GEG Working Paper 2015/96
January 2015

The International Investment Regime is Stronger Than You Think

Understanding the Interplay of Diplomatic, Insurance and Legal Approaches for Protecting FDI

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Geoffrey Gertz

DPhil Candidate, University of Oxford

Abstract

Today the assets of foreign investors are protected by three distinct yet overlapping pillars: diplomatic pressure applied by the home state; political risk insurance purchased by the investor; and investor-host state legal arbitration. These pillars represent mutually reinforcing approaches to compensating foreign investors for the adverse effects of host state policy. This paper places these three pillars within a unified conceptual framework, and argues that their overlaps and interactions lead to stronger protections for foreign investors than much of the literature commonly assumes. The creation and institutionalization of new forms of protection for foreign investments over the last half-century have not necessarily replaced or substituted old forms of protection, but rather have complemented and added to them. Two brief case studies – of the Cora de Comstar dispute in Cote d'Ivoire and the Dabhol dispute in India – illustrate how the three pillars operate simultaneously and collectively in contemporary investment dispute settlement. The paper's findings hold important implications for both investors and states.

The Global Economic Governance Programme is directed by Ngaire Woods and has been made possible through the generous support of Old Members of University College. Its research projects are principally funded by the Ford Foundation (New York), the International Development Research Centre (Ottawa), and the MacArthur Foundation (Chicago).

An earlier version of this paper was presented at the 2014 annual meeting of the International Studies Association. Many thanks to Taylor St John for valuable comments on an earlier draft. Comments welcome: geoffrey.gertz@politics.ox.ac.uk.

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Introduction

It is frequently observed that, unlike other areas of international economic exchange such as trade, there is no formal multilateral institution at the heart of the international investment regime. Indeed, attempts to forge such a regime have repeatedly failed. In place of such a strong regime lies a patchwork of bilateral treaties, industry-specific plurilateral agreements such as the Energy Charter Treaty, and investment chapters in trade agreements. The result is a regime for protecting foreign investment that is partial, inconsistent and plagued by gaps in coverage, across both countries and industries.

This narrative is not necessarily incorrect, but it is incomplete in a number of important ways. By focusing narrowly on the formal legal protections for international investment, many scholars fail to appreciate that legal channels are but one tool available to investors seeking to protect their assets overseas. Today there are three major pillars to the international regime for protecting foreign investment: political protection through the use of diplomatic pressure, insurance protection through political risk insurance and legal protection through investor-state arbitration. While political scientists and legal scholars have extensively studied investor-state arbitration, much less attention has been paid to diplomatic protection and political risk insurance, and almost no attention paid to the interaction of the three.

This paper begins to fill this gap. It provides a conceptual analysis of the architecture of the international regime for protecting investment by bringing diplomatic, insurance, and legal protections into a unified framework. The paper argues that these three pillars represent different approaches to the same problem of settling investment disputes. Moreover, it argues that the function of these pillars cannot be understood independently of one another; each pillar does not operate in a void, but rather in connection with the others, as part of the broader investment protection regime. The institutionalization of the newer pillars of risk insurance and legal arbitration have not necessarily replaced or substituted old forms of protection, but have instead complemented and added to them. These arguments are empirically supported with two brief case studies of contemporary investment disputes, in the telecommunications sector in Cote d'Ivoire and in the energy sector in India.

The implication of this analysis is that the protections available to foreign investors through the international investment regime are in fact much stronger than is typically assumed. The majority of the current literature on the investment protection regime is focused squarely on investment treaties and investment arbitration, alongside a smaller literature on political risk insurance.[1] Yet analyses focused solely on the legal pillar will tend to underestimate both the scope and depth of the investment regime as well as the level of protection available to investors. While the legal pillar does include gaps and inconsistencies, these gaps are (partially) compensated for by protections offered by the other two pillars. The less visible, less formalized elements of the investment regime – most importantly diplomatic pressure – continue to play a crucial role in underpinning investment protection. It is only by adopting a holistic view of the investment protection regime, and understanding how investors use

[1] For overviews of the literature on investment treaties and arbitration, see Milner (2014), as well as further citations below; on risk insurance, see Gordon (2008) and Moran, West and Martin (eds) (2008), as well as further citations below.

multiple, overlapping strategies to protect their assets overseas, that we can appreciate how the investment regime operates in practice today. Such an understanding is important not only for private investors, but also for states, who remain the guardians of the investment protection regime.[2] Investors are already acting strategically in combining the protections offered under these three different pillars to advance their interests; states could similarly approach the protections and promises they provide to foreign investors in a more strategic, unified policy, yet to date there is little evidence that they do so.

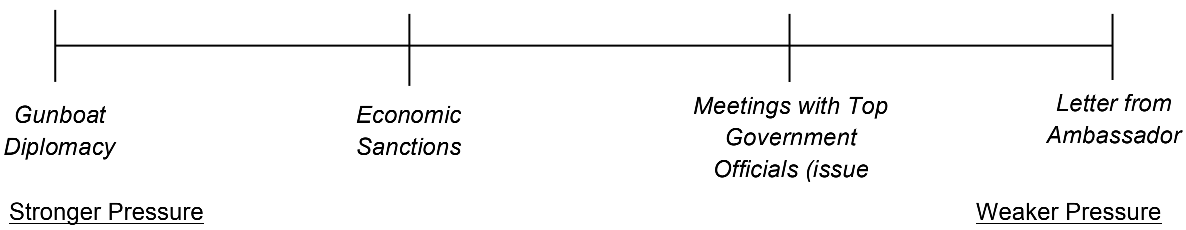
[2] See Gertz and St. John (2014).

Three Options for Protecting Foreign Investments

The contemporary investment protection regime is primarily about determining under what circumstances a foreign investor deserves compensation for adverse government action (or inaction) which limits or destroys the value of their investment. Borrowing from Lasswell's (1936) classic definition of politics, the investment protection regime is about who gets what, when, and how: which investors should be compensated for what government actions, and who should pay (and how much). The three pillars of the foreign investment regime present different answers to this same general set of questions.

