for resolution of cross border disputes in increasing numbers. ICSID's published decisions, of which there are many, have become significant contributors to the jurisprudence of foreign investment. These decisions, developed by distinguished and experienced arbitrators, are providing guidelines and principles which can assist investors, host governments and PRI insurers in determining the specific content of obligations under their agreements and international law as well as the remedies for failure to meet those obligations.

ICSID FORMATION

In 1965, the Executive Directors of the World Bank, motivated by the belief that orderly settlement of cross border investments disputes would promote increased investment in the developing countries, submitted to their member governments a Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "Convention"). In 1966, the Convention came into force having been ratified by 20 Member States. As of May 25, 2005, 142 countries have ratified the Convention. ICSID is closely linked to the World Bank and is based at the World Bank's headquarters in Washington, DC.

PURPOSE AND FUNCTION

ICSID establishes a framework for the conciliation and arbitration of investment disputes between Member States and nationals of other Member States. The Arbitration Rules set timelines for the establishment of the panel (unless the parties otherwise agree) and provide for the appointment of arbitrators by the Secretariat if the parties do not do so within the allowed time. ICSID's costs, including payments by ICSID to the arbitrators, are funded by advance payments from the parties in equal shares without prejudice to the allocation of costs by the final arbitral decision. The parties are free to agree on rules for establishment and procedures of the arbitral panel, but to the extent that there is no such agreement, the Arbitration Rules will apply.

In the early years ICSID got off to a measured start but use of its facilities has recently increased sharply, particularly for disputes related to Argentina. As of June 14, 2005, 91 cases have been concluded and, coincidently, 91 cases are pending. Most of the pending cases relate to disputes in the energy sector (37%) followed by transportation (14%) and water and sewerage (10%)

PROCESS AND PROCEDURES

Proceedings can be initiated by either individuals or entities of Member States or by the states themselves by filing a Request with the ICSID Secretary General providing information regarding the parties, evidence of their consent to ICSID arbitration and the nature of the dispute. Once the parties have consented to ICSID arbitration, they cannot unilaterally withdraw.

ICSID arbitration proceedings usually take place in Washington, DC, although the parties may agree upon another venue. ICSID arbitration awards must be in writing, reasoned and are final and binding on the parties subject only to possible stays to accommodate further permitted ICSID proceedings for Supplementary Decisions, Rectification, Interpretation, Revision or Annulment under Arbitration Rules 49, 50, 51 and 52. There are fairly tight deadlines to initiate these review procedures, except in the case of newly discovered evidence or corruption, which continue to be available until the relevant facts become known to the aggrieved party but in any event may not be initiated after 3 years from the date of the award. ICSID may publish the awards with the consent of the parties.

In 1978, ICSID issued Additional Facility Rules which expanded the eligibility for use of ICSID conciliation and arbitration facilities to i) allow one of the parties to be a non Member State or national of a non Member State, ii) non investment disputes so long as they are distinguishable from ordinary commercial transactions and iii) fact finding proceedings within the scope of agreement of affected parties. These additional facilities, however, do not carry with them the obligations of the ICSID Convention.

AWARDS AND ENFORCEMENT

Under Article 54 of the Convention, final awards are required to be recognized as binding by all Members and are to be enforced as if the award were a final judgment of a court in the Member State. Article 54 (3) makes it clear that enforcement of an ICSID arbitration award is to be governed by laws concerning the execution of judgments in the Member States in which enforcement is sought. Article 55 expressly states that nothing in Article 54 should be construed as derogation from any law of a Member State respecting sovereign immunity from execution. While many investors may assume that ICSID arbitration awards are, by reason of the ICSID Treaty obligations of the Host Government, automatically enforced, a careful reading of Articles 54 and 55 does not support that conclusion.

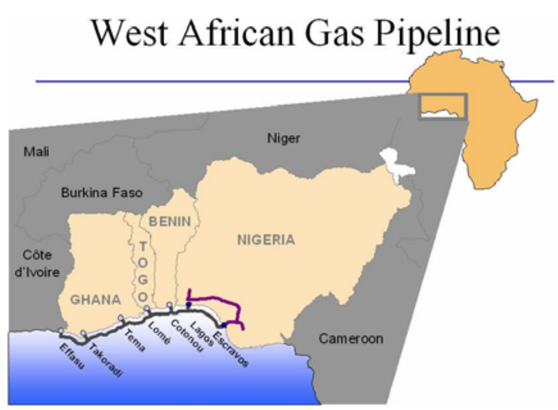
In fact, an ICSID award has no better position than the final judgment of a court in the Member State and procedural delays associated with enforcement of such judgments may well accompany any ICSID enforcement efforts. It is also important to note that sovereign immunity may be raised as a defense to ICSID enforcement unless it is effectively waived by the Host Government.

