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MIGA / I.F.I Shihata Provisional Manuscript, Jy 1987

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THE MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA) AND THE LEGAL TREATMENT OF FOREIGN INVESTMENT

[Ibrahim F.I. Shihata]

July 1987

PROVISIONAL MANUSCRIPT
7.2.87

THE MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)

AND

THE LEGAL TREATMENT OF FOREIGN INVESTMENT

Lectures Delivered at The Hague Academy
of International Law

on July 13-17, 1987

By

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AND

THE LEGAL TREATMENT OF FOREIGN INVESTMENT

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CHAPTER ONE

THE MAKING OF MIGA - A HISTORICAL ACCOUNT

I. The Earliest Proposals

The World Bank's (the Bank's) earliest discussion of the promotion of international investment by means of insurance against non-commercial risks dates back to 1948, the same year in which the first national program of this type of insurance was introduced by the U.S. Government.1/ The first record of this discussion is to be found in a confidential draft memorandum dated March 3, 1948, entitled "Proposed Plan for Guaranteeing Foreign Private Investments Against Transfer Risk and Certain Other Risks.2/ Interestingly, this draft, which in fact preceded the launching of the U.S. Investment Guaranty Program, did not seem to receive much attention in the Bank.

The idea re-emerged two years later in a staff memorandum dated October 1950 which suggested that the Bank could stimulate private foreign investments by adopting a number of measures including the investment of a certain percentage of its earnings in an "insurance fund" to guarantee foreign investments against risks such as nationalization without full compensation, war, and inconvertibility of currencies.3/ As in the earlier proposal, it was envisaged that the Bank would either provide such insurance directly or through a subsidiary.

Meanwhile. several other sources outside the Bank proposed, in the 1950s and the early 1960s, the creation of a multilateral investment insurance scheme, with many suggesting a role for the Bank in the administration

or financing of the scheme. A study group of the Council of Europe's Consultative Assembly proposed in 1957 the establishment of a "Guarantee and Financial Assistance Fund" to cover European investments in Africa.4/ In the same year, Mr. Richard Nixon, the then Vice-President of the United States, called for an examination of the possibility of establishing an international fund for investment guarantee. This fund, Mr. Nixon suggested, would be managed by an autonomous entity and would cover existing and future foreign investments against the risks of nationalization, currency devaluation and inconvertibility and similar risks.5/ Within a year, a detailed proposal was discussed in a sub-committee of the U.S. House of Representatives on the creation, by governments in association with private shareholders or by "an international organization such as the IBRD," of an international corporation to provide this service.6/ In 1958, Mr. B. L. Jalan of India elaborated a proposal for an international investment insurance scheme which he had first presented three years earlier before the All-India Trade conference of 1955.7/ In the same year, 1958, a member of the French Senate, Mr. Luc Durand-Reville, suggested to the Economic and Financial Committee of the Inter-Parliamentary Union the creation of an international guarantee fund for private foreign investment and the Union endorsed the suggestion.8/ The "European League for Economic Cooperation," a private association with strong connections to the European movement of the time and to European financial and industrial circles, also proposed in 1958 the establishment of a guarantee system for European investments abroad. The proposed system was to be carried out by national agencies which would in turn be reinsured by a "European Guarantee Agency" that would also provide direct insurance to European joint ventures.9/ In 1959, the Council of Europe's Consultative Assembly approved the proposal to

establish a "Guarantee Fund against Political Risk" in the context of European-African Cooperation.10/ A number of plans were also presented by individuals to the Organisation for Economic Co-operation and Development (OECD),11/ and to the International Chamber of Commerce (ICC)12/ in the late 1950s on specific multilateral investment insurance schemes. The International Association for the Promotion and Protection of Private Foreign Investments (APPI) published its scheme for the same purpose in 1960.13/

Aware of all these developments. the World Bank decided in the Spring of 1961 to undertake a study of multilateral investment insurance and to consider whether it could perform a useful service to its members by associating itself with an investment insurance program.14/ A Bank/International Finance Corporation (IFC) International Investment Insurance Working Party was thus established and held its first meeting on June 28, 1961. Within days, the Development Assistance Group (now the Development Assistance Committee or DAC) of the OECD, at its July 1961 Tokyo Meeting, considered a number of proposals in this field and decided to ask the Bank to undertake a study of possible multilateral investment guarantee schemes. By September 1961, the President of the Bank, Mr. Eugene Black, was in a position to announce in his address before the Bank's Board of Governors' Annual Meeting in Vienna that, following a number of proposals and a suggestion by the OECD, the Bank was studying the possibility of devising a multilateral scheme for the insurance of private foreign investment against various non-commercial risks. He made it clear, however, that "while we were generally familiar with the various proposals. we had no preconceived ideas about their usefulness or feasibility ... [and] I am not yet in a position to forecast our conclusions."15/

A. The 1962 Study and its Impact

The Bank staff prepared their first comprehensive report on Multilateral Investment Insurance in January 1962.16/ The report reviewed the proposals submitted so far and identified the principal issues thought to be relevant to any consideration by governments of the desirability and feasibility of establishing a multilateral program. Written in non-committal language which did not express any position of the Bank management, the report did not include recommendations regarding the creation of such a program or an outline of its most desired features in case it was decided to pursue the matter further. Nor did it discuss where responsibility for the program would lie and what role, if any, the Bank would play in this regard.

The 1962 report was published and transmitted by the Bank to DAC. Its preface stated that the Executive Directors authorized its publication "in the belief that the analysis contained in the report will prove useful both to governments and to private interests" but maintained the non-committal language, explicitly stating that it "expressed no views either on their [i.e. the Executive Directors'] own behalf or on behalf of the governments which appointed or elected them concerning the issues discussed in the report." Nevertheless. the 1962 report attracted considerable interest. Within a few days of its publication, the ICC prepared a "Preliminary Statement of Views"17/ for consideration by DAC which was scheduled to meet in the summer of 1962 to discuss the report. This statement was also distributed to the Bank's Executive Directors. Unlike the 1962 report, the ICC statement was clearly supportive of the concept and of the Bank's involvement in its implementation. "The administration of such a scheme," the Statement said, "should be in the hands either of the World Bank itself

... or of some specially created international institution operating under its aegis." Similarly, a favorable statement of views was issued in the following month by the "Legal Committee of the Consultative Assembly of the Council of Europe."18/

DAC discussed the Bank's report along with a number of other suggestions presented to it, most notably the draft Charter of an Inter-Governmental Investment Guarantee Program submitted by Professor Stanley Metzger.19/ In 1963, the Secretary-General of OECD was requested to prepare, with the assistance of experts to be made available by member governments. a report on the technical and legal aspects of different systems of multilateral investment guarantees while taking into consideration the Bank's report and consulting with the Bank. As a result, OECD convened two meetings of experts in Paris on May 27-30 and December 6-7, 1963 which were both attended by Bank representatives. The technical nature of the meetings was emphasized; no government views were sought and no attempt was made to reach agreement on the features of a feasible scheme. Following these meetings, an OECD Secretariat report was considered by DAC in 1964. DAC then requested the Secretary-General to consult with interested OECD member governments and to prepare draft articles of agreement for a multilateral program reflecting the goverments' views and the conclusions of the Secretariat report.

In June 1965, the OECD Committee of Experts completed a "Report on the Establishment of a Multilateral Investment Guarantee Corporation."20/ This "OECD Proposal" was submitted to the Bank with the request that the Bank "undertake such official consultations and other action" as it deemed appropriate "with a view to establishing an investment guarantee institution which could meet the objectives defined in the [OECD] report. While

emphasizing that it did not commit any OECD member, the OECD Proposal set forth the principal features of a scheme which in the view of the OECD Council would command the widest measure of support from member countries. It envisaged a program to be administered by a new and independent international entity called the "International Investment Guarantee Corporation," which would be loosely affiliated to the Bank. New private investments originating in the Corporation's capital-exporting member countries and made in less developed member countries were proposed to be guaranteed against any non-commercial (i.e. political) risks. The scheme did not call for a capital fund to which all members would subscribe and out of which losses would be met. Less developed country members were not to be required to share in losses. Their pecuniary obligations were proposed to be normally limited to contributions toward the program's administrative costs. They would have to agree to recognize the Corporation as successor to the rights of an investor paid under a guarantee and to make arrangements for settlement of any disputes with the Corporation, but adherence to an agreement for the protection of foreign property was not proposed to be a prerequisite to their membership. Losses were proposed to be borne by capital-exporting country members only. The share of each such member in any loss would reflect the extent to which its nationals had made use of the program, and the country's maximum potential liability would be subject to its control through a requirement that each investment must be approved for guarantee by the country of the investment's origin. The multilateral scheme was not intended to supersede national programs; on the contrary, any member country wlth a national program could reinsure with the multilateral scheme risks covered by guarantees issued under its own program, provided that the norms set for direct guarantees by the Corporation were met.

The issues raised in the Bank's 1962 report and the OECD Proposal meanwhile became a topic of discussion at the first United Nations Conference on Trade and Development (UNCTAD I) in Geneva in the Spring of 1964. The Final Act and Report of UNCTAD I included a recommendation requesting the Bank to "expedite its studies on investment insurance in consultation with goverments in both developing and developed countries, and to submit by September 1965 at the latest, the result of its studies and consultations to the United Nations."21/ Significantly, this was the first time a clear interest in the proposal was expressed by representatives of developing countries.

