MIGA Multilateral Investment Guarantee Agency WORLD BANK GROUP

MIGABRIEF

DISPUTE RESOLUTION AND CLAIMS

INSURING INVESTMENT ■ ENSURING OPPORTUNITIES

MIGA: Helping Keep Sustainable Investments on Track

MIGA has provided political risk insurance supporting for investments into more than 700 projects in the Agency's developing member countries. Each of these investments has a unique set of financial considerations and development goals. MIGA provides solutions that serve its clients' risk-mitigation needs while also providing maximum benefits to host countries. In many cases, MIGA's ability to find innovative ways to support complex or unusual deal structures enables transactions that otherwise would not have been possible to move forward, benefiting both investors and developing countries.

In the event that MIGA's clients experience a covered loss, they can rely on the Agency for a thorough and fair analysis of the claim and prompt payment. Even more important than the assurance that valid claims will be paid, however, are the efforts MIGA undertakes to avoid claims. The Agency helps resolve disputes and negotiate agreements that allow projects to remain operational, generate revenue, and continue to contribute to the local economy.

Resolving Disputes to Avoid Losses and Keep Projects on Track

In order to prevent a potential claims situation from escalating, MIGA provides dispute resolution services to all of its clients. MIGA maintains close contact with investors and monitors projects and potential issues so that the Agency can respond at the first sign of trouble 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. MIGA's proactive facilitation efforts have been pivotal in the resolution of nearly 100 project-related disputes since the Agency's founding in 1988.

To date, MIGA has been able to resolve disputes that would have led to claims in all but two cases, and both of those claims were paid. MIGA also has paid six claims resulting from damage related to war and civil disturbance.

Understanding the Political Risk Landscape

Although commercial risks can be mitigated by conducting thorough due diligence, political risks remain difficult to predict and mitigate. Facilities may be damaged or operations interrupted by acts of war, civil disturbance, or terrorism. New laws or regulations may make carrying out the business's activities difficult, impossible, or even illegal. A government may seize a company's assets or nationalize an entire industry. Local currency may no longer be convertible into dollars, euro, or yen for transfer out of the country. And a host country government may unilaterally change terms already agreed to, impose unacceptable new conditions after the fact, or simply not honor its word. Political risks such as these make investing in developing countries challenging.

Political risk insurance helps provide a more stable environment for foreign direct investment which, in turn, unlocks access to finance for the host country. Political risk insurance allows investors to concentrate on the commercial aspects of their investments, confident that someone else—the insurance provider—will help them avoid potential losses, or reimburse them in case of a covered loss resulting from political causes.

MIGA insures foreign direct investments against losses related to:

- Currency inconvertibility and transfer restrictions
- Expropriation
- War, civil disturbance, terrorism, and sabotage
- Breach of contract
- Non-honoring of financial obligations

MIGA's experience and success in managing claims can also help investors understand the problems they may encounter in their cross-border investments. MIGA has identified a number of scenarios in which disputes are more likely to occur. These scenarios include the following.

- Utility projects and public service projects, which are both prone to tariff disputes, especially if the tariffs are linked to foreign currencies or variable input costs.
- Instances in which the government or the investor has unrealistic expectations regarding the performance of the counterparty.
- Investments in which there is a lack of full coordination among government bodies, such as sovereign and sub-sovereign entities.
- Investments in a country where the government makes major changes in its policies.
- Investments in which there is a lack of coherence in sectoral policies.

Some scenarios increase the risks of certain types of events occurring. For example, economic or financial stress within a country increases both transfer and convertibility risks. Similarly, potential expropriation and breach of contract claims frequently arise in public service projects that encounter financing problems or environmental or other public policy issues. Major changes in a government's policies may result in a breach of contract claim. In addition, research conducted by MIGA for its *World Investment and Political Risk* report also concluded that expropriation and sovereign defaults are more likely to occur in countries with a previous history of these events.

Highlights of MIGA's Work Addressing Potential Claims

The following cases represent examples of the role that MIGA has played, in conjunction with other units of the World Bank. Company and country names are used with permission or drawn from public sources.

Sub-Sovereign risk

In infrastructure investments, private firms often enter into agreements with provincial or municipal authorities. These "sub-sovereign" entities often face political pressures or lack experience when it comes to contract management and hands-on knowledge of operating large utility projects.

China: Deqing Darco Producing Water Co., Ltd

The county of Deqing in China's Zhejiang province was facing a serious shortage of potable water due to its rapid growth. Investment in the water sector was sorely needed. In 2004, MIGA issued a guarantee covering an equity investment by Darco Environmental Pte Ltd of Singapore in a water treatment plant that would supply 60,000 cubic meters of potable water per day.

The plant was nearly complete when a dispute broke out between the investor and the local authorities. As the dispute escalated, and each party claimed breaches of the joint-venture contract by the other party, the construction of a water plant that would provide potable water to nearly half a million people was delayed.

To prevent further delay of this critical project, a MIGA conflict-resolution team traveled to China. MIGA successfully helped the parties reach a settlement, through the cooperation and goodwill of all parties concerned including the foreign investor, the Chinese government, and the provincial authorities. The water treatment plant is now completed and operational.

In fact, one day after commissioning the plant in April 2006, company officials announced that it signed letters of intent for two new projects in the province. At the end of June 2007, the company signed an insurance policy with MIGA for the new projects.

According to Darco executives, "Without MIGA the dispute would not have been resolved and the project could not have been completed."

Transfer Risk

Transfer risk issues tend to come in the wake of economic crises and affect investors broadly across industries regardless of nationality. MIGA, however, has been very successful in gaining favorable treatment for the holders of its guarantees.

Country in South America: Multiple Banks–Guarantees of Loans

This country abandoned its 1:1 dollar exchange rate system, issued emergency decrees that instituted a flexible exchange rate system, and then converted foreign currency obligations and US dollar bank deposits into the local currency at a depreciated rate. Loan payments to lenders outside the country were required to be authorized by the Central Bank, with payments likely to be subject to transfer restrictions and delays. MIGA had guaranteed numerous non- domestic bank loans to local borrowers. MIGA negotiated with the Ministry of Finance and Central Bank and secured an exception to the requirement for Central Bank authorization for the holders of MIGA's guarantees.

Unilateral Restrictions Imposed by Governments

New governments may not always adhere to terms and conditions of contracts and licenses entered into by previous governments, especially in the case of a coup d'état.

Mobile Telephone Operator in West Africa

The government of a West African country unilaterally closed several private cell phone operators. In this case, the government first attempted to make a retroactive increase of 600 percent in the 10-year licensing fees of the MIGA-insured cellular phone company, and then simply terminated the company's license. MIGA met with the government to discuss the suspension and noting the detrimental impact of the government's actions on the nation's investment climate, especially given the government's publicized desire to make the country a target of investment. Continued negotiations, the assistance of the World Bank, and diplomatic pressure from the investor's home country resulted in an amicable settlement of the dispute in only a few months.

For general information

Multilateral Investment Guarantee Agency
World Bank Group
1818 H Street, NW
Washington, DC 20433
t. 1.202.458.2538
f. 1.202.522.2630
migainquiry@worldbank.org

www.miga.org

Dispute resolution services are anchored in MIGA's convention:
www.miga.org/convention