Historically, the most common approach to protecting the assets of foreign investors is the application of diplomatic pressure by the home state government.[3] When a foreign investor objects to the actions of a host state, it may lobby its home state to pursue the issue diplomatically. The home state then may or may not seek to apply pressure to the host state in order to redress the situation. Such pressure lies along a spectrum: from very overt actions, such as the threat or use of force, to gentler, subtler actions, such as communication from an embassy. Up until at least the mid-to-late 20th century, powerful capital exporting states – notably the US – frequently applied diplomatic pressure toward developing country host states to resolve investment disputes.[4] There is less extensive data available for the contemporary period, yet recent research suggests investors continue to frequently turn to their home state governments for assistance in investment disputes.[5]

The Spectrum of Diplomatic Pressure

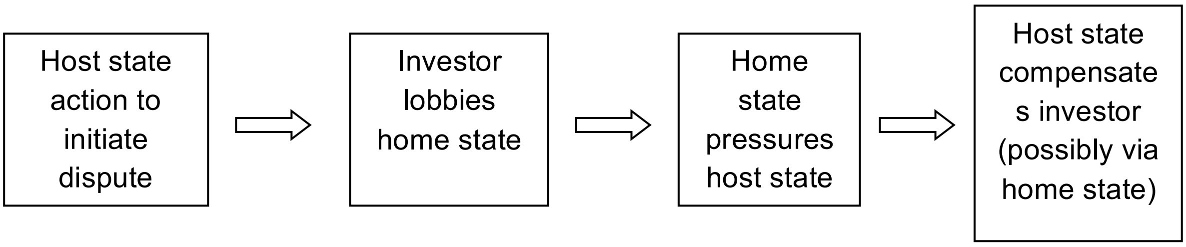


Whether or not diplomatic pressure is viable as a form of protection will depend on how much leverage the investor has over the home state, the extent to which the home state considers the actions of the host state to be egregious, and the diplomatic relations between the home state and the host state. It is worth noting that in addition to bilateral diplomatic relations, diplomatic pressure may also be applied multilaterally, such as through the World Bank, IMF or regional development banks. For example, in the early 1990s the United States used its power within the Inter-American Development Bank to block a $175 million loan to Costa

[3] See Mauer (2013) and Lipson (1985) for more discussion on the historical use of diplomatic pressure in protecting investment.
[4] Maurer (2013).
[5] See Gertz (2015) and Jandhyala, Gertz and Poulsen (2015).

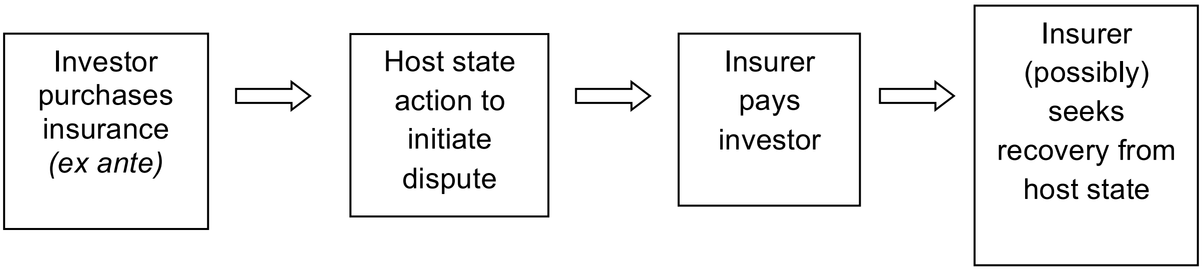
Rica, until the latter agreed to submit a pending dispute with an American investor to international arbitration.[6]

Pillar I: Diplomatic Pressure



The second pillar for protecting investments is the provision of political risk insurance (PRI).[7] These insurance contracts are purchased ex ante by foreign investors to cover specific political risks for particular foreign investment projects. If a political risk materializes, the investor files a claim with the insurer; the insurer then makes a claim determination based on the contractual clauses in the insurance contract, and if the claim is deemed valid the investor is promptly compensated. Insurance is typically priced based on a combination of the risks of the host country and the specifics of the project. PRI is available through home state government agencies, which typically operate as self-financing agencies of the government; private insurance brokers; and multilaterally through the World Bank's Multilateral Investment Guarantee Agency (MIGA). Approximately 30 percent of investment into developing countries, and 3 percent of global FDI, are covered by political risk insurance.[8]

Pillar II: Political Risk Insurance

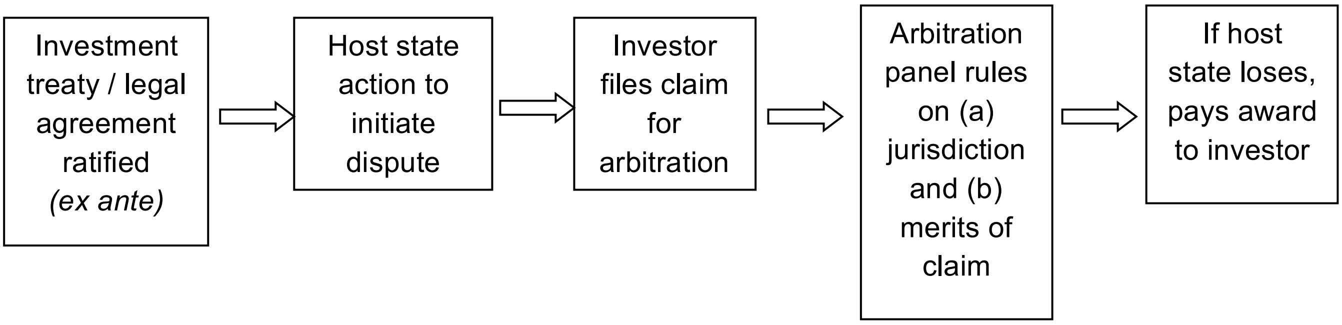


The third pillar of the investment protection regime seeks to protect investment using legal international instruments, notably investment treaties and the investor-state arbitration system through which treaty claims are arbitrated.[9] Most bilateral investment treaties (BITs) in force today include investor-state dispute settlement clauses which allow investors to directly sue host states in legally binding international arbitration forums, such as the International Centre for Settlement of Investment Disputes (ICSID). Certain investor-state contracts, investment clauses in preferential trade agreements, and regional and multilateral agreements, such as the Energy Charter Treaty, contain similar clauses. Importantly, the legal institutions for protecting foreign investment are designed to remove disputes from the