Despite these limitations, ICSID awards may be more likely to enjoy prompt enforcement than those of other fora, given ICSID's more direct enforcement procedures and its affiliation with the World Bank Group. Indeed, it appears that more than half of the ICSID arbitrations have resulted in settlements prior to award, and nearly all of the ICSID awards to date have been complied voluntarily. Nonetheless, potential circumstances that might frustrate or unreasonably delay enforcement of ICSID awards should be a focus of due diligence exercises by project investors and, when relevant, by political risk insurance providers. ■

Insuring the West Africa Gas Pipeline Project: Multi-country, Multi-millions and Multi-insurer

We invited Nathan Younge, Senior Underwriter at Zurich Emerging Markets Solutions, to discuss the underwriting of investment in the complex West Africa Gas Pipeline, in which ZEMS has taken a leading role.

THE West Africa Gas Pipeline (WAGP) project was originally proposed in 1982 by the Economic Community of West African States (ECOWAS) as one of its key regional economic policy projects. Over time, the World Bank confirmed the commercial feasibility of building a natural gas pipeline to transport Nigeria's abundant natural gas to satisfy the energy needs of Benin, Ghana and Togo. Following the World Bank's findings, the governments of the four nations signed an accord which provided a framework for the project's development. Once completed, the pipeline will extend from Nigeria's Niger Delta region via an offshore route to Takoradi-Sekondi, in Ghana, while delivering gas along the way to customers in Benin and Togo as well.



The pipeline is being built by the West African Gas Pipeline Company (WAPCo), whose major shareholders include ChevronTexaco West African Gas Pipeline Ltd (41.87%), Nigerian National Petroleum Corporation (NNPC) (25.25%), Shell Overseas Holding Ltd (16.5%) and Takoradi Power Company Ltd (VRA) (16.38%). It is estimated that the total project will cost over $620 million.

Nigeria has tremendous natural gas reserves, estimated at approximately twice the size of its oil reserves. Since much of Nigeria's natural gas is associated with its oil fields, with little immediate local application, its natural gas output had typically been flared over the years. The decision to capture this gas and transport it to neighboring countries marks a significant milestone in regional economic development, presents a significant revenue earner for Nigeria, and provides a needed long-term fuel source for Benin, Ghana and Togo.

Energy users in all three neighboring countries are likely to gravitate from liquid fuels toward natural gas over time, and energy demand is likely to increase at the same time. Ghana's demand for reliable electricity, for example, has been growing steadily in recent years, and increased demand for natural gas is also expected in Benin and Togo, with public sector electric power utilities being the primary end users. Use of cleaner burning natural gas is expected to benefit the region's environment as well as its economy.

Investors in WAPCo sought to mitigate the political risks of the project, particularly the risks associated with gas sales to government-owned power companies. The magnitude and tenor of the insurance required, and the importance of having participation by influential public sector entities, meant that both public and private sector sources needed to be tapped. A unique combination of public and private sector insurance and guarantee support was assembled to yield the coverage required by the investors.

Notably, the Ghanaian component of the pipeline carries the participation of Zurich, the Overseas Private Investment Corporation (OPIC), Multilateral Investment Guarantee Agency (MIGA) and the International Development Association (IDA). Zurich (through its emerging markets unit) and MIGA are providing political risk coinsurance coverage to the transaction, while OPIC is providing facultative reinsurance to Zurich. Meanwhile, the World Bank Group's International Development Agency (IDA) is providing a "partial risk guarantee" as a key risk mitigant for the transaction.

"In order to comply with the disparate requirements of the individual insurers, it was necessary to conclude properly interlocking arrangements for coinsurance and reinsurance."

Bringing together a private sector insurer, a national insurer and two multilateral sister institutions to provide custom-tailored coverage for a large, complex, multi-country transaction required considerable cooperation, innovation, and determination among all parties. In order to comply with the disparate requirements of the individual insurers, it was necessary to conclude properly interlocking arrangements for coinsurance and reinsurance. Close coordination and an early start proved keys to finding timely solutions to potentially difficult problems in achieving common wordings and structural coherence, for the benefit for both insurers and the insured. According to Julie Martin of Marsh, the Project Political Risk Insurance Adviser, "In the end, through a structure that involved co-insurance between MIGA and Zurich, and an arrangement under which OPIC provided reinsurance capacity for Zurich's direct exposure, the client's needs were addressed. This outcome was critical to the initiation of pipeline construction, for a project that will yield considerable benefits for West Africa." ■

Loss and Recovery Journal

Overseas Private Investment Corporation: OPIC has agreed to pay $50 million to Ponderosa Assets, LP in compensation for the expropriation of its investment in Transportadora del Gas Sur ('TGS') in Argentina. In its Memorandum of Determinations, OPIC found that the Argentine Government's failure to allow tariff increases in accordance with the license it granted to TGS (without compensation) amounted to a repudiation of its contractual obligations, deprived the investor of its fundamental rights, and was a violation of international law.

