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NON-COMMERCIAL (POLITICAL) RISKS OF IMPLEMENTATION OF FOREIGN INVESTMENTS

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Defining non-commercial (political) risk as a threat (probability) of violation by a state the guarantees of foreign investors' rights, the author examines the mechanisms of protection of investors against non-commercial risks (mainly insurance).

Here is noted a direct or indirect link of emergence non-commercial risks with the action of a state-recipient of investments.

The author focuses that national legislation in most cases includes non-commercial (political) risks to the category of so-called force majeure events that do not entail the obligation of insurer to compensate to the injured party the damage suffered.

Keywords: foreign investments, investment activity, investment risks, non-commercial risks, political risks, non-commercial risks insurance.

The implementation of foreign investments in the territory of foreign countries involves numerous risks, including the risks of nationalization of investments, non-payment of adequate compensation for requisition of investments, breaches of obligations by contracting party of investor and etc. The risk to one degree or another is always present in the cross-border investment activity, is its integral sign, “an inevitable, and moreover, an essential element of investment activity” [9, 14]. There is a determinative position in the scientific literature, according to which “risk institute is an institute of the theory of law, receiving development and concretization both in sectorial legal institutes of risk and in complex institutes” [16, 88].

Investment risk is considered as an integral part of overall financial market and is determined as the “probability” (threat) of financial losses, unreceived income from investments or occurrence of additional investment costs” [17, 283]. Also the concept of investment risk is disclosed through the negative consequences that occur due to certain circumstances. In particular, A. A. Bogatyrev understands investment risk as “damage inflicted to investments in the event of nationalization, requisition, excessive taxation, as well as physical damage to investment property in the case of war...” [5, 11]. The economic literature contains such definition of investment risk: this is the “possibility of investments loss, unreceived or short-received income in implementation of investment projects” [11, 52].

The criterion of risk as a necessary investment sign was designated by the International Centre for Settlement of Investment Disputes (ICSID) in course of consideration the case of *Salini Costruttori S.P.A. and Italstrade S.P.A v. Morocco*. Based on the proceedings of the case ICSID introduced the so-called “Salini-test”, which it started to use to determine investments in accordance with the Washington Convention. This test lies in the presence of four conditions, which an investment must meet: 1) there must be a kind of injection; 2) project must be continuous; 3) presence of an operational risk, and 4) contribution to the development of the host state [20] (For more on the determination of the concept of “investment” in the documents or decisions of ICSID [4, 44-46; 7, 7-9]). The Lloyd Corporation in order to investment risks can be insured makes to them two basic requirements. Namely, for inclusion in an insurance policy the risk should be an event, the probability of occurrence of which is unknown, and it should be able to be measured in monetary terms [22].

The problem of determining the classification criteria for investment risks is associated with the legal essence and specific features of investment risk, as well as with the types of investment activities in general. So, traditionally in the legal

literature they single out the following main types of investment risks. Depending on the object of investment activity – single out the risk of financial investment touching on stock and cash (currency) market, and the risk of real investment (risk associated with capital investments, construction risks). By forms of ownership of the means of investment there are distinguished: the risks of state investment; the risks of private investment; risks of foreign investment; joint investment risks. By the criterion of the basis of emergence and the nature of insured event in the international investment activity single out commercial risks and non-commercial (political) risks [15, 22-23; 17, 283-286; 18, 16-20].

On the basis of examination of the represented in doctrine various definitions of non-commercial (political) risk with taking into account the provisions of international-legal documents in this field, it can be concluded that under such a risk it is justified to understand the risks arising from the events of political nature, which cannot be controlled by a foreign investor; these risks are conditioned by the possible actions of state-recipient, which may directly or indirectly adversely affect the ability investor to possess, use and dispose of its investments. Consequently, non-commercial (political) risk is the threat (probability) of violation by a state of the guarantees of foreign investors' rights. All kinds of non-commercial risks are peculiar of direct or indirect connection of their emergence with the actions of state-recipient of investments.