In view of the requests received from UNCTAD I in 1964 and OECD in 1965, the Bank decided, after initial hesitation on the part of its management, to continue to investigate the desirability and feasibility of establishing a multilateral investment guarantee program. On September 22, 1965, the Secretary-General of the United Nations received (as requested by UNCTAD I) an "interim report" from the President of the Bank, Mr. George Woods, giving an account of the status of the studies. The Bank's Executive Directors also received on December 6, 1965, a staff report on the "Principal Points for Consideration in Connection with Multilateral Investment Guarantees."22/

B. The 1966 Draft Articles: IIIA - 1

The "Principal Points" report made it clear that the preparation of a draft convention establishing the proposed system would require lengthy discussions and the Executive Directors wisely decided that such discussions would best be held in a "Committee of the Whole" consisting of all of them and chaired by the Bank's General Counsel.23/ Although this Committee

held some sixty sessions over a seven-year period it did not succeed, as will be shown later, in recommending a draft convention for adoption by the Bank's members. Following the Committee's preliminary round of discussions in March and April 1966, guidelines for the preparation of a first draft of the Articles of Agreement of an investment insurance agency were drawn up by July 5, 1966. This modest step enabled the President of the Bank to report some progress in his second progress report on the subject to the Secretary-General of the United Nations dated July 27, 1966.

The first draft Articles of Agreement of the International Investment Insurance Agency (IIIA) were issued by the Bank's staff on November 30, 1966[24/] and were distributed to member governments and interested international organizations for comments. A second round of discussions was then held by the Committee of the Whole to review the draft Articles in the light of the comments received which included comments of OECD, ICC and APPI.[25/] Apart from the firm support of the Canadian Executive Director, the initial discussions of the Committee of the Whole were noteworthy for the apathy and skepticism displayed. The management position, however, was that "the Bank's duty was to press forward with the task of drafting a well-considered charter for the agency, without considering what eventual support it might find." In the end, the Committee spent over a year in reviewing the draft Articles.[26/] During this period, unexpected support was expressed by the UNCTAD II meeting held in February, 1968, which almost unanimously adopted a resolution on "Increasing the Flow of Private Capital to Developing Countries" strongly endorsing "the Bank's efforts toward establishing a multilateral investment insurance scheme."[27/]

The 1966 draft Articles adopted the main tenets of the OECD Proposal of the previous year. Without specifying the overall objective of IIIA in

the text of an Article28/ and limiting the scope of IIIA's activities to insurance operations, the draft envisaged an international agency loosely associated with the Bank which would insure eligible investments against all or part of the loss resulting from specific non-commercial risks. Membership in IIIA was to be open to any country by virtue of its membership in the Bank or the United Nations or its being a party to the Statute of the International Court of Justice, or by virtue of an invitation from IIIA's Council upon the recommendation of its Board by a two-thirds vote in each. Governors and Alternate Governors of the Bank appointed by members of IIIA would *ex officio* serve as the representatives of these members in IIIA's Council, and the President of the Bank would *ex officio* be the Chairman of IIIA's Board of Directors. Only countries designated as developing countries would be eligible as host countries of the investments eligible as host countries of the investments eligible to benefit from IIIA's insurance. But these countries would have no financial stake in IIIA. Ultimately, losses and administrative expenses were expected to be met out of the premiums paid by the insured investors. In the meantime, losses were to be shared on a pro rata basis only by the member countries which sponsored investments for insurance.29/ In other words, as in the OECD Proposal, IIIA was to act merely "as the agent of and on on account of" the sponsoring members who would exclusivelv bear the financial risk of IIIA's operations. (Initially, administrative expenses were to be met from a refundable advance contributed by members other than developing countries.)

Thus, under the 1966 draft all insured investments were to be "sponsored." It was envisaged that any member could sponsor an investment made outside its own territory in a developing country, even if the

investor were not a national of that member. IIIA was, however, to be precluded from insuring an investment if another member of the agency objected on the ground that the investor was its national. While IIIA would have been permitted to rely upon the sponsor's determination of the investor's nationality, it was also to be authorized to make its own determination for this purpose. The risks to be covered by IIIA included any non-commercial risk, especially the three typical "political risks," i.e., the taking of property (expropriation risk), the inconvertibility of currency (transfer risk) and armed conflict and civil unrest (war risk). However, the risks of currency devaluation and depreciation were explicitly excluded.

Eligible investments were to be new, foreign and developmental in character. They would have had to be made by a private investor who was a national of a member country and to be approved both by the sponsoring member and the host country. They were to include the contribution of assets in either a monetary or non-monetary form, the reinvestment of earnings; the purchase of outstanding securities of an existing enterprise in conjunction with its modernization, expansion or development; and the purchase of securities representing investments originally made by IFC or other public international development financing institutions. Eligible investments did not, however, cover securities issued or guaranteed by governments and short-term loans.30/ The text provided that other tests might be prescribed by IIIA, including elements which affect the investment conditions in the country such as "the effect on private foreign investment of the laws and policies of the Host Country regarding the treatment of, and the settlement of disputes with, private foreign investors."

IIIA was also to be authorized to provide reinsurance to national political risk insurance agencies if the risk to be covered and the investment to be insured met the criteria for IIIA's direct insurance activities.

The draft provided that IIIA would be subrogated to the rights of the investors it compensated. Disputes between IIIA and a member which could not be settled by negotiations were to be settled by arbitration according to rules detailed in an annex to the Articles. Entry into force of the Articles was to be conditioned on the modest requirement of the deposit of instruments of ratification by at least five host countries and five other members.

Although each member of IIIA's Council and Board was to have one vote, the predominance of the investors' home countries was to be ensured through the special composition of the Board of Directors. This Board, which was to be responsible for the general operations of IIIA and was to have the general power to take any action required or permitted under the Articles, was to have between nine and eleven members of whom only four were to represent host countries. Other countries were to elect five to seven Directors according to the amount of insurance sponsored by each of them, the country that sponsored 15% of all insurance being entitled to appoint a Director.

C. The 1968 Draft Articles: IIIA - 2

Discussions of the 1966 draft Articles in the Committee of the Whole took over a year, from May 1967 to August 1968, and resulted in the preparation of a revised draft which was submitted to the Bank's Executive Directors on August 19, 1968,31/ with the suggestion that they consult with their governments on its provisions. The then new President of the Bank,

Mr. Robert McNamara, asked the Executive Directors to ascertain whether the governments they represented were prepared in principle to participate in an international investment insurance scheme. Mr. McNamara repeated this request in later Board meetings while implying that the Bank's interest in the subject would be dependent on the interest shown by its members. For its part, the Bank's Board, which certainly did not fail to note that after almost a year since the distribution of the 1968 draft members such as the United States had still not responded, decided not to resume discussion on the matter unless additional support was shown. After receiving responses from some 44 countries, of which 36 were in principle supportive of the scheme or interested in pursuing it further, the Committee of the Whole resumed its meetings on March 19, 1970. Its initial discussions showed that a number of countries including Japan, Germany, Canada, some Latin American countries and a few others were still not prepared to join a scheme of this type. Other countries such as the United States and the United Kingdom had reservations on certain aspects of the draft, especially the lack of financial participation by host countries in the financing of IIIA and in the loss sharing arrangements. Later discussions revealed, however, some growing interest on the part of major capital-exporting countries such as the United States, the United Kingdom and Japan. Yet, controversy continued over important policy issues. In addition to the issue of financial participation by developing countries, major controversial issues included subrogation of IIIA to the rights of compensated investors, the voting structure in IIIA's governing bodies, the organizational link with the Bank and the settlement of disputes between IIIA and its member countries. Although the majority of the Committee agreed, in its meeting of January 7, 1971, that it should continue to study the subject, some

members were still questioning the propriety of even discussing the proposal in the councils of the Bank. Meanwhile, the Special Gommission for Latin American Coordination issued a resolution strongly opposing the proposal32/ and setting a pattern that was to be closely followed by many Latin American countries in all subsequent discussions. At the beginning of 1972, the Executive Directors' Committee of the Whole reached the point of discussing whether to remove the subject altogether from the agenda and to inform UNCTAD and OECD, which were still patiently waiting for an approved draft from the Bank, that no further action was envisaged. Not wishing to bring the long exercise to an abrupt end, the Committee finally opted for the safer course of requesting the staff to prepare yet another draft that was "most likely to achieve the widest possible acceptance as a basis for further consideration and negotiation."

The 1968 draft Articles presented, in addition to numerous drafting improvements, a number of departures from and additions to the earlier draft of 1966. The risks eligible for cover were expanded to include, in addition to the three typical political risks, "other non-commercial risks which discourage international investment and which cannot be insured through normal channels at reasonable rates" provided their coverage was approved by a two-thirds majority of the Board's members. Greater flexibility was also introduced in the eligibility criteria for investments and investors. Thus, reference to "private investment" was replaced by "investment of a non-governmental character," while "an investment in securities representing an investment originally made by a public development financing institution, national or international" (and not just by IFC and other public international institutions as in the 1966 draft) was deemed eligible "upon sale thereof by such institution." Government

guaranteed securities and some forms of loans excluded in the 1966 draft were made eligible by limiting the exclusion in the new draft to "investments evidenced by direct obligations of governments or political subdivisions thereof" and investment determined by IIIA to be "in the form of short-term suppliers' credit." (A footnote suggested, however, that it was expected that "initially, investments in the form of loans would be limited to those with a final maturity of at least five years.") The text conceded that IIIA might prescribe other eligibility tests but, unlike the 1966 draft, no examples were provided for this purpose and reference in this context to the effect of the laws and policies of the host country on the foreign investor was intentionally deleted.