Zurich Emerging Markets Solutions: ZEMS has paid 15 claims totaling about $14 million for non-honoring of Dominican Republic sovereign guaranteed principal payments in respect of commercial projects and structured trade loans. The Government has held up the principal payments pending conclusion of the rescheduling of 2005 and 2006 commercial debt obligations.

MARKET PROFILE:

Sovereign
RISK INSURANCE LTD

Sovereign is a Bermuda-based joint venture between XL Insurance and ACE Bermuda Insurance Ltd, two large insurers. It was formed in 1997 to provide long-term investment insurance capacity to financial institutions, export credit agencies, multilateral agencies and equity investors. As a specialist underwriting agency Sovereign issues political risk insurance policies on behalf of ACE and XL, on a 50/50 basis.

Products: Expropriation, Convertibility/Exchange Transfer, Political Violence, Sovereign and Sub-sovereign Non-payment, Unfair Calling of Bonds, Non-repossession of Aircraft or Mobile Equipment, and Other Customized Covers.

Capacity: Up to $125 million per project, up to 15 years.

Credit rating: Sovereign's policies are the several obligations of ACE (A+) and XL (AA-), and reflect their ratings.

Claims experience: Sovereign is the only private sector PRI underwriter who lists its claims experience on its website. The company reports paying a total of six claims since its formation in mid-1997. Claim types were for contract frustration (3 claims), expropriation (non-payment of arbitral award) (1 claim), currency inconvertibility (1 claim), and expropriation of funds (1 claim). These claims have occurred in Indonesia, Argentina, and most recently, as a result of debt restructuring, in the Dominican Republic.

Company comment: Because of its structure as a 50-50 joint venture between two large insurers, Sovereign is the only 'net lines' PRI underwriter in the market. This means that Sovereign is not dependent on reinsurance treaties or the reinsurance markets as its capacity comes directly from ACE and XL. This structure is one of the firm's main competitive advantages as it gives Sovereign greater speed and flexibility in customizing contracts than other underwriters.

Sovereign operates under a very flat organizational structure, where all Senior Underwriters are based in Bermuda and report directly into the CEO. Sovereign's portfolio of $5.9 billion is split into three broad areas of business:

(1) working with commercial banks on corporate, project and export finance transactions,

(2) facultative and country-specific treaty reinsurance for ECAs and Multilateral Agencies, and

(3) working with investment banks on providing currency inconvertibility and transfer wraps on securitizations and 144A bond issues in the capital markets.

Sovereign is also one of four private sector members of the Berne Union.

Key people: Price Lowenstein, *President & CEO*
Nila Davda, *Vice President & Senior Underwriting Officer*
Jack Collier, *Vice President & General Counsel*
Christina Westholm-Schroder, *Vice President and Chief Underwriting Officer*
Dave Bailey, *Vice President & Senior Underwriting Officer*
Barker Keith, *Vice President & Corporate Counsel*
Natalie Luthi, *Vice President & Political Risk Underwriter*

Contact information: Wessex House, 5th floor
45 Reid Street, Hamilton HM12, Bermuda
Phone: 441-296-4279
Fax: 441-296-4281
Email: svninfo@ace.bm
Website: www.sovereignbermuda.com

■

People and Organizations

Zurich Emerging Markets Solutions: Zurich has reorganized to reflect the convergence of political risk and trade credit covers in emerging markets. All underwriters will now be engaged in both business lines, led by product managers Michael Bond (political risk) and Frederick Louat (trade credit). Ed Coppola, chief underwriting officer, will lead an expanded Risk Management and Underwriting team. Sean Cassidy has been named to a new position as Manager, Business Development.

MIGA: Peter D.Cleary has succeeded Luis Dodero as General Counsel. A leading project finance practitioner, he was previously a partner at Freshfields Bruckhaus Deringer in Hong Kong.

Exporters Insurance Company: Richard S. Maxwell is this Bermuda-based group captive insurer's new Underwriting Officer, and is a member of the Risk Management and Underwriting Committee of the Board. He previously managed U.S. Ex-Im Bank's short and medium term insurance and guarantee product lines.

Willis Limited: Julian Macey-Dare has resigned from Jardine Lloyd Thomopson and will join Willis Global Markets Financial Solutions in a senior production role. John Yelding, formerly of Aon Trade Credit, is also joining Willis to enhance the growth of its trade credit business.