One of the main mechanisms for the protection of investors' rights against non-commercial risk is insurance of private investments in the implementation of cross-border investment activity. The primary task of foreign investment risks insurance is the rapid compensation of losses incurred by the investor from an independent source upon occurrence of an insured event. The main international-legal instrument in this field is the Seoul Convention of 1985 "On establishment the Multilateral Investment Guarantee Agency" [21] (*hereinafter referred to as the Convention on the establishment of MIGA*). The Russian Federation had joined to the Convention on the establishment of the MIGA in 1992, and this international-legal act entered into legal force on the territory of our country since 1995.

It should be emphasized that national legislation in the majority of cases attributes non-commercial (political) risks to the category of so-called force majeure events, which do not entail an insurer's obligation to compensate damages to the aggrieved party. In particular, article 964 of the Civil Code of the RF provides that under general rule the insurer shall be released from the payment of insurance compensation and the insurance sum, when the insured accident commenced owing to military action, as well as maneuvers or other military events; civil war,

civil unrest or strikes of any kind, for damages arising out of the seizure, confiscation, requisition, arrest or destruction of the insured property by the order of public authorities. In this regard, the MIGA insurance of exactly political risks acts as an important legal protective mechanism in the implementation of foreign investments.

Convention on the establishment of the MIGA (art. 11) singles out the following types of non-commercial (political) risks, in respect of which the insurance is exercised:

- 1) currency transfer risk;
- 2) risk of expropriation and similar measures;
- 3) breach of contract risk;
- 4) war and civil disturbance risk.

The content of the mentioned risks in more detail is disclosed in the MIGA Operational Regulations [19]. It is justified to describe the main aspects characterizing the species of non-commercial risks covered by the guarantee of MIGA.

1. The risk of currency inconvertibility of a host state and the risk of untranslatability abroad of local currency (if it is converted) or foreign currency, to which the national one is converted. This guarantee applies only to the amounts of currency received as income of investment activity or proceeds from the liquidation of investments. An essential condition for the provision of insurance indemnity on this type of non-commercial risk is an objective impossibility of conversion because of exchange restrictions imposed by the recipient country. The considered type of insurance guarantees protection of investor in case of delays in obtaining convertible currency because of an action or omission of the Government of the host state; unfavorable changes in foreign currency exchange laws; deterioration of the conditions affecting the currency exchange and outflow of foreign exchange. However, from the analysis of the provisions of article 11 of the Convention on the establishment of MIGA, it follows that this type of insurance does not cover one of the most common and property significant for investor adverse events – the devaluation of local currency. In particular, paragraph (b) article 11 of the Convention contains the following prescription: “Under the joint statement of investor and host party the Board of Directors of ... may approve the extension of coverage under this article to specific non-commercial risks ... but in no way to the risk of devaluation and depreciation of currency”.

2. The risk of expropriation or similar measures – this type of insurance protects an investor from “any legislative action or administrative action or omission coming from the host government, which has the effect of depriving the holder

of guarantee of ownership of its investments, control over them or a substantial benefit from such investment” [10]. Insured event under this type of guarantee can be not only the measures of public authorities of recipient country depriving the investor the rights on its property, but also restricting investment activity. However, this type of insurance does not cover measures relating to taxation, compliance with environmental and labor legislation, measures to maintain public order and other generally applicable non-discriminatory measures that are usually taken by Governments to regulate economic activity on their territory.

3. Breach of the terms and conditions of treaty (contract). This type of insurance is designed to protect the property interests of investors against losses arising from breach of terms or rupture of contract on the part of the Government of host state. For insurance reimbursement, you must have one of the following circumstances: an investor does not have the ability to appeal to a court or arbitration body with a claim on a treaty (contract) against the Government of host-state; such authority does not take a decision within a reasonable time, as it is provided for in the treaties on guarantee in accordance with the provisions of MIGA; after a final judgment in its favor a foreign investor cannot achieve its execution.

4. Insurance of the risk of war and civil disturbance protects an investor from damage, destruction or disappearance of the fixed assets as a result of these events. This risk includes revolutions, revolts, state coups and other similar acts, which cannot be regulated by the Government of host state. However, paragraph 1.53 of the MIGA Operational Regulations contains restrictive conditions for action of this type of insurance. So, under a general rule, MIGA shall not compensate the investments’ damage resulting from trade unionists, students and other actions to protect the specific interests, as well as in the case of terrorist acts directed against the holder of guarantees (investor), and kidnapping.