The "sponsorship" concept was maintained in the 1968 draft with the additional flexibility of allowing a member to sponsor an investment made by any investor regardless of his nationality. i.e., even if he was not a national of any member. IIIA was to notify all its members and all members of the Bank of any proposed sponsorship and to refrain from insuring an investment if another member of IIIA objected on the ground that the investor was its national. If such objection came from a member of the Bank which was not also a member of IIIA, the latter would be obliged to consult with that Bank member before taking action on the application. Losses were to be shared by sponsoring members according to a new formula (presented by the staff during the discussion of two alternatives provided in the 1966 draft)33/ whereby 25% of any loss would be borne by the country sponsoring the affected investment and the remaining 75% would be shared by all sponsoring countries in the proportion of the amount sponsored by each to the total amount of insurance sponsored by all sponsoring countries. The draft also provided that in the event of a default by a member, all the

non-defaulting sponsoring countries (and not just the sponsor of the affected investment, as was the case in the earlier draft) should make up the amount of such default on a proportionate basis. The liability of each sponsoring country was, however, to be limited to the aggregate of the amounts of maximum liability provided for in the insurance contracts sponsored by that country.

In other respects, especially in terms of the relative voting power of developing countries and the link between IIIA and the Bank, the 1968 draft introduced little change. Thus the provision for developing host countries to have just four seats in IIIA's Board was maintained in substance and changed only to add requirements regarding equitable geographic representation among these countries and giving appropriate weight to the volume of insured investment made in the territory of each of them. If a developing country had sponsored more insured investment than the outstanding insurance on investments made in its territory, it would then have the right to participate in the election of the Directors representing the home countries of the investors just like any other capital-exporting country. The same linkage with the Bank provided for in the 1966 draft was also maintained but with the additional provision that after the initial five years, IIIA's Council could decide, on the recommendation of the Board and acting by a two-thirds majority, that the Managing Director of IIIA would serve as Chairman of the Board. In addition, the 1968 draft included some new provisions allowing coverage of investments in the dependent territories of developed countries, provided they did not originate in the mother country, and deleted the provisions in the 1966 draft regarding the exclusion by a sponsoring country, in exceptional circumstances, of its liability for losses incurred in a particular country. subject to IIIA's right to reject

such exclusion in cases of abuse. Finally, entry into force of the Articles was made subject to the deposit of instruments of ratification of a larger number of countries, a minimum of ten developing and five developed countries, and not just five from each category as in the earlier draft.

D. The 1972 Draft Articles: IIIA - 3

The Bank staff were prompt in producing the new text required by the Executive Directors' Committee of the Whole and did so on February 28, 1972.34/ Like the earlier drafts of 1966 and 1968, the text was prepared by the Bank's Legal Department under the direction of Mr. Aron Broches, the General Counsel, who also chaired the Committee of the Whole throughout its work on the matter in the previous six years.35/ Having this time a mandate to present a text which in their judgment would have the "widest possible acceptance", the staff used their greater freedom to introduce more drastic changes which were clearly meant to meet concerns expressed in earlier discussions and to strike what seemed to them at the time as an appropriate balance.

In addition to many detailed changes, innovations in five major areas were introduced in the 1972 draft Articles.

Rather than accepting the earlier assumption that developing countries would neither participate in IIIA's administrative expenses nor share its losses, the new draft provided what seemed to be a major concession to those who wished to establish the principle of financial participation by all members. It included provisions on the establishment of a permanent "Common Working Capital Fund" to be contributed to by each member of IIIA on the basis of members' subscription in the Bank's capital. Through that Fund, IIIA was to meet its administrative expenses when its income fell

short of such expenses, and to make advances to its members "in connection with the discharge of their obligations" under the Articles.

The above "concession" may be compared to changes introduced in the provisions on subrogation of IIIA to the rights of an insured investor upon payment. The new draft exempted host countries from recognizing such subrogation if the country involved had agreed to submit its disputes with the insured investor to arbitration before the International Centre for Settlement of Investment Disputes (ICSID)36/ unless the dispute proved to be outside ICSID's jurisdiction or the host country failed to comply with the award.

In fact, the new draft went so far as practically to exempt the host country from binding arbitration as the mechanism for the settlement of disputes with IIIA acting as subrogee of an insured investor in cases where the country involved agreed to settle its underlying disputes with the insured investor through ICSID arbitration. Such exemption was to apply unless IIIA's Board authorized it, by a special majority, to institute formal arbitration proceedings under these circumstances.

The new draft also sought to accommodate to some extent the demands of representatives of developing countries for a greater role in IIIA's Board. The Board was to consist of ten elected members, half of them representing developing countries. Voting was to be weighted within each group to take into account contributions to the "Common Working Capital Fund" and the amount of insurance hosted (for representatives of developing countries) or sponsored (for the others). Any member sponsoring more than US$1 million of insurance was authorized to participate in the election of the five Directors representing capital-exporting countries (regardless of the size of insured investments in its territories). The equal representation of

the two groups of countries did not entail equal voting rights, however. Directors representing capital-exporting countries were allocated 65% of the voting power, against 35% for the Directors elected by developing countries. The role of this Board, which was clearly to be dominated by representatives of industrialized countries, was so broad as to cover the issuance of insurance and reinsurance and even the payment of claims, unless the Board itself, acting by a special majority, delegated the power to make such decisions to the Managing Director.

The 1972 draft also weakened further the linkage between IIIA and the Bank by giving IIIA's Council the right to decide <u>at any time</u> that the Managing Director of IIIA, instead of the Bank's President, should become the Chairman of IIIA's Board.

In addition to the above innovations, the new draft introduced other important changes in the operational aspects of IIIA's work while still conceiving it exclusively as an investment insurance mechanism. IIIA was thus to be prohibited from insuring risks that could be insured through commercial channels on reasonable terms.37/ New investments eligible for cover were defined in the new draft as investments committed to be made after the date of the contracts of insurance or after the date when IIIA declared its willingness to consider insuring such investments. More rigidly than in earlier drafts, additional tests to be prescribed by IIIA for elegible investments (no examples mentioned) were to be introduced only by a special majority in IIIA's Board of Directors. The provisions on reinsurance were also expanded to give IIIA, when reinsuring risks insured by a national scheme, first the right to require sponsorship for reinsurance of a reasonable cross-section of the risks, and second, the right to reinsure itself all or a portion of its risks with commercial insurers. In

addition, a new provision dealt with cooperation with national agencies, suggesting a close working relationship with them, as requested in earlier discussions by many representatives of capital-exporting countries. Finally, the entry into force of the new draft Articles was made subject to the deposit of instruments of ratification by fourteen developing countries and seven capital-exporting countries, provided that the aggregate membership fees of these twenty-one countries was not less than US$12 million (representing 65% of the total fees if all members of the Bank joined IIIA).

Interestingly, the 1972 draft was never discussed by the Bank's Executive Directors or their Committee of the Whole. On May 9, 1972, the President of the Bank, Mr. McNamara, noting that some Executive Directors still doubted that the Bank was a proper forum to prepare the scheme, raised with the Bank's Directors the question whether the initiative should be abandoned or continued. In early 1973, he suggested to them that the Committee of the Whole should not resume discussion of the proposal. In his view, it would suffice to send the 1972 draft, along with a commentary identifying outstanding issues, to member governments with a note stating that if enough developed and developing countries expressed positive interest in proceeding, the Bank would be prepared to serve as a forum for further consideration or to provide technical assistance should governments prefer another forum. The Executive Directors approved this recommendation on February 2, 1973 and the required documents were submitted to them on April 16, 1973. Among these documents was a staff memorandum which identified and explained five issues on which no consensus was reached in earlier discussions. Not surprisingly, these issues were: financial participation by developing countries; subrogation; settlement of disputes between IIIA

acting as subrogee and a host country; the extent of the link between IIIA and the Bank; and voting rights in IIIA's governing bodies.

Following the circulation of the 1972 draft Articles and the accompanying documents, no further work was done in the Bank with respect to the international investment insurance agency proposal38/ until the matter was revived again by a new Bank management, in late 1981.

II. The Clausen Initiative and the MIIA Outline

The selection of A.W. Clausen as President of the Bank in 1981 brought to the top of the institution a strong believer in the role of the private sector, including private foreign investment, in the development process. His direct and long experience in international banking and finance made him particularly aware of the relevance and importance of non-commercial risks as a major impediment to the flow of international investment. Predictably, he approached the issue with an enthusiasm that was rather absent in the Bank's senior management in earlier years. In his first annual address, before the Bank's Board of Governors in 1981, Mr. Clausen referred to the need to "improve the investment climate - for potential investors and potential recipients alike" and presented the multilateral investment guarantee scheme as an instrument for the creation of "a synergism of cooperation between capital-exporting and capital-importing countries."39/ This led to the preparation by the General Counsel, in November, 1981, of a "Multilateral Investment Insurance Scheme - Interim Report" in which he proposed extensive informal consultations with the Executive Directors and their governments on the basis of a detailed "Issues List" for the purpose of ascertaining whether there was a reasonable identity of interest among a significant number of governments to justify further action on the establishment of the scheme.

Such informal consultations took place in a meeting between the Executive Directors and the General Counsel on November 30, 1981. At the meeting, a number of familiar issues were raised, particularly those relating to the Scheme's ability to generate additional investments and the likelihood of its viability in the light of the experience of national investment insurance schemes. A number of other contacts with governments and business executives took place and allowed the General Counsel to submit a series of internal reports, culminating in a formal staff report entitled "Multilateral Investment Insurance Agency" (MIIA) which was submitted by the Bank's President to the Executive Directors in July 1982.40/ The report concluded that there appeared to be a need for a MIIA, suggested that the possibility for creating it should be further explored and provided an outline of its main features.