[6] See discussion in Brower and Wong (2005).
[7] For more on political risk insurance, see Lipson (1978), Gordon (2008) and Moran, West and Martin (eds) (2008).
[8] Gordon (2008).
[9] Key articles on the international legal system for protecting investment include Elkins, Guzman and Simmons (2006), Kerner (2009), Peinhardt and Allee (2012), Milner (2014), Simmons (2014) and Poulsen (forthcoming).

domestic judicial systems, which foreign investors may perceive as inefficient or biased toward the host state.[10] Today almost every country has ratified at least one BIT, and many have ratified dozens. ICSID has seen its annual caseload increase from just two or three cases 15 years ago to 40 cases in 2013 (down from a record 50 cases in 2012).[11]

Pillar III: Legal Arbitration



[10] Investors from Western countries investing in other Western countries may not fear biases or inefficiencies of the host state legal system, perhaps explaining why historically there were very few investment treaties signed between Western countries.
[11] ICSID (2014).

The Intersections of Diplomatic, Insurance and Legal Protections for Foreign Investments

As noted earlier, most of the literature on the investment protection regime analyses one of these three pillars in isolation (and indeed most of the literature focuses on one specific pillar, the legal regime). This leaves the intersections of the three pillars relatively unexplored. Yet these intersections are crucial for understanding how investment protection works in practice, and how investors act strategically to maximize the compensation they receive in the event of an investment dispute by drawing on the protections provided by all three pillars. This section considers the three intersection points of the broader investment protection regime: the connections between the diplomatic and insurance pillars, between the diplomatic and legal pillars, and between the insurance and legal pillars.

Diplomatic interventions and political risk insurance are closely intertwined. Public insurers appear to rely heavily on diplomatic pressure to limit the number of claims they need to pay out (and hence allow them to offer lower risk premiums, increasing the availability of insurance contracts). The clearest example of an insurer benefitting from diplomatic pressure is MIGA, the World Bank's risk insurance arm. Whenever an incipient claim arises, MIGA lawyers get involved in the dispute to encourage the investor and the host state to reach a negotiated settlement. The agency proudly advertises its "dispute resolution" features to potential customers, and notes that "MIGA's immediate access to officials at the highest levels of government in the countries for which MIGA provides guarantees and its status as a member of the World Bank Group significantly strengthen MIGA's ability to resolve potential disputes to the satisfaction of all parties and deters some government actions that otherwise could disrupt guaranteed investments."[12] Host states are extremely reluctant to put their relationship with the World Bank – and therefore their access to loans and grants – at risk, and are thus highly motivated to resolve disputes related to MIGA-guaranteed investments. Remarkably, throughout its history MIGA has only paid out two claims related to disputes, and has successfully resolved close to 100 incipient disputes.[13] In this light MIGA's clients are not so much buying insurance but buying access to World Bank diplomatic backing, which facilitates the resolution of disputes. OPIC, the American public insurer, similarly advertises its "advocacy" ability in resolving incipient disputes before they reach the level of a formal claim, and demands that clients inform OPIC of any potential claims so that it may intervene. The fact that it is an agency of the US government requesting settlement of the dispute undoubtedly induces host states to be more open to resolution than they might otherwise be.

Home states which offer public PRI may be more inclined to intervene diplomatically in disputes than they otherwise would. Risk insurance sold by public insurers increases the incentives for governments to apply diplomatic pressure in the early stages of a dispute, because the government will have a monetary stake in the outcome; if a claim is filed the public insurer will have to pay, but if the dispute is resolved before a claim is filed then there

[12] "MIGA: Keeping Sustainable Investments on Track".
[13] Ibid. MIGA has also paid out four claims related to civil war and disturbance.

is no payment.[14] On the other hand, by offering PRI through a public agency home states may also be able to more credibly deny investor requests for diplomatic support, and shift the burden for investment protection onto the investor. If a government has an agency which offers political risk insurance to its overseas investors, when an investor shows up asking for diplomatic support following an expropriation, it can more easily reply "sorry, you should have purchased political risk insurance."

Moreover, the intersection of diplomacy and insurance is not limited to pre-claim activities; public PRI agencies also rely on diplomacy to help them recover claims after they've been paid. Once an insurer pays out a claim to a foreign investor, the insurer can seek to reclaim funds from the host state, allowing the insurer to potentially recover some – or even all – of the claim that has been paid. OPIC, for example, has paid out 294 claims in its 43-year history, totaling $750.7 million in cash payments. Of this total, however, OPIC has successfully recovered $448.6 million in cash and $219 million in receivables, or 89 percent of total claims paid.[15] Such recoveries are primarily the outcome of negotiated settlements between OPIC (acting as an agency of the US government) and the host state, i.e. an example of the application of diplomatic pressure to protect investment. As with efforts to limit the number of claims paid, efforts to recover funds post-claim lower the price (and therefore increase the scope) of political risk insurance.

There are also substantial interactions and overlaps between the diplomatic pillar and legal pillar for investment protection. The legal regime was largely designed to replace diplomatic pressure as the key mechanism for protecting investment, yet empirically it is unclear if this has in fact occurred.[16] Indeed, the fears of some of Germany's earliest BIT negotiators that granting private investors the right to sue host states would compel German diplomatic engagement in disputes it could otherwise ignore may equally be true.[17] As revealed by the Wikileaks cables, the United States continues to intervene diplomatically in disputes, whether or not the host state has signed a BIT with the US; whether other powerful capital exporting states do as well is less clear.[18] Moreover, home states have demonstrated a willingness to diplomatically sanction states that fail to comply with the international legal system: for example, when Argentina refused to pay a series of arbitral awards owed to a number of American investors, these investors successfully petitioned the US government to suspend Argentina's trade benefits under the U.S. Generalized System of Preferences.[19] The international legal protections available to foreign investors are given real teeth by the fact