Asian Development Bank: Werner Liepach has been named ADB's Principal Director of the Office of Cofinancing Operations, which includes official and commercial cofinancing operations. Among those reporting to him are three veteran political risk insurance underwriters: Martin Endelman, formerly of EFIC, Daniel Wagner, formerly of AIG and MIGA, and Christophe Bellinger, formerly of MIGA, AIG and OPIC. ADB's cofinancing products include its partial risk guarantee which covers a range of political risks.

African Trade Insurance Agency (ATI): Roland Pladet has been appointed Chief Underwriting Officer of this Nairobi-based African multilateral export credit agency. He has previously served at ABN AMRO overseeing cross-border risk mitigation, at MIGA, and Atradius (formerly NCM).

Political Risk Developments: Venezuela

By Mariano Gomezperalta C.

IN AUGUST of 2001, the government of President Hugo Chavez enacted a controversial hydrocarbons law which established new rules for investors having oil operating agreements with PDVSA (Venezuela's state-owned oil company). The new law provides the legal platform for the Venezuelan government to convert the existing operating agreements (which cover 32 oil fields with a production of roughly 500,000 barrels of crude a day) into new contracts or *convenios* by which the state will hold at least 51% of the shares of the existing project companies and will collect higher income taxes and royalties by increasing the tax rate from 34% to 50% and royalties from 16% to 30%. The new law also requires that all operating contracts contain a provision requiring that investments in property and equipment made by the project companies be transferred to the state without any compensation and free of all liens upon termination (with or without cause) of the agreements. By accepting the new regime, the project companies will have also consented to the exclusive jurisdiction of the courts of Venezuela to solve all disputes that cannot be resolved through amicable means "including arbitration" and will have acknowledged that such disputes may not give rise to any foreign claims whatsoever. The Venezuelan government is requiring project companies to accept the new rules and convert their existing agreements into new operating contracts by the end of the year or face termination.

From an expropriation perspective, it will be interesting to see how the new measures will be treated by insurers and their insureds. Although a non-discriminatory increase in taxes typically would be excluded under PRI policies for expropriation, special policy terms may apply under coverage for production sharing agreements. Moreover, some of the other measures such as the mandatory conversion to the new regime, the 51% state ownership of the project companies and the provisions requiring the acceptance of an uncompensated transfer of all investment property upon contractual termination are clearly confiscatory in nature. The mandatory conversion to the new regime and the resulting exclusive jurisdiction of the Venezuelan courts will also have interesting implications for arbitration and recovery, namely the effect on the insurers' subrogation rights, the duties of an insured to mitigate potential losses (e.g. convert to the new regime in order to minimize losses) and the added value of denial of justice coverage.

So far thirteen (out of twenty-two) companies, including Spain's Repsol, China National Petroleum, Teikoku Oil, Petrobras and Houston-based Harvest Natural Resources are said to have signed contracts to adopt the new regime. How some of the other major players such as ChevronTexaco and Shell will react will probably depend on whether the losses they suffer under the new regime are offset by the diminished but potentially still significant revenues associated with their projects, and how willing the companies are to subject their rights under the new contracts to the jurisdiction of Venezuelan courts. ■

about this newsletter

This is the second edition of the robert wray PLLC **political risk insurance newsletter**. Our intention is to provide a forum for the exchange of information and opinions relating to topics that will be of interest to political risk insurers, buyers, brokers, attorneys and others. We invite contributions and suggestions from professionals in the field.

We also encourage readers to submit information about notable transactions, personnel changes and other important developments in the political risk insurance sector.

If you would like to receive this or future editions of the PRI Newsletter electronically or if you have friends or colleagues who would be interested to join our distribution list, please e-mail us at *info@robertwraypllc.com*.

For submissions or further information regarding this Newsletter, please contact:

Robert T. Wray
202.349.5015
rwray@robertwraypllc.com

Felton (Mac) Johnston
202.349.5012
mjohnston@robertwraypllc.com

about robert wray PLLC

robert wray PLLC is a specialized law firm focused on analyzing complex issues and providing innovative solutions in the areas of political risk insurance, project finance, transportation infrastructure, privatization and aircraft finance. The firm's political risk insurance practice, led by Robert T. Wray and Felton (Mac) Johnston, offers comprehensive advice related to the mitigation of risks and selection and acquisition of political risk insurance associated with international investments.

robert wray PLLC
1150 connecticut avenue, nw
suite 350
washington, dc 20036

Phone: 202.349.5000
Fax: 202.293.7877
E-mail: *info@robertwraypllc.com*

www.robertwraypllc.com