The 1982 staff report presented the new MIIA proposal "as a vehicle for raising in concrete terms the major issues related to multilateral investment insurance and .. [not as] the final conclusions of the staff in relation to these issues." According to this preliminary outline, MIIA "would require only limited capital contributions, or none, from members." A one-time contribution from the Bank or, failing this, a small capital subscribed by all members would meet initial administrative expenses, on the assumption that later expenses and potential losses would be financed from accumulated premiums and from the sponsorship arrangements provided by capital-exporting members. MIIA was to be legally independent but would have close links with the Bank through contractual arrangements (a management agreement) and possibly initial financial support. More than in the earlier proposals, the new outline placed special emphasis on MIIA's cooperation with national investment insurance agencies. It emphasized the

complementary role of MIIA, which "would not supersede the existing national schemes but would complement them," and its "decentralized administration" which would "rely heavily on national schemes ... thereby preventing the growth of an unwieldy international bureaucracy." The voting structure was to be "consistent with the objective of attracting the support of investors from developed and capital-exporting countries." Votes were, therefore, to be ultimately determined "on the basis of the volume of investment insurance sponsored by respective members," while preserving some unclearly defined role for host countries. Subrogation and international arbitration were mentioned along with the need for arrangements with host countries to safeguard MIIA's interests in preventing losses and obtaining redress. Such arrangements were to be obtained through the requirement of approval of the host country of each individual investment to be insured or by requesting investors to include ICSID clauses in their contracts with host countries and to exhaust this remedy before obtaining a final settlement from MIIA. Finally, the outline proposed that the agreement establishing MIIA should become effective upon its ratification by a smaller number of countries than envisaged in earlier drafts: twelve countries in total which would include OECD members, oil producing countries and developing non-capital-exporting countries. To address the criticism expressed in certain developed countries, the outline also took pains to emphasize that MIIA "would not undercut investment protection based on bilateral treaties."

The Executive Directors' discussion of the 1982 staff report, which took place on August 10, 1982, merely resulted in agreement that the staff should "continue to examine, in cooperation with the Executive Directors, the feasibility of establishing a MIIA within the framework or under the

auspices of the World Bank Group, with a view to submitting a progress report or reports and, as soon as practicable thereafter, a final report on this matter." Although this seemed like placing the project back at the stage it had reached some 16 years earlier, it gave the Bank the occasion to undertake in-depth studies of the issues which remained controversial after so many years of discussion. The lack of enthusiasm among Executive Directors had, however, its effects on the Bank's Managing Committee which decided that it should be "completely neutral" on this matter and directed the staff, in May 1983, not to prepare new draft articles on MIIA. A number of staff studies, including substantial input by independent consultants, were however prepared and distributed to the Executive Directors on June 3, 1983[41] with a note from the President proposing that, after a suitable interval, the staff would proceed to consult informally with Executive Directors to ascertain their views concerning the feasibility of proceeding further before a management recommendation was made. These studies examined the relationships of MIIA with host countries, with the private political risk insurance market and national investment insurance schemes and with the Bank itself. Voting rights, the finances of MIIA and the magnitude of additional investment it might stimulate were also treated in the studies.

III. Formulating a New Proposal

After I joined the Bank as Vice President and General Counsel in August 1983, the Bank's Managing Committee agreed to give the proposal a new try under my responsibility. A review of the Bank's past efforts in promoting a multilateral investment insurance agency led me to conclude that the first target would be to establish, within the Bank itself, a

general conviction that there was a need for the agency and to define and narrow the controversial issues surrounding its establishment. If this target were met, I felt that two steps would have to follow. First, a new outline would have to be prepared which would try to meet the actual concerns expressed and attract as many countries as possible to the projected agency. Second, it would be necessary to transform this outline into a widely acceptable convention. The difficulty of this dual task was compounded by a number of factors. Mainly due to the failure of past efforts, the support of colleagues in the Bank's senior management was waning and the morale of the staff working on the subject was low. Meanwhile, most Executive Directors of the Bank had inherited recorded positions towards the concept which were largely negative or skeptical. The Executive Directors however agreed to meet in late 1983 in a seminar to discuss the issues involved in the light of a basic paper. The Seminar Paper,42/ benefitting from the earlier staff reports and studies but avoiding much of their jargon and technicalities, explained the rationale for the proposed agency and defined the major issues to be considered in ascertaining its potential basic features and the options for solving each of these issues. The paper made clear that its objective was to enable the Executive Directors, through their informal discussion of these issues, to give the staff the opportunity to work out a new scheme which would be "tailor made" to suit the needs and concerns the Executive Directors expressed. Although the Executive Directors' seminar which I chaired on December 16, 1983, was not a decision-making forum, it was thus meant to focus the Executive Directors' attention on the basic issues involved and, if possible, to create a general awareness of the relevance and importance of future work on the proposed agency. As expected, the discussions did

not indicate consensus on any issue, including the very feasibility of establishing the agency. But some Directors, over the objection of several others, suggested that the management consider the discussion and return to the Board with a specific proposal. Some others requested first a staff paper explaining the basic features of the envisaged agency. In spite of this seemingly disappointing outcome, the seminar served its basic purpose of showing that, absent consensus on any particular issue, there was no strong objection to the preparation of a new specific proposal. As a result, the President of the Bank, after allowing some time to pass, circulated a memorandum to the Executive Directors43/ informing them that the staff would "prepare a paper outlining the principal features of a possible multilateral investment insurance scheme and will consult on the basis of the outline with experts from member governments, national investment insurance agencies and the private insurance market to obtain their views." "With the benefit of these consultations," the brief memorandum added, "the outline of such a scheme could be presented at a future date to the Executive Directors for discussion."

Three Executive Directors representing Latin American constituencies in the Bank's Board opposed the proposed action which they rightly saw as the first step in a new assertive strategy.44/ One month after the President's memorandum, they wrote their own memorandum to the President asking him to bring the subject to the Board for an early decision as to whether to consider the matter further, citing their belief that the Bank "should not divert human or financial resources towards an issue which does not have the necessary wide multilateral support." Upon the insistence of these three Directors, the issue was put to the Board on April 3, 1984 with the President's suggestion that the Board's discussion would be more pro-

ductive if it were based on a specific proposal from the management which was being finalized in light of the views expressed earlier by Board members. In this first test of the management's new approach, the majority of the Board agreed that the staff should proceed with the preparation of its specific proposal for informal discussion with the Executive Directors without commitment on the part of the Board or any of its members.

At the end of April 1984, the Bank's Executive Directors received a rather concise paper entitled "Main Features of a Proposed Multilateral Investment Guarantee Scheme."45/ Despite its brevity, it included all the elements which, in the light of earlier discussions, seemed to constitute a sound basis for a new attempt to establish a successful and widely accepted agency. The paper, discussed and endorsed earlier by the Bank's Managing Committee, adopted a new name which I chose the projected institution: the Multilateral Investment Guarantee Agency (MIGA).46/ The characteristics of this agency were explained in the context of the financial needs of developing countries. After describing the disappointing status of financial flows to these countries, the paper presented the case for the increase of foreign investment flows in the following language:

> Concerted action is required to increase or, at least, restore net flows of capital to developing countries without unduly increasing their indebtedness. Since public funds remain scarce, this calls for the promotion of other foreign capital flows and, in particular. of foreign direct investment where outflows are directly dependent on the revenues generated by the investment. Such investments, if they operate under appropriate conditions and adequate safeguards, would not only contribute badly needed funds but would also provide such essential factors as advanced technology as well as management and marketing services.47/

The role of the projected MIGA in this context was clearly elaborated, depicting it as an instrument of international public policy serving common concerns, and not a one-sided mechanism for the protection of foreign investors against the actions of their host governments. In this frame-

work, the new features of MIGA were basically designed to meet two fundamental aims. First, to endow MIGA with a broad range of functions to make it the primary international institution charged with the promotion, encouragement and protection of foreign investments, and not simply another facility for political risk insurance; and second, to provide built-in mechanisms which would alleviate the fears and risks associated with foreign investments and establish mutual confidence among the investors and their governments on the one hand and the governments of recipient countries on the other. The innovations presented in the new proposal were also meant to address several other issues raised through the years of earlier discussions. The new main features of the proposed MIGA as described in the April 1984 paper were thus as follows:

1. <u>A Broad Objective and Two Basic Functions</u>

The paper addressed the purpose of the projected MIGA in clear terms. "The basic objective of the Agency would be to encourage and promote the flow of private resources to productive enterprises in its member countries."48/ The issuance of guarantees against non-commercial risks was thus not to be the objective of MIGA but merely one of its functions, albeit the primary activity. A second function serving the same objective was described in the paper as the carrying out of a variety of activities, all designed to enable developing countries to attract a greater volume of foreign investment to meet their needs and aspirations. The examples mentioned included acting as a source of information on investment opportunities; facilitating communication and mutual understanding between host governments and foreign investors and, more importantly, rendering advice to member States on the formulation and implementation of their policies towards foreign investments.

By describing MIGA's objective and functions in these broad terms, the paper represented a clear departure from earlier approches where, as explained earlier, the overall objective of the scheme became obscure and its insurance operations were discussed as if they, and the protection they brought to bear on the investments, were the ultimate objective of the proposal.

2. <u>A Dual Financing System</u>

Unlike the previously discussed schemes, in their several draft Articles, MIGA was not presented as an administrator on behalf of the capital-exporting members which sponsor investments for its guarantee. MIGA was to have a financial regime which combined capital subscription by all members and sponsorship by capital-exporting member countries. Members would subscribe to a relatively modest share capital envisaged as one billion US dollars, open-ended and increasable with accessions of new members, of which no more than 5% would be paid in at the outset. In addition, investments which could not be underwritten by MIGA in reliance on its share capital and reserves could be sponsored by the interested member or members and be guaranteed on the basis that a loss which could not be met from the net income generated under sponsored operations would be shared on a pro rata basis among sponsoring members only.