[14] While most public PRI agencies are self-financing and not funded out of the central government's budget, the insurance contracts sold by public PRI agencies are ultimately backed by the government. Thus if a large number of claims are filed the government guarantee may need to be called upon. Indeed, in OPIC's early years the agency faced potential insolvency when a number of customers filed claims following expropriations in Chile; this threat of insolvency nearly led the US Congress to refuse to reauthorize OPIC. See Lipson (1978), pp. 366-368.
[15] See OPIC (2013). Note that these figures exclude OPIC guarantees of government obligations which were not called on, as such guarantees did not require active "recovery".
[16] On suggestions that the legal regime could reduce diplomatic pressure, see Shihata (1986), Johnson and Grimblett (2011) and Maurer (2013). On evidence that the legal regime has not in fact led to less diplomatic pressure, see Jandhyala, Gertz and Poulsen (2015) and Gertz (2015).
[17] Quoted in Poulsen, forthcoming.
[18] See Jandhyala, Gertz and Poulsen (2015)
[19] See US Department of State (2013).

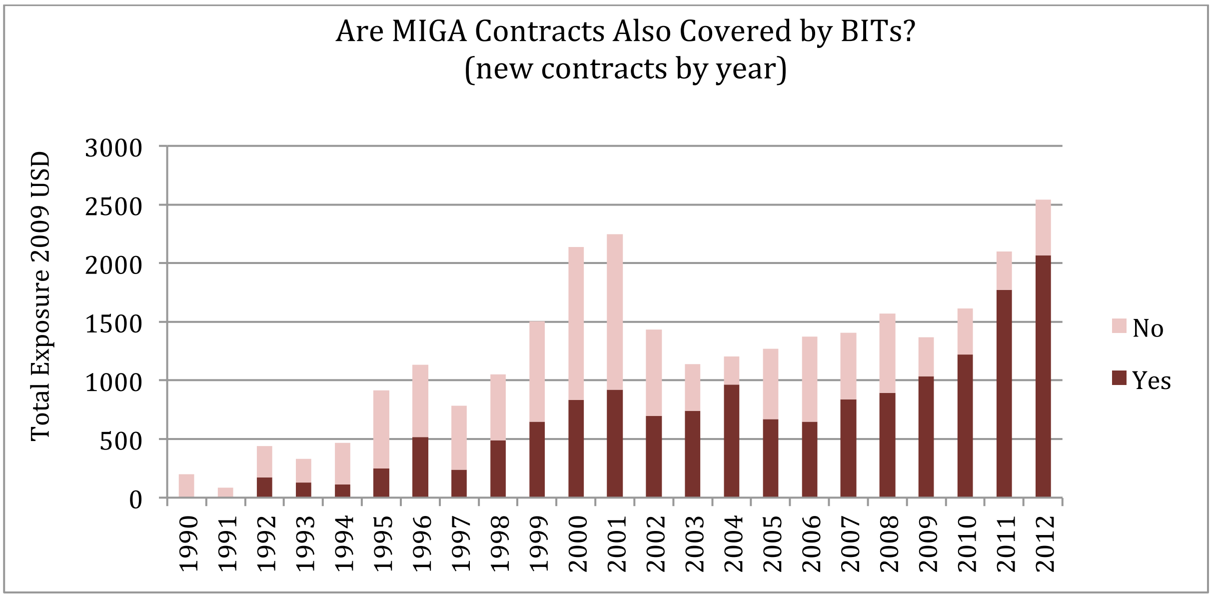
that home states are willing to apply diplomatic pressure to home states that flaunt legal rulings.

It is also worth noting that even if legal protections have not replaced diplomatic interventions, as the most ardent supporters of the legal regime claimed they would, it is likely the rise of legal protections for foreign investors has affected the exercise of diplomacy to protect assets overseas. Specifically, precedents set in the legal system for protecting investment shape and constrain home states' use of diplomatic pressure. It is likely to be difficult for a home state to use diplomatic pressure to aggressively push for a settlement which is considerably more generous than what the investor could have achieved through the legal system. An important question for future research is what weight home states place on the legal validity of an investor's complaint in determining how actively to intervene in the dispute.

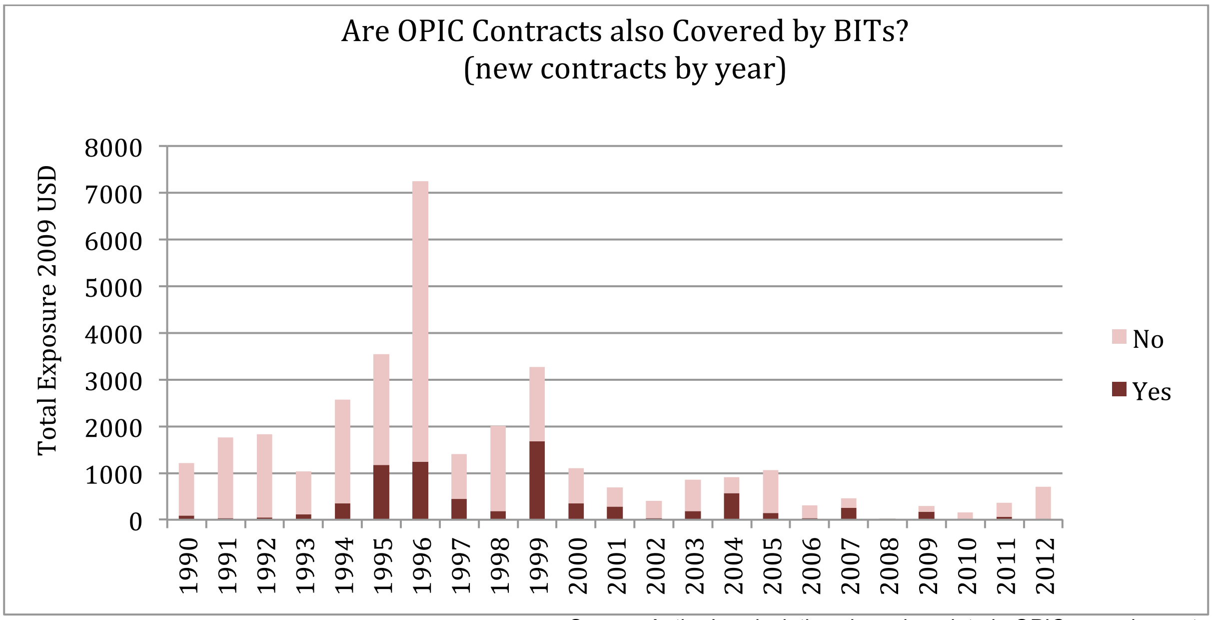
Finally, there are also substantial interactions between PRI and legal protections for foreign investment. In recent years a number of scholars have begun to explore the relationship between risk insurance and BITs, and have generally found that they function as complements rather than substitutes.[20] That is, the existence of an investment treaty with binding investor-state arbitration does not negate the need for PRI; again, the new institutions developed to protect investments have added to, not replaced, their predecessors. The insurance and legal pillars support each other in many ways. For one, insurance policies and investment treaties generally cover somewhat different host state government actions and political risks; for example, PRI policies generally don't include promises of "fair and equitable treatment" which are found in many BITs, but do include protections against currency inconvertibility which are absent from most BITs.[21] Thus to receive the most comprehensive protection investors may choose to both purchase PRI and invest in a country with a BIT. Furthermore, insurance contracts typically include a subrogation clause stating that after a claim has been paid the right to pursue any international arbitration related to the matter is transferred from the investor to the insurer. As noted above, public insurers typically pursue such claims diplomatically, but private insurers could use their right to residual claims to pursue arbitration (though to date there are no known cases of a PRI provider pursuing a claim under an investment treaty). Thus the ability to pursue recovery of a subrogated claim through arbitration could lower the initial price of PRI coverage.