MIGA will insure foreign investments against political risks, if the investments meet certain requirements, which can be identified through the analysis of article 12-14 of the Convention. Firstly, the investments should be medium-term or long-term investments; secondly, the insurance applies only to private investments, i.e., in the role of investors may be only foreign individuals and legal entities acting on a commercial basis; thirdly, investing should be carried out only on the territory of a developing member country belonging to Category II specified in the Annex to the Convention on the establishment of MIGA. In addition, investments must be economically justified and contribute to the development of host country, as well as investments shall comply with laws, regulations, objectives and priorities of the development of the host country. In addition to

the above, when concluding an insurance agreement, MIGA must verify the existence of conditions for investments in a host country, including existence of a fair and equal approach to investment and legal protection for it. At that, MIGA, pursuant to article 15 of the Convention, shall not conclude any contract of guarantee before the host government has approved the issuance of the guarantee by the Agency against the risks designed for cover.

As noted in the literature, despite the fact that Russia has fully joined to the analyzed Convention December 29, 1992, "but no cases of the reference to it in order to make best practical use of all the benefits provided by this Convention has not yet been observed" [8]. In this context, it is reasonable to suggest that exactly the system of high requirements and conditions for investment, so that they can be insured by MIGA, creates serious legal obstacles to the practical implementation of the provisions of the Convention on the establishment of the MIGA. Meanwhile, as rightly pointed out by A. G. Bogatyrev, the role and importance of foreign investments' insurance institute within the framework of MIGA will increase substantially with the development of the investment activities of the International Bank for Reconstruction and Development, the International Finance Corporation and other international financial organizations [6, 167].

The next question, before which it is advisable to stop for disclosure the mechanism of insurance of foreign investments against non-commercial risks, concerns the legal regulation of subrogation. In bilateral investment agreements subrogation is understood as a relation, by virtue of which "Contracting Party or its authorized body, which have made payments to an investor on the basis of guarantee of protection against non-commercial risks in connection with its investment in the territory of another Contracting Party, will be able to exercise in the order of subrogation the rights of the investor in the same extent as the investor" [1; 2; 3]. In accordance with article 18 of the Convention on establishment of the MIGA, after payment or consent to the payment of compensation to the owner of the guarantee (the insured), the Agency is assigned the rights or claims related to a guaranteed investment that can be of the owner of the guarantee in respect of host country or other debtors. The treaty on guarantee provides for the terms and conditions of such assignment.

The MIGA's need during subrogation to interact with recipient states, whose actions have caused the insured event, makes unique the legal status of MIGA that has a dual nature. On the one hand, it is an international intergovernmental organization with an international legal personality. On the other hand, regarding the content of its main activity (investment insurance against non-commercial risks) MIGA can be characterized as a subject of international business law, so MIGA

also has signs specific to a commercial organization (has a share capital; bears an independent property responsibility on its insurance obligations to policyholders, etc.). The dual nature of the legal status of MIGA is described by some authors [12, 112-113; 14, 206-207; 17, 294].

When subrogation the relations from the private-law sphere on the insurance contract of MIGA with the investor move into international public sphere, the parties to which are two entities of international public law (international organization and recipient state). This is the main feature of the international-legal mechanism for foreign investment insurance against non-commercial (political) risks within the framework of MIGA. This transformation of the legal status of MIGA discloses the originality of investment legal relations in general.

Summarizing the above, it should be noted that non-commercial risks insurance of foreign investments occupies an important place in the system of civil-legal methods to protect the rights of foreign investors. Implementation and increased efficiency of protective legal mechanisms in the implementation of international investment activities largely depends on the solving the tasks of harmonization of national legislation with the provisions of international documents, development of insurance companies engaged in insurance of various risks of cross-border investment activity, detailed elaboration and improving the content of insurance contracts in this area, extension the list of risks of foreign investments covered by insurance, creation of legal opportunities to facilitate access of private investors to the use of insurance of investments within the framework of MIGA.

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