Under this dual system, MIGA would from its inception have funds to cover its administrative expenses without depending on contributions from the Bank (as was envisaged under some of the earlier proposals). Also, with share capital of its own, MIGA would be more readily accepted by investors as a credible insurer. Furthermore, investments would not need to be supported by a member government in order to be considered by MIGA,

as would be required under a system exclusively based on sponsorship. Participation in MIGA's capital by all its members would mean their participation without exception in loss sharing and create a common interest in the avoidance of losses. By requiring very modest paid-in subscriptions, the disadvantages to members of up-front capitalization would be avoided. However, it was recognized that MIGA's modest capital would limit the scope of its operations. Although, in view of the expected wide diversification of the MIGA's operations, the capital could be leveraged to allow for guarantee coverage several times its size, there would have to be conservative limits to the risk asset ratio. For this reason, the sponsorship system would present an extremely useful <u>addition</u> to an agency properly funded and run by all its members. It would allow for an extension of MIGA's work beyond the limits imposed by the size of its capital and reserves and, if needed, would substitute for periodic increases in MIGA's share capital that would otherwise be necessary if MIGA were to play a significant role in increasing investment flows. All decisions of MIGA, as administrator of guarantees for sponsored investment, would be taken by MIGA itself, although some additional votes would be allocated to the sponsoring member and the host country of the sponsored investment.

In addition to the above advantages of the combination of a share capital with a sponsorship system, another advantage was envisaged, though not spelled out explicitly at that stage. Since operations under the sponsorship arrangements would not affect MIGA's own resources, this system could be extended, with the approval of the countries involved, to investments in <u>developed</u> countries. This would meet the demands of those developing countries which, citing the principle of reciprocity and their own interest in the coverage of their investments in industrialized

nations, wanted MIGA's cover to be world-wide. It would not, however, diminish the ability of MIGA to cover investments in developing countries as guarantees issued on the basis of MIGA's capital resources would be limited to investments in the latter countries.

3. <u>A Broader Scope of Coverage</u>

The "Main Features" paper recognized that "there exists a variety of forms of economic cooperation and risks associated with them and that these are subject to change." It mentioned, however, two conflicting important considerations in this respect: (i) the general interest in extending the scope of coverage to include non-traditional types of investments of particular relevance to developing countries and, (ii) MIGA's interest in narrowing this scope in view of its limited underwriting capacity and the difficulties it might meet in precisely assessing and delimiting the risks associated with new forms of investment. To reconcile these conflicting aspects, the paper proposed that MIGA set conservative limits on its coverage at the start with a view to expanding it over time as it built up financial reserves and gained experience. The scope of operations would thus be broadly defined in the Convention Establishing MIGA (the MIGA Convention) while giving MIGA's Board of Directors the power to describe precisely the types of investments to be covered by adoption of appropriate policy rules and amending them as the need arose. The paper elaborated on this important point as follows:

> In principle, [MIGA] could extend coverage to any transfer of assets, in monetary or non-monetary form, for productive purposes, which is not specifically excluded. This would include equity participations and project loans associated with a participation of the lender in the venture; it could also encompass profit-sharing, service, management and turnkey contracts, arrangements concerning industrial property rights, international leasing arrangements and arrangements for the transfer of know-how and technology. It might also be considered to extend

coverage to straight project loans, portfolio investments as well as to some forms of export credits.49/

The proposal specified, however, that eligible investments would, in all cases, be long or medium term investments which contribute to the economic development of the host country. While recognizing that MIGA was basically to cover private investments, it departed from earlier proposals by specifically mentioning that the Board of Directors could, by special majority, decide that "investments made by investors owned in part or even completely by an entity of public law would be deemed private investments for the purpose of insurance, if the investor operated on a commercial basis."50/

According to the proposal, the risks to be covered would also be broadly described in the MIGA Convention to encompass non-commercial events which affect an investor's rights associated with the investment or reduce his benefits from the investment. The paper mentioned the three typical examples (the transfer, expropriation and war risks) but added an important qualification, which was meant to quieten the concern of the potential host countries regarding an over-extended role for MIGA. Non-discriminatory measures that a State normally takes for the purpose of regulating economic activity in its territory were explicitly mentioned as being outside the scope of MIGA's expropriation coverage.51/

4. Relationship with Existing Investment Insurance Agencies

In deference to the concerns of the countries which have national schemes of their own, the paper emphasized that MIGA would "complement national agencies, rather than compete with them." This complementarity would not only take the form of providing reinsurance for these agencies, as envisaged in earlier proposals; it would also take place through coin-

surance activities with national agencies which would enable them to improve their risk diversification. In its exclusive operations, MIGA would concentrate on operations which did not conflict with those of national agencies, e.g., investment from countries which did not have national agencies, or in host countries in which such agencies were over-exposed, investments or risks not eligible for a national guarantee and, especially, multinationally financed investments.

As for private political risk insurers, the paper suggested that MIGA would cooperate in order to leverage its underwriting capacity, diversify its risks and maximize its administrative efficiency, and suggested in particular that MIGA would seek to reinsure part of its own portfolio with private insurers and to coinsure large investments with them.

5. A More Acceptable Treatment of Institutional Issues: Linkage with the Bank: Control of MIGA

Major institutional issues which occupied a good part of earlier discussions were addressed with a view to allaying the concerns of developing countries while maintaining for MIGA the essential requirements of viability and success. Thus, while keeping the typical three-tiered (Board of Governors, Board of Directors, President and Staff) organizational decision-making and control system known in other multilateral financial institutions, a looser visible linkage with the Bank was proposed along with the general concept of parity in the voting power between home countries and host countries.

The linkage with the Bank was patterned after that provided for in the ICSID Convention52/ rather than the more elaborate links to be found in the Articles of Agreement of IFC and IDA.53/ In other words, "the only

organizational link envisaged between the Agency and the Bank would be that the President of the Bank serve ex officio as chairman of the MIGA's Board of Directors."54/ Members of MIGA's Boards did not need, therefore, to be the same as the members of the Boards of the Bank. The proposal, though emphasizing MIGA's autonomy, mentioned that an identical linkage between ICSID and the Bank had led in practice to a much stronger relationship and explained that MIGA might enter with the Bank into a cooperative agreement to achieve administrative economies without inconveniencing its operations. Referring to the attention that the Bank pays under its standing policies to unresolved investment disputes, the proposal also emphasized that "in effect, the Agency's guarantee may lessen the chances of the Bank's involvement, as aggrieved investors would resort directly to the Agency."55/

As for voting rights in MIGA's governing bodies, the paper proposed that each member would classify itself, subject to acceptance by MIGA's Council, as a home or a host country and that, "as a starting point for negotiation," voting power be divided equally between the two categories of countries. However, by requiring a special majority for certain decisions, the proposal ensured that the home countries' interests could be adequately protected. Members would not vote as groups, however; each Director or Governor would cast the votes of the members he represented according to the merits of each issue. Within each category, the votes would be distributed according to a formula agreed by members of the group and approved by the Council. Sponsoring members and hosts of sponsored investments would each have one additional vote for a specific amount of the investment sponsored, to be counted only in respect of decisions related to sponsored investments.

While the proposal stated that decisions were likely to be taken by consensus in most cases, it highlighted the importance of recognizing the equal stake in foreign investment of both home and host countries and the need to build up mutual confidence between the two groups. The proposed "parity in principle" represented a clear departure from earlier proposals which, based on the assumption that the investment insurance scheme would be exclusively financed by the home countries of investors, kept for these countries an effective control over its governing bodies.56/

6. Settlement of Disputes

The issue of the settlement of disputes between MIGA, acting as subrogee of a compensated investor, and the host country, was addressed in some detail in view of the heated arguments it stimulated in earlier discussions where representatives of Latin American countries in particular objected to any form of international arbitration. The paper restated the obvious assumption that such disputes were expected to be settled in most cases by negotiation and mentioned the fact that actual resort to arbitration had not taken place in disputes involving international financial institutions. It suggested, however, that "failing negotiation, such disputes would be submitted to conciliation, and failing conciliation they would be submitted to international arbitration."57/ The proposal provided nevertheless for an important exception:

> The Agency would be authorized to enter with individual member States into bilateral agreements concerning insured investments; these agreements could modify and supersede subrogation/dispute settlement mechanisms as embodied in the Convention. As an alternative to the incorporation of a dispute settlement procedure in the Convention, it might be contemplated to rely on the conclusion of bilateral agreements between the Agency and individual member States. Even in the absence of any agreement on dispute settlement with a particular host country, the Agency might still be able to reinsure investments in that country which are guaranteed by a national investment guarantee agency of a

member, since a dispute, in which the Agency might be involved, could arise in that case only between the Agency and the national agency.58/

Alternative bilateral arrangements to be pursued "in addition to or in lieu of" the dispute settlement system provided for in the MIGA Convention were elaborated on and five examples were given.59/ Although this aspect of the proposal proved to be too liberal to be accepted by developed countries in subsequent discussion,60/ it reflected a new spirit which, along with the other innovations mentioned earlier, helped create an atmosphere of a basic change. This was required to establish the minimum interest needed to receive consideration of the proposal and to give developing countries' representatives the assurance that their concerns were not ignored.