Indeed, data reveal that the majority of investors purchasing MIGA insurance, and a much smaller – though non-negligible – share of investors purchasing OPIC insurance would also be covered by a BIT (see figures below). Some of these investors are primarily seeking protection against risks not available in BITs, such as loss due to war or political violence, while others are likely buying insurance despite BIT protection because they believe it will be a faster or more efficient process to recover any losses. In any case, it is clear that investors do not believe that the existence of an investment treaty negates the need for PRI coverage.

[20] See Kantor (2014), Bekker and Ogawa (2013) and Ginsburg (2013).
[21] See Kantor (2014).



Source: Author's calculations based on database of MIGA projects available on MIGA's website



Source: Author's calculations based on data in OPIC annual reports

The key point is that the diplomatic, insurance and legal protections available to investors do not exist in a void, but are rather complementary approaches to protecting foreign investment. Combined, the three pillars constitute a deeper, richer regime for protecting investments than is commonly assumed in the literature.

The Investment Protection Regime at Work: Case Studies

This section considers two case studies which illustrate how the three pillars of the investment protection regime intersect in the resolution of actual investment disputes: Cora de Comstar in Cote d'Ivoire and Dabhol in India.

Cora de Comstar in Cote d'Ivoire

Cora de Comstar was a mobile telephone company operating in Cote d'Ivoire with two principal American investors, Western Wireless and the Modern Africa Fund, the latter an investment fund backed by US and foreign firms with capital partially guaranteed by OPIC.[22] Cora de Comstar was embroiled in an investment dispute when an Ivorian former investor in the company seized, with support from the Ivorian police, the company's offices and assets on 9 October 2003.[23]

As part of the capital in the project came from OPIC, the American investors in Cora de Comstar would not bear the full cost of the lost assets. Yet they still stood to lose considerably, and thus quickly mobilized to recover their assets and/or receive compensation from the Ivorian government.

Within two weeks of their assets being seized, the company had marshaled considerable US diplomatic pressure on the Ivorian government: American Assistant Secretary of Commerce William H. Lash, III officially complained to Ivorian embassy officials in Washington, and publicly described the case as "the worst treatment of an investor and the worst example of state-sponsored thuggery I have seen anywhere."[24] Lash went on to note that the case could threaten Cote d'Ivoire's eligibility for trade preferences under the African Growth and Opportunity Act (AGOA), which the US administration may revoke for individual countries if they are not making sufficient economic and political progress.[25]

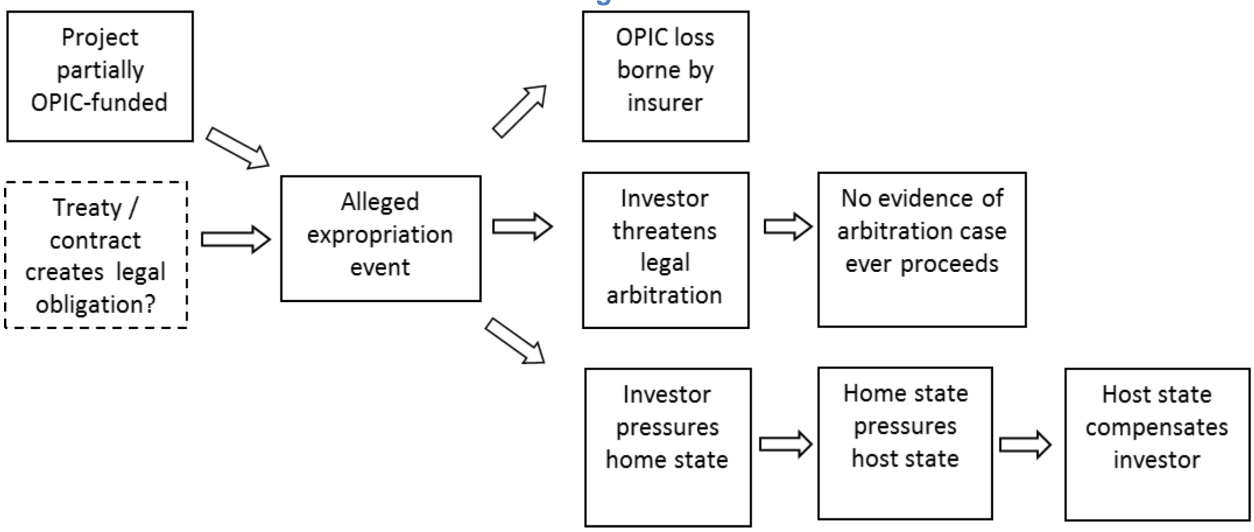
Cora's investors, however, did not solely rely on diplomatic pressure to protect their interests. They simultaneously pursued legal solutions, announcing almost immediately after the event

