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In the Wake of the Global Financial Crisis, Political Risk Becomes a Growing Concern for Investors in Emerging or Unstable Markets

CAPITAL MARKETS CLIENT ALERT

This Alert provides only general information and should not be relied upon as legal advice. We would be pleased to discuss our experience and the issues presented in this Alert with those contemplating investments in these markets. For more information, contact your Patton Boggs LLP attorney or the authors listed below.

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In the aftermath of the 2009 economic crises in Eastern Europe, Spain, Greece and Dubai and the commercial risks these failures have presented to investors, it is not surprising that avoiding political risk remains a high priority for investors in emerging markets.¹ Many view political risk as a growing concern given the potential for the financial pressures on states to affect their ability to meet contract obligations or to lead them to exercise greater control over their economies through confiscation, nationalization or expropriation.²

Political risk insurance (PRI) protects commercial investors against politically motivated acts or government actions that negatively impact a project. PRI insures against, among other things, the risks of expropriation (including outright expropriation and creeping expropriation), war, civil disturbance, terrorism, sabotage, currency inconvertibility, transfer restrictions and non-honoring of sovereign financial obligations. In some cases it also covers breach of contract by a foreign sovereign. In addition to guarding against ultimate losses, PRI can provide an investor access to third-party dispute resolution services, added leverage prior to and during an arbitration and coverage against the non-honoring of an arbitral award.

Both public and private entities provide PRI to cover investments of all sizes - from those at the microfinance level to huge infrastructure projects.

The Multilateral Investment Guarantee Agency (MIGA), a part of the World Bank Group, provides PRI for foreign investments in developing member countries, including by sovereign investment firms. The types and costs of its coverage depend on the site of the investment and type of coverage. For claims relating to breach of contract or the non-honoring of sovereign financial obligations, MIGA pays PRI claims upon the sovereign's failure to satisfy an arbitral award rendered in favor of the investor. For claims relating to transfer, expropriation, war and civil disturbances, no prior adjudication is required. MIGA offers free dispute resolution services to all its clients for all types of disputes that could give rise to a claim under a MIGA guarantee. As difficulties between a foreign government and an investor arise, MIGA may undertake to mediate the parties' differences and attempt to settle the dispute prior to the initiation of arbitration between its insured and the foreign sovereign. As a member of the World Bank with a mission of promoting foreign direct investment into developing countries, MIGA assists foreign sovereigns to foster a hospitable investment climate through its intercession in such disputes. The fact that the international convention establishing MIGA enables it to seek reimbursement payments of claims due

¹ BERNE UNION, THE INTERNATIONAL UNION OF CREDIT & INVESTMENT INSURERS (INCLUDING BERNE UNION PRAGUE CLUB), BERNE UNION ROUNDTABLE 2010 49 (Exporta Publishing & Events Ltd.) (2010).

² *Id*

insured investors from the sovereign can function as additional leverage to persuade the sovereign to resolve disputes with the investor.

Since its inception in 1988, MIGA has paid a total of five claims. MIGA attributes this small number of claims payments to its success in working with investors and host countries to achieve amicable solutions in over sixty disputes related to MIGA-guaranteed projects.

The Overseas Private Investment Corporation (OPIC) provides PRI to U.S. investors, contractors, exporters and financial institutions involved in transactions in less-developed countries and countries transitioning from a non-market to market economy. In addition to PRI coverage for currency inconvertibility, expropriation, standalone terrorism, and political violence, OPIC also offers special PRI products to assist investors involved in cross-border leasing, institutional lending, or oil and gas exploration. On a case-by-case basis, OPIC also provides advocacy services similar to those provided by MIGA. OPIC has assisted insured investors in obtaining recognition of arbitral awards by foreign sovereigns that, prior to OPIC's intercession, refused to recognize or enforce such awards. It has also stepped in and, through letters and executive-level meetings, prevented the threatened expropriation of a major broadcaster's licenses.

In contrast to MIGA, OPIC has paid hundreds of claims since its inception in 1971. As of late 2009, OPIC had made two hundred and ninety claims settlements totaling \$969.8 million in the form of cash settlements and guarantees of host government obligations.

Several countries, including Australia, the United Kingdom, France, Belgium, Canada, Germany, China and Japan offer investment insurance products for overseas investments through entities similar to OPIC.

While private PRI providers may not have the same amount of leverage as a public institution owned by 187 member countries or the U.S. government, they offer PRI for investments in both developing and developed countries. Private PRI providers have the advantage of being able to create customized coverage for other political risk situations specific to a transaction. Like their public counterparts, private providers also offer claims mitigation capabilities according to the terms of the policies and by virtue of their role as major investment insurers and as members of the Berne Union, an international association of public and private trade and investment insurers that enjoys substantial international credibility. Major private providers of PRI include Sovereign of Bermuda, Chartis Insurance (formerly AIG) and several Lloyd's syndicates.