IV. Mobilizing Support

The proposal outlined in the Main Features Paper of April 1984 was to be discussed by the Bank's Executive Directors on July 19 of the same year. Before that date, intensive efforts were needed to create a general awareness inside and outside the Bank of the newness and the importance of this proposal and to build up the support required to ensure a positive outcome of the July discussions. A detailed "Questions and Answers" paper was thus prepared to explain the proposal in greater detail, differentiating it from earlier initiatives and answering questions which the Executive Directors were likely to raise.61/ Meanwhile, efforts were made to ensure that every Executive Director was adequately briefed. An information campaign, through publications and meetings with business and professional groups, was also planned with a view to creating a generally more supportive environment at the time of discussion.

As a result, the outcome of the July 19 "seminar" of the Executive Directors, which was chaired by Mr. Clausen, was completely different from that of the earlier seminar of December 1983. Only two Executive Directors (representing mainly Latin American constituencies) spoke clearly against the proposal. Four others expressed some reservations while indicating that they were "keeping their minds open." The remaining fifteen Directors spoke with varying degrees of enthusiasm in favor of the proposal, enabling the Chairman to conclude that there was a strong support for the preparation of a draft MIGA Convention to be the basis of further consultations with governments and business circles.

The draft MIGA Convention, prepared in the summer of 1984, was distributed to the Executive Directors one week before the 1984 Annual Meeting of the Bank's Board of Governors with a note indicating that direct consultations would be undertaken with member governments and interested business and professional groups before a second draft, prepared in the light of these consultations, was submitted to the Executive Directors for discussion. The distribution of the first draft MIGA Convention and a detailed Commentary thereon62/ at this critical stage was meant to allow the President to announce in his speech before the 1984 Annual Meeting that the draft MIGA Convention had been circulated, and to call on governments actively to participate in the envisaged consultations over its provisions.63/ It was also meant to make it possible to use the Annual Meeting as an occasion to brief ministers of Bank members on the developments achieved so far and to alert them to the steps required subsequently.

The period October 1984 to March 1985 witnessed the launching of the most intensive campaign connected with the creation of MIGA. Bank staff held consultations with the governments of both developed and developing

countries in all of the regions covered by the Bank's worldwide membership. In addition to these governmental discussions, consultations were held with a number of international agencies, including OECD, the League of Arab States, the United Nations Economic Commission for Latin America, the Commonwealth Secretariat, the Gulf Cooperation Council and the Inter-Arab Investment Guarantee Corporation. Furthermore, exchanges of views took place with such bodies as ICC, APPI, the Confederation of European Industries, the Confederation of British Industries, the Confederation of German Industries, Japanese banking and insurance agencies, the US Council for International Business and the US National Foreign Trade Council. Along with these efforts, and in part thanks to them, public announcements supporting the proposal emanated from different quarters, including a Western Hemispheric Conference on Social and Economic Order,64/ the US President's Task Force on International Private Enterprises65/ and the ICC.66/ Letters of support were also received from such varied sources as the Commonwealth Secretariat, the League of Arab States and the United Nations Economic Commission for Latin America. Attempts to create a general awareness of the relevance and importance of the proposal and a sense of involvement on the part of large and varied constituencies had obviously succeeded.

By early March 1985, we were in a position to produce a revised draft MIGA Convention and Commentary which benefitted from the comments received from governments as well as from business and professional groups.67/ The importance of the timing of distribution of the revised draft MIGA Convention was clear. The Executive Directors would be invited to meet formally in early April to decide, before the semi-annual meeting of the Development Committee68/ scheduled for April 18-19, 1985, on how to proceed with the

matter. A favorable decision would allow the President of the Bank to report to the Development Committee that discussion by the Executive Directors of the draft MIGA Convention was underway, and would give this Committee the opportunity to endorse formally the on-going efforts.

V. Choosing the Forum (for Finalization of the Text of the Convention)

The draft MIGA Convention of March 8, 1985 and the Commentary thereon were not to be discussed in the formal Board meeting scheduled for April 9, 1985. The meeting was merely to discuss the procedure to be followed in discussing the text of the draft MIGA Convention. The issue of which procedure was most appropriate had been raised earlier in the context of the IIIA draft Articles in 1970[69] and became again a bone of contention during consultations on the draft MIGA Convention of October 1984. I had explained on different occasions that the draft MIGA Convention could either be finalized by the Executive Directors themselves or in meetings involving the Executive Directors and experts from member countries of the Bank or else in a negotiating conference of interested countries to be convened for this purpose. While the latter conference would be attended by plenipotentiaries with the power to negotiate on behalf of their governments, the former alternative procedures would only result in a text which the Bank could offer to its members as a service undertaken in the performance of its function as a promoter of foreign investment.

Some Bank members preferred that discussions be held in a negotiating conference. In support of this approach, some cited considerations of propriety such as the technical character of the discussions, the weak link envisaged between MIGA and the Bank, and the probable difference in composition of membership in the two institutions. Others went so far as to

question the legality of the preparation of the text by the Bank's Executive Directors, who do not possess full powers to negotiate treaties on behalf of governments, or by the Bank which is not empowered to undertake the negotiation of multilateral conventions between states.70/ My inclination, however, was definitely against such a negotiating conference. In my experience, these take years to prepare. They group together delegates who rarely know, let alone trust, each other and who are accustomed to lengthy procedures and a confrontational atmosphere. Quite often, participants in such conferences are more concerned with broader, and at times irrelevant, issues of a political character and in some cases pay greater attention to pleasing their respective national audiences rather than reaching agreement on the subject matter at hand. I therefore suggested to the Bank's Managing Committee in March 1985 that the appropriate procedure was for the Executive Directors to meet as a Committee of the Whole assisted, if required, by experts from their constituencies. Once this Committee completed its work, the agreed text could then be submitted to the Executive Directors formally meeting as the Bank's Board to recommend it to the Board of Governors for transmittal to member governments. The President's proposal, circulated to the Executive Directors on March 11, 1985, after recommending this procedure, explained that:

> "The Board of Governors, if it approves the recommendations would open the Convention for signature by eligible countries (similar procedures were followed in the adoption of the text of the Articles of IDA, IFC and ICSID. In the case of IFC the draft was first discussed in the then existing Financial Policy Committee of the Board and in the case of ICSID it was discussed first by a Legal Committee headed by the Bank's Vice-President and General Counsel and attended by representatives of interested member countries.) In their deliberations in the Committee of the Whole, the Executive Directors might be assisted by experts from their constituencies. This is deemed to be a simpler and less time consuming procedure than holding a full-fledged negotiating conference of all interested countries."71/

As I explained later on in a memorandum dated April 1, 1985 to one Executive Director whose authorities objected in writing to this procedure, the recommendation was not that the Executive Directors would act as a negotiating conference of plenipotentiaries which adopts a text on behalf of member countries; rather it was that they would prepare the text and recommend to the Board of Governors that the latter invite interested members to sign it. This task was well within the powers of the Bank whose Articles of Agreement require it to "promote private foreign investment" and "to promote international trade by encouraging international investment for the development of the productive resources of members." Under the proposed procedure, the Bank was simply called upon to provide a technical service, while its members maintained the freedom to sign the prepared text without being bound in any way to do so. Though substantially different from the procedure envisaged under the 1969 Vienna Convention on the Law of Treaties for the adoption of the text of multilateral conventions,72/ this was in fact the only procedure followed by the Bank in the preparation of the texts of earlier multilateral treaties establishing other institutions.

The Executive Directors' discussions on April 9, 1985, resulted in substantial agreement with the management's recommendation and a consensus was reached on discussing the draft MIGA Convention in a Committee of the Whole chaired by the Vice-President and General Gounsel and consisting of all Executive Directors who would be "assisted by a small and manageable number of experts." In defending this approach, the Bank's President said that he intended to propose to the Development Committee that it "discuss the steps required to ensure the creation of the proposed MIGA in the near future" and that it was important in this respect that the Development Committee knew that the draft MIGA Convention was in the Board's hands and that certain procedures for discussing it had been approved by the Board.

As expected, the Development Committee, in spite of reservations expressed by a few members,73/ was generally supportive of the Bank's plans. Its press communique included the following paragraph:

> "The Committee agreed that private direct and portfolio investment could make useful contributions to development. Such flows can be promoted by improving the policy environment toward foreign investment in both developing and industrial countries. In this connection, the proposal being developed by the World Bank for the establishment of a Multilateral Investment Guarantee Agency (MIGA) which would seek to improve the investment environment in developing countries by issuing guarantees against non-commercial risks and providing promotional services, was noted. The Bank was encouraged to hold further discussions in order to reach an understanding among governments for the creation of MIGA on a voluntary basis."74/

Detailed procedures for the Committee of the Whole were elaborated in a note dated April 25, 1985, approved by the Executive Directors on a no objection basis. According to these, each Director was entitled to have with him in the Committee up to two experts from his constituency, but Directors representing more than one country could have up to three. Such experts could participate in discussions at the request of the Director they assisted, but only the positions of the members of the Committee were to be taken into account in formulating its conclusions. All conclusions would be reached by consensus and in the absence of such consensus the "different views would be reported as alternatives, while indicating the degree of support received by each."

When the Committee of the Whole finally met on June 10, 1985, two Latin American Directors indicated at the outset that three countries among their larger constituencies wished to be recorded as not participating in the meeting. Speaking from the chair, I responded that, indeed, no country was participating. "The meeting was a meeting of Executive Directors of the World Bank sitting as a Committee of the Whole. It was not a meeting of governments; it was not a plenipotentiary conference."75/ A similar

answer was given in writing to a third Director who, notwithstanding this explanation, submitted a memorandum indicating that a Latin American country in his constituency also wished to be recorded as not participating. With the settlement of this preliminary issue, the Committee of the Whole started the difficult business of trying to reach consensus on the lengthy and complex provisions of the draft MIGA Convention.