[22] Modern Africa did not have a political risk insurance contract with OPIC, but rather was an investment fund supported by OPIC capital. There are of course important distinctions between the two, but the effect on actors' incentives is broadly similar: since some of Modern Africa's capital was backed by OPIC, the fund would not completely internalize losses (similar to an investor with an insurance contract) and, should the fund lose its assets, OPIC would face losses (similar to an insurer who had to pay a claim).
[23] The details of the case stretch back several years earlier, but these are omitted here for the sake of brevity. For further information see Kramer (2003) and Wikileaks Cable 07ABIDJAN676.
[24] Kramer (2003).
[25] Officially, the US President is authorized to designate countries as eligible to receive the benefits of AGOA "if they are determined to have established, or are making continual progress toward establishing the following: market-based economies; the rule of law and political pluralism; *elimination of barriers to U.S. trade and investment*; protection of intellectual property; efforts to combat corruption; policies to reduce poverty, increasing availability of health care and educational opportunities; protection of human rights and worker rights; and elimination of certain child labor practices." (Italics added) See AGOA eligibility criteria at http://trade.gov/agoa/eligibility/index.asp.

that they would be filing an arbitration claim against Cote d'Ivoire.[26] Two months later the company officially announced that it had filed a case at the International Center for the Settlement of Investment Disputes (ICSID), seeking at least $54 million in damages.[27] This legal channel, however, does not appear to have proved fruitful, and there is no official record of an ICSID case. Indeed it is not even clear under what jurisdictional basis Cora would pursue arbitration.[28]

Meanwhile, the company continued to call on the US government to apply diplomatic pressure. The State Department, Commerce Department, United States Trade Representative (USTR), and OPIC were all engaged in the case, with the US ambassador and Under Secretary of State for African Affairs repeatedly raising the issue with Cote d'Ivoire's President and Prime Minister.[29] AGOA benefits for the country were revoked in 2005, though the investment dispute was at most a secondary cause in this decision, which was primarily driven by a failure to make sufficient progress in restoring democracy following the first Ivorian Civil War. In April 2006, however, when the newly-installed Prime Minister of a post-conflict unity government travelled to Washington to meet with World Bank, IMF, and US officials in order to restore economic relations between his country and the international community, the US made settlement of the dispute – along with democratic progress – a condition of resuming aid and trade benefits.[30]

The Investment Protection Regime at Work: Cora de Comstar



In May 2007, the case was finally settled when both sides agreed to a deal in which the Cote d'Ivoire government paid the Cora de Comstar investors $5 million. The US embassy in

[26] Kramer (2003).
[27] PRNewsWire (2003); see also Wikileaks Cable 07ABIDJAN676.
[28] There is no United States-Cote d'Ivoire investment treaty, though it is feasible that the company may have sought to pursue the claim through one of Cote d'Ivoire's other investment treaties, as Modern Africa had other European investors. Perhaps more likely, the contract between Cote d'Ivoire and the company may have included a clause allowing for investor-state arbitration in the case of a dispute. However, the contract is not publicly available.
[29] AllAfrica.com (2005); Wikileaks Cable 07ABIDJAN676.
[30] AllAfrica.com (2005); Wikileaks Cable 06ABIDJAN409.

Abidjan noted that it was "pleased to report" the end of the dispute to State Department headquarters, and investors thanked the US government for their help throughout the dispute.[31] The restoration of AGOA benefits was delayed due to ongoing political violence and contested elections; Cote d'Ivoire's AGOA eligibility was restored in October 2011.

The Cora example illustrates a number of features of the complex international investment protection regime. All three pillars were involved in some fashion.[32] When the dispute emerged the company immediately and repeatedly sought the assistance of its home government, both through the US embassy in Abidjan and in Washington, D.C., engaging a lobbying firm to espouse their cause and push government officials for support.[33] (As the CEO of Western Wireless later described the company's lobbying goal, "We needed to get support from various constituencies in the U.S. government to basically say, 'You can't do this. It violates contract sanctity. It's screwing a U.S. investor. It is a bad thing to do.'")[34]

Perhaps not surprisingly, of the two investors in Cora de Comstar, the one that was not supported by OPIC capital (Western Wireless) appears to have taken a more active role in lobbying for government support and seeking a resolution than the investor that was (Modern Africa); Modern Africa was investing OPIC money, while Western Wireless had its own capital at stake. Yet it is not clear how much, if at all, the incentive to protect OPIC capital motivated the government's actions: at least in the record which is available, government officials appear to have been more driven by the desire to support the interests of American citizens and uphold the norm against expropriation without compensation than by OPIC's commercial interest in the particular project (which by one estimate was $16 million).[35] Whatever its motivations, however, it is clear that the US government took the issue seriously, placing the dispute high on the bilateral agenda alongside other pressing priorities such as a fragile peace process and the restoration of democracy.

Finally, Cora de Comstar's use of arbitration (such as it was) bears a few comments. The company quickly announced publicly that it would be suing the Ivorian government, but after this initial action there is no evidence of further arbitration. The use of the legal pillar appears to have been designed primarily as a threat to the Ivorian government if it refused to settle; however outrageously the Ivorian government may have acted, it's not clear the Cora investors had a strong legal case (and the fact that they eventually settled for a tenth of what they had been seeking in arbitration suggests they were aware of this). Going through the motions of an arbitration case may also have helped to convince the US government that the shareholders were doing everything they could to resolve the dispute. At the same time, of course, if the case had actually gone ahead and Cora had lost (even if only on jurisdiction grounds rather than on the merits), it might have been more difficult for the US to push for compensation for investors who had lost in arbitration. Thus for investors hoping to engender home state diplomatic pressure, the semblance of appealing to the legal system – without actually risking a loss in arbitration – may be an optimal strategy.