V. Improving the Chances of Reaching Agreement

In spite of the positive outcome of the Executive Directors' discussion on April 9 and of the Development Committee on April 18-19, 1985, it was clear by then that strong opposition persisted in certain countries, either against the proposal as a whole or against certain features of it. It was important, therefore, to intensify our efforts before and during the meetings of the Committee of the Whole with a view to creating a more supportive general environment for the approval of the draft MIGA Convention. While all the speeches made by Mr. Clausen before different policy fora in that period included a general reference to MIGA, my colleagues and I continued our campaign to explain and defend the initiative through consultations with governments, holding seminars and giving lectures and press conferences. In addition, special efforts had to be exerted with two groups of Executive Directors in particular: those representing Latin American countries which receive a large portion of foreign investments and those representing the five large developed countries which account for most of these investments. The former group had instructions from some of the larger countries they represented to oppose the MIGA initiative, possibly due to concerns relating to its perceived adverse effect on their comparative advantage as host countries, erroneous perceptions of the

projected agency as being simply a protector of foreign investors against host governments and objection in principle to the draft MIGA Convention's reference to settlement of disputes in certain cases through international arbitration. Some developed countries, on the other hand, were still doubtful about the additionality to be brought about by MIGA76/ and concerned about its possible adverse effect on their national agencies and their bilateral investment treaties. All developed countries also had strong objections to some features of the draft MIGA Convention, especially the concept of voting parity between capital-importing and capital-exporting countries in MIGA's governing bodies and the fact that international arbitration was not automatic in all cases of disputes. Some of the efforts to address these objections may be worth mentioning at this stage.

Before the Committee of the Whole held its first meeting, I circulated on May 14, 1985, a memorandum to the three Executive Directors representing Latin American countries in which I highlighted the following points. which I later on discussed with them individually in greater detail:

"1. Membership in MIGA would be open to all members of the Bank and Switzerland on a voluntary basis. As in the case of ICSID, every country would be free to join or not to join the Agency without any effects on its position in the Bank or any other organization.

2. A member may decide to use the Agency only for the guarantee of its own investments in foreign countries without allowing it to cover foreign investments in its own territory. This is particularly relevant for the developing countries which have expanding public and/or private sector investments abroad.

3. The Agency cannot extend its guarantee to investments in any member without the prior approval of that member not only of the investment but also of the Agency's guarantee (Article 15 of the draft Convention).

4. National investors could benefit from the Agency's guarantees when their position is similar to that of foreign investors, i.e., when they transfer resources from abroad (Article 13(c)).

5. If the Agency compensates a guaranteed investor, it would be subrogated to the investor's claims vis-a-vis the host country only to the extent of such rights as the investor might have had regardless of the guarantee (Article 18). This subrogation would not, in other words, create any new obligations on the host country which did not exist before the guarantee.

6. The draft Convention does not deal with the substantive standards of treatment of foreign investors or with the method of settlement of disputes between them and their host countries. It provides for guaranteeing existing rights in a framework agreed in advance by the host country in each case. The arbitration referred to in the draft Convention applies only to disputes between the guaranteed investor and the Agency (Article 64) and between the Agency (an international organization) and the host government (Article 63 and the Annex). The latter arbitration could even be replaced by another method to be agreed upon by the Agency (Article 1(a) of the Annex).

7. The services of the Agency would not be limited to the issuance of guarantees as MIGA would offer complementary services such as technical assistance, etc. (Article 23). Members may benefit from these services regardless of whether they have approved guarantee operations in their territories."

Although the position of the opposing governments was not expected to be immediately affected by the above points, their impact was not lost on the Executive Directors who took a very helpful attitude in the Committee of the Whole, actively participating in its deliberations and strongly defending the interests of host countries.

As for the five largest shareholders in the Bank to whom the proposed voting system represented a major stumbling block, additional efforts were needed after the first round of meetings in the Committee of the Whole to prepare the ground for a reasonable compromise on that issue. Following the latter meetings, I circulated a detailed memorandum (dated June 25, 1985) to the Executive Directors of these countries presenting the case for equality in the voting power between the two proposed Categories of the agency's members and differentiating MIGA in this respect from inter-

national lending institutions.77/ The memorandum explained the importance of the principle of parity in allaying the suspicions of developing countries, and its effect on attracting them to join the agency and to cooperate extensively under its umbrella. There was no basis, I argued, for the fear of establishing a precedent that could be used to support a change in the present voting structure of other international financial institutions. While these were lending institutions, the agency would not be in the business of transferring resources of its own to developing countries. In fact, its payments would be made to investors, mostly from developed countries, out of accumulated reserves funded primarily by the investors themselves, and would in many cases be recouped from no source other than the governments of developing countries. The memorandum also explained that notwithstanding the principle of voting parity, the special role of large shareholders was recognized in the special majority required for decisions which would have a bearing on the financial exposure of the agency. At any rate, the envisaged parity between the two categories did not entail equality in the votes of each member. In practice, most decisions would be reached by consensus and it was more important, therefore, to establish mechanisms for building up mutual confidence in the sensitive area of the treatment of foreign investment. I took pains to explain that any compromise solution should not do away with the principle of equality at least as a target to be achieved shortly after the establishment of the agency and presented a possible alternative to that effect. In the intensive discussions which followed between me and the Executive Directors concerned, I pointed out that if the formula adopted in the Articles of Agreement of IBRD and IFC (250 votes for each member plus one vote per share) were used for MIGA without any change, developing

countries could indeed acquire more votes than developed countries, given the small size of MIGA's capital. Such arguments, supported by comparative studies of the situation in other institutions and tables showing the position of each country under different formulae, proved in the end to be effective in helping Directors to reach a satisfactory solution to that issue which, given its political character, seemed at times to defy any possible compromise.

VII. The Meetings of the Gommittee of the Whole

Altogether, the Committee of the Whole held four rounds of meetings (June 10-14, July 18-19, August 7-8 and September 5, 1985). At its June 10-14 meetings, the Committee of the Whole made impressive progress, but five parts of the MIGA Convention remained to be finalized: these included the basis of subscription in MIGA's capital; the voting system; MIGA's privileges and immunities; the method of settlement of disputes between a host government and MIGA acting as subrogee to the claims of an investor; and the extent to which suppliers' credits could be covered by MIGA's guarantees. In addition, individual reservations were made, in the form of requests by Directors to have their dissenting positions recorded, as follows:

(i) that MIGA's capital be denominated in US dollars, not SDRs (one Director);

(ii) that eligible investment should be qualified in the Convention as "economically efficient" (one Director);

(iii) that dependent territories of developed countries be treated as developing countries for the purpose of MIGA's operations (two Directors);

(iv) that an investment be ineligible for cover by MIGA if the investor's home government objected to its coverage (one Director);

(v) that a specific ceiling for MIGA's reinsurance operations be specified in the MIGA Convention and not left to be determined by the Board (one Director);

(vi) that the initial risk asset ratio (total contingent liability of the agency against its capital, reserves and a portion of its reinsurance cover) be 1:1 rather than 2:1 (three Directors), although there was no disagreement on the ultimate maximum of 5:1;

(vii) that substantive standards for the treatment of foreign investment be mentioned or referred to in detail in the MIGA Convention (two Directors);

(viii) that the sponsorship system as a whole be dropped or at least not allowed to cover investments in developed countries (three Directors); and

(ix) that entry into force of the MIGA Convention require ratification by more than 20 countries (mentioned only as a preference by two Directors).

The July meetings of the Committee resulted in agreement on the text of the chapter on privileges and immunities which was patterned after similar provisions in the IFC Articles of Agreement,78/ and in a breakthrough on the hitherto unresolved issue regarding the voting structure. The adopted formula appeared to follow that of the Bank (equal membership votes plus one vote per share), but (i) ensured that developed and developing countries would have equal votes once all Bank members joined MIGA and (ii) protected the minority group by guaranteeing them in the first five years 40% of the votes through supplementary votes, if required, while requiring that all decisions be taken by special majority during this initial period.79/ Agreement was also reached on the allocation of shares in MIGA's capital on the basis of the allocation of shares in the Bank's capital. An amendment to what was then article 63 (now article 57) was adopted. It kept open the possibility of settlement of disputes between a host government and MIGA acting as subrogee of an investor, by means other than those provided for in the draft MIGA Convention and its Annex, but limited such a possibility to cases where MIGA reached agreement with a host country on alternative methods accepted by the MIGA's Board acting by special majority.80/

When the Committee met again in August 6, 1985, I asked the participants to confine discussions to the nine provisions of the draft MIGA Convention which had not yet gained unanimous approval, including some over which controversy developed at later stages. These were:

(i) article 5(a) regarding the unit of capital valuation;

(ii) article 7(i) regarding the portion of capital subscription to be paid in initially;

(iii) article 12(b)(ii) with respect to the extent to which suppliers' credit might be covered;

(iv) article 22(a) regarding the initial risk asset ratio;

(v) article 23(b)(ii) with respect to its possible mentioning of the standards of treatment of foreign investment;

(vi) article 38(b), article 47 and Schedule B regarding whether some members of the Agency's Board of Directors should be appointed by large shareholders;

(vii) article 42 regarding the location of the Agency's headquarters;

(viii) article 45(e) regarding the length of the initial period during which all decisions would be taken by special majority and the minority group of countries would be guaranteed 40% of the votes (five years as agreed by the majority or two years as suggested by others); and

(ix) Schedule A on the actual classification and subscription of members.