[31] Wikileaks Cable 07ABIDJAN676.
[32] Though as described in Note 21 above, the investor did not have a political risk insurance contract but rather was supported by OPIC capital, with similar effects on actor incentives.
[33] The Hill Staff (2006).
[34] Ibid.
[35] Kramer (2003).

Dabhol in India

The Dabhol power plant was at the time the largest ever foreign investment in India. It was to be a 2400 MW power plant near Mumbai, jointly owned by three American companies: Enron, General Electric (GE) and Bechtel. The main deal was agreed in 1993; the final financing agreement included $200 million in OPIC insurance for the three main investors, as well as a $160 million OPIC loan and $32 million in PRI for banks financing the plant.[36] Construction was underway by 1995, and after some initial hiccups the first phase of the plant was operating by 1999. Relations between the plant's owners and the local state government power agency quickly deteriorated, however, mostly because the terms of the contract had badly overestimated energy demand.[37] By late 2000 the local state electricity board, who had guaranteed to purchase power from the plant at a fixed price, was delaying electricity payments to Dabhol's owners, and by mid-2001 the project had effectively collapsed.[38]

Dabhol's owners initiated a long, complex multi-pronged strategy to attempt to resolve the dispute. As in the case of Cora de Comstar, the strongest initial push was through diplomatic pressure, with the hope of reaching a settlement which could allow the project to go forward.[39] The Dabhol investors engaged numerous high-ranking American government officials to intervene with their Indian counterparts to encourage a quick settlement to the dispute. In April 2001 then-Secretary of State Colin Powell raised the Dabhol dispute with the Indian Foreign Minister.[40] In late June then-Vice President Dick Cheney mentioned the dispute in a meeting with Sonia Gandhi, the leader of India's opposition Congress Party.[41] By the summer of 2001 the United States' National Security Council – an interagency council run out of the White House – had established a "Dabhol Working Group" to coordinate US diplomatic pressure related to the dispute.[42] In an interview with the Financial Times that August, Enron CEO Kenneth Lay stated that if Dabhol was expropriated American laws "could prevent the U.S. government from providing any aid or assistance or other things to India going forward;" company spokespeople later qualified the statement, and made clear that Enron had not requested the US government to impose sanctions.[43] The strong diplomatic push continued at least through the fall of 2001, yet with no real evidence of any success in compelling the Indian government to settle the dispute.

Enron's spectacular collapse that November and December fundamentally altered the dispute. Enron had been the largest investor in the project (65 percent, compared to 10

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[36] Hanson, O'Sullivan and Anderson (2005). Enron also approached the World Bank for financing, but after studying the project the Bank concluded it was not economically viable, and thus declined to participate.
[37] Petra (2008).
[38] For the sake of brevity, this article only includes a cursory overview of the events which led to the dispute and the complex legal manoeuvres which followed the dispute. More comprehensive accounts can be found in Van Harten (2011), Bettauer (2009), Kundra (2008) and Hanson, O'Sullivan and Anderson (2005).
[39] Indeed, there had previously been an earlier dispute over the same project in 1995, which was informally resolved – with the help of US diplomatic engagement – and allowed for construction to go forward.
[40] US Department of State (2002).
[41] Milbank and Blustein (2002).
[42] Ibid.
[43] BBC News (2001).

percent each for GE and Bechtel), and its creditors inherited its claims against the Indian government. Following Enron's bankruptcy, the fight over Dabhol grew increasingly complicated, as the interests of the various investors and creditors to the project were not always aligned. In December 2001, GE and Bechtel notified OPIC that they intended to file claims on their PRI contracts.[44] OPIC, however, resisted paying out the claims, preferring instead to attempt to broker a sale of the project to prospective Indian buyers.[45] In turn GE and Bechtel initiated an arbitration case against OPIC, arguing that their claims had been improperly denied. GE and Bechtel won, and OPIC ultimately paid out a total of $110 million to the investors and Bank of America.[46] As noted above, once OPIC had paid the investors, through subrogation the claim against the Government of India was transferred to OPIC. Initially unable to resolve this claim amicably, OPIC launched an arbitration case against the Government of India in November 2004 to pursue recovery of the claims paid. This remains the only time in its history in which OPIC has filed a formal arbitration claim to pursue recovery.

While the protections offered by PRI partially compensated the American owners of Dabhol, the final PRI payout of $110 million represented only a fraction of the approximately $3 billion which had been invested in the project. To recover further funds, the investors pursued a wide range of international legal claims (which again were made substantially more complex by Enron's ongoing bankruptcy). In September 2003, Bechtel initiated a claim against the local government agencies based on the arbitration clause in the state contract.[47] In April 2005 the arbitration panel in this case ruled in favour of Bechtel, ordering the respondents to pay $95 million. Meanwhile, GE and Bechtel simultaneously pursued claims under Indian investment treaties. As there is no BIT between the US and India, the two American companies relied on subsidiaries in Mauritius and the Netherlands – two countries which did have ratified BITs with India – to pursue the claims.[48] In September 2003 GE and Bechtel filed a case under the Mauritius-India BIT, claiming on their combined 20 percent stake in the project.[49] By 2004 GE and Bechtel had bought out the remaining shares owned by Enron, and that year launched a second treaty case – this time claiming for Enron's shares – under the Netherlands-India BIT.[50]

By 2005, thus, the Indian Government had already lost one case and was still facing three additional legal claims related to Dabhol – one from OPIC in recovery of PRI claims paid out, and two from the GE/Bechtel consortium, under both the Mauritius-India BIT and the Netherlands-India BIT. Meanwhile, both OPIC and the State Department continued to push for a negotiated settlement. In a meeting on 24 June 2005 including US Undersecretary of State William Burns and Indian Foreign Secretary Shyam Saran, American Ambassador to

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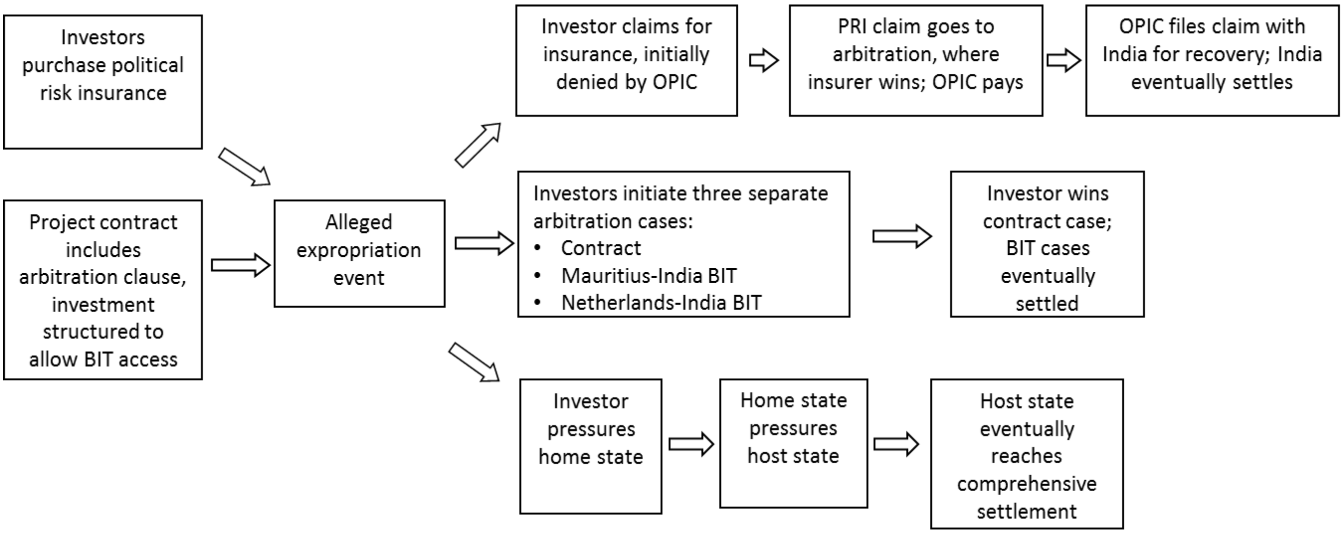
[44] Bechtel et al v. OPIC (2003).
[45] Hanson, O'Sullivan and Anderson (2005).
[46] Bechtel et al v. OPIC (2003).
[47] GE was also initially a claimant in this case, but then decided to remove itself from the case and withhold rights to future arbitration claims. See Capital India Power Mauritius I and Energy Enterprises (Mauritius) Company v. Maharashtra Power Development Corporation Limited et al (2005).
[48] The ability of multinationals to structure investments through subsidiaries and thus gain access to nationality-based legal protections is, in itself, another way in which the investment protection regime is more extensive than it initially appears.
[49] Bechtel (2003)
[50] Economic Times (2004).

India David Mulford stressed to the Indians "the positive impact an end to the Dabhol dispute would have on US investors, and urged that a target date of early July be set for the completion of negotiations."[51] The following month, an agreement was reached – on confidential terms – which saw full ownership return to Indian government agencies and all pending arbitration cases settled. OPIC – acting as an agency of the US Government – appears to have been the crucial broker of the deal.[52]

The Investment Protection Regime at Work: Dabhol



As the above summary indicates, the settlement of the Dabhol dispute was extremely complicated, both because the initial financing arrangements were complex and because of factors related to Enron's bankruptcy. Given the exceptional circumstances related to resolving a dispute after the main investor has declared bankruptcy, one must be cautious in generalizing from the Dabhol case. Yet a number of aspects of the Dabhol dispute settlement process are worth underlining and shed light on the broader investment regime. The first is the comprehensiveness of the strategy pursued by Dabhol's investors, which involved all three pillars of the investment protection regime. Second, as in the Cora de Comstar case, Dabhol demonstrates that diplomatic pressure remains an important tool for investment protection, working alongside the other two pillars. A strong diplomatic push proved ineffective initially, yet years later – when India was facing a number of legal claims related to the dispute – state-state diplomacy was an important driver in reaching a comprehensive, negotiated settlement. Third, the Dabhol case particularly illustrates the intersections of the three pillars. The risk insurance payment prompted two separate legal arbitration cases – the first between the investors and the insurer, the second between the insurer and the host state – and ultimately was resolved through diplomatic negotiations between OPIC and Indian officials. Moreover, the pending legal cases appear to be one of the key reasons why India was motivated to agree to a settlement negotiated partially through diplomatic channels. The three pillars of the investment protection regime operated simultaneously and

[51] Wikileaks Cable 05NEWDELHI5047.
[52] Hanson, O'Sullivan and Anderson (2005).

collectively, offering greater protection to Dabhol's investors than traditional analyses of the legal regime for investment would expect.

Conclusion

This paper offers a new perspective on the international investment regime by placing diplomatic, insurance and legal procedures for protecting assets overseas within a unified framework. It underlines how these three pillars overlap and interact, and how they operate collectively. By emphasizing these less visible pillars of the investment protection regime, this analysis suggests that the regime is more extensive than previously thought, and that the level of protection available to foreign investors is stronger than typically imagined.

As the cases of Cora de Comstar and Dabhol demonstrate, savvy investors are acting strategically to utilize all three pillars in attempting to receive compensation following investment disputes. Host states that are on the receiving end of such claims should also develop their defenses with an understanding of how the three pillars of the investment regime operate and interact. This is true both in the context of an individual dispute, and in shaping their broader investment policies. In recent years a number of countries – including Venezuela, Ecuador, South Africa, Indonesia, India and Australia – have expressed displeasure with current investor-state dispute settlement procedures, announcing reviews of the legal protections they offer foreign investors. Such reviews should be informed by an understanding of how the broader investment protection regime operates in their countries, and country-specific analyses of how limiting access to legal protections will influence investors' use of the other two pillars of investment protection. The current pressures on the investor-state dispute settlement system could ultimately provoke broader multilateral reforms to the investment regime, ones which will potentially more fundamentally shift the investment protection landscape. For the near future, however, the present three pillar approach to investment protection appears to be here to stay.

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