In the August 6-7 meetings, a few of these issues were resolved to the satisfaction of all while many remained subject to individual reservations. In the report I originally prepared on the Committee's work, which was envisaged to have been completed at that stage (the September 5 meeting was

subsequently called upon the request of one delegation), I drew attention to the fact that the text of the MIGA Convention was adopted by consensus except for eight provisions where individual reservations were attached. These provisions were:

(i) article 5(a): agreement was reached on the adoption of the SDR as the standard of value but only in terms of the US dollar according to the average dollar value of the SDR between January 1, 1981 and June 30, 1985. However, one member wanted the average dollar value calculated on the basis of an eleven-year period (June 30, 1974 to June 30, 1985) and another on the basis of a six-month period (the first six months of 1985);

(ii) article 8(a): agreement was reached on payment by developing member countries of 25% of the cash portion of their subscription in their respective local currency. One member questioned the justification for this accommodation;

(iii) article 20(a): agreement was reached on setting an initial limit on reinsurance operations at the level of 15% of the Agency's exposure. One member preferred a lower limit;

(iv) article 23: two alternative texts were prepared on the Agency's promotional activities, each including reference to the standards applicable to the treatment of foreign investments. Executive Directors were to choose one of these texts;81/

(v) articles 25 and 30: agreement was reached on maintaining the articles on the sponsorship system. One member objected;

(vi) article 45: agreement was reached on the formulation of the voting structure as adopted in the July meetings. One member expressed his reservation and another indicated that he might wish the issue to be discussed again;

(vii) article 53 (now article 47): one member reserved his position on the application of tax exemption to assets acquired by the Agency through subrogation, until he received satisfactory clarification; and

(viii) article 63 (now article 57): agreement was reached to keep the formula adopted in the July meetings. Two members reserved their positions.

When the Committee of the Whole held its final meetings on September 5, 1985, the reservations to articles 5(a), 8(a) and 53 were dropped, the sponsorship system was maintained without change, but the articles relating to it became Annex I of the MIGA Convention, the initial limit on reinsurance operations was reduced to 10% but applied only to specific investments which would be completed more than twelve months prior to the application for reinsurance; a new provision of article 23 was adopted along with an additional paragraph in article 12;82/ article 45 was accepted unanimously after the initial period, where supplementary votes could be acquired by countries in the minority Category, was reduced from five to three years;

and article 63, which became article 57 after moving the articles on the sponsorship system to Annex I, remained unchanged, with one Director only maintaining his reservation on its second sub-paragraph.

VIII. Adoption of the Convention

This single reservation did not deter the Executive Directors' when they met formally on September 12, 1985, from approving (without objection) the draft MIGA Convention and the documents related to it for transmittal to the Bank's Board of Governors. At its Annual Meeting in Seoul, the Board of Governors adopted a resolution on October 11, 1985 opening the MIGA Convention for signature.83/ The MIGA Convention was signed immediately by three developing countries. Within six months, it had been signed by twenty-two countries including four developed countries. The Development Committee, in its communique of April 11, 1986, found it therefore appropriate, without any dissention this time, to "encourage other countries to sign and ratify the Convention so that it may enter into force as soon as possible." The following month, the leaders of the main industrialized nations stated in their Tokyo summit declaration that "we look for progress in activating the Multilateral Investment Guarantee Agency."

Less than a year after its opening for signature, over forty countries had signed the MIGA Convention. During September 15-19, 1986, a committee of representatives of the signatory States met as envisaged in the Board of Governors October 1985 resolution to prepare "for consideration by the Council or the Board of the Multilateral Investment Guarantee Agency, as the case may be, draft by-laws, rules and regulations as shall be required for the initiation of the Agency's operations." At its meetings, which

were also chaired by the Bank's Vice President and General Counsel, this Preparatory Committee adopted draft by-laws covering such diverse topics as meetings of MIGA's Council and the terms of service of its Directors and President, draft rules of procedure for meetings of MIGA's Board of Directors, draft financial regulations, and a detailed set of draft operational regulations for MIGA's guarantee operations and consultative and advisory activities. The draft by-laws will be submitted to MIGA's Council of Governors while the remaining rules and regulations will be considered by the Board of Directors.

Since the Preparatory Committee's meeting, further signatures of the MIGA Convention have taken place. As of June 15, 1987, 58 countries, including 46 developing and 12 developed countries, had signed the Convention, and 14 of these countries had ratified it. It is interesting to observe that 10 of the signatories are countries from the Latin America and Caribbean region. As the pace of ratifications increases, it is hoped that MIGA will become a reality before the year is over.

Conclusion

The Bank's involvement in the proposal to establish a multilateral investment guarantee agency started much earlier than is generally realized. For almost 40 years, the Bank spent considerable effort on this project, beginning with a confidential report written in early 1948 and culminating in the opening for signature of the MIGA Convention in late 1985.

Objections to the proposal came mainly from two sources. Developed countries, motivated by their perceived respective national interests, initially preferred to establish their own national programs for political

risk insurance. Once they did so, a few of them seemed to fear competition from an international agency which, in the view of some, might undermine the relative advantages of their respective national schemes and their efforts to establish better substantive standards for the treatment of foreign investments through bilateral treaties. Some developing countries, few in number but quite vocal in their opposition, also feared that the agency's guarantees would deprive them of their privileged position as the preferred hosts of foreign investments under the mistaken assumption that, with the availability of guarantees, all countries would be equally attractive to investors. A general suspicion also seemed to have prevailed among representatives of developing countries that the proposal was merely a scheme to provide further protection to foreign investments against the actions which host governments may justifiably take in the exercise of their economic sovereignty.

Against such objections and suspicion, the Bank's senior management, seemed at first to have opted for a rather passive attitude in pursuing the matter. While a large number of its member countries expressed support for the initiative, through the resolutions taken in UNCTAD I and II,84/ and through the answers to the Bank's request in 1968 for an indication by members of their explicit position regarding the proposal85/ the Bank failed over a long period of time to produce definitive answers to the various doubts and to quieten the concerns which underlay the opposition to the initiative. It did not, in particular, formulate a proposal tailored to meet these particular concerns so that it might be attractive enough to an adequate number of Executive Directors from both developed and developing countries. And it continued to promote the agency as an instrument for the protection and encouragement of foreign investment

rather than as an engine of growth and a mechanism for transfer of resources for development purposes.

However, the elaborate work of the Bank staff, including the successive draft Articles of Agreement of 1966, 1968 and 1972, and the detailed studies undertaken in 1982/1983, were certainly not an exercise in futility. They slowly prepared the ground for the successful developments which were to follow as of mid-1983.

At the same time, the world debt crisis, accompanied by stagnating official flows, had by the early 1980s made it increasingly apparent that foreign investment in developing countries could be a source of external financial flows with great growth potential. The increased need to tap this potential made MIGA, which was conceived to have a wider role in investment promotion than merely the issuance of guarantees, a specially timely initiative. This factor, together with the careful balance of interests required for the agency to be successful, should be borne in mind in considering not only the history of the MIGA Convention, but also the implications of some of its key provisions.

NOTES TO CHAPTER ONE

July 1, 1987

1. Eager to increase the flow of private investment funds to war-devastated Europe after World War II, the U.S. Government included in the Economic Cooperation Act of 1948, 62 Stat. 144 (1948), ch. 169, para. 111(b)(3), a system for guaranteeing U.S. private investments in West European countries against restrictions on the conversion of currencies. This program was later subject to successive changes in its geographic scope, the risks eligible for cover and the agency administering it, and culminated in offering coverage to investments in developing countries against all political risks by a separate entity established for this purpose, the Overseas Private Investment Corporation (OPIC). A description of relevant developments is provided in Whitman, The United States Investment Guarantv Program and Private Foreign Investment (1959); a recent description of OPIC's activities may be found in Lipman, "Overseas Private Investment Corporation: Current Authority and Programs", N.C.J. Int'l L. & Comm. Reg. 5 (1980): 337. For successive legislative texts, see 64 Stat. 198 (1950); 65 Stat. 384 (1951); 67 Stat. 158 (1953); 68 Stat. 847 (1954); 70 Stat. 555 (1956); 71 Stat. 355 (1957); 73 Stat. 246 (1959); 75 Stat. 429 (1961); 83 Stat. 807 (1969); 88 Stat. 763 (1974); 92 Stat. 213 (1978); 95 Stat. 1021 (1981). The U.S. program soon became a model for other industrialized, and more recently. semi-industrialized, countries most of which adopted similar programs through the expansion of their previously established systems of export credit insurance. See OECD. Investing in Developing Countries (5th ed. 1982); Shihata, The International Guarantee of Foreign Investment 11-20 (1971) (in Arabic).

2. The draft memorandum, though written without attribution, was referred to later in the Bank's files as the memorandum of Mr. C.A. McLain, the first General Counsel of the Bank. Bank files also show that in July 1949, a memorandum was submitted to Mr. McLain's successor (Mr. D. Sommers) which dealt in some detail with the plan to foster foreign-, owned equity investments and to guarantee certain non-commercial risks facing such investments.

3. Staff Memorandum entitled "Means of Stimulating Private Foreign Investments: Specific Suggestions," dated October 24, 1950 (without attribution).

4. See Council of Europe, Consultative Assembly, Doc. No. 701, Report of the Study Group for the Development of Africa 22 (1957).

5. See Nixon, "Private Investment and the Economic Challenge," 37 Dept. State Bull. 703. 706 (1957).

6. Robinson, "A Program for International Business," in Private Foreign Investment. Hearings before the Sub-Committee on Foreign Trade Policy of the Committee on Ways and Means, U.S., H.R., 85th Cong., 2nd Sess., Dec. 1958, pp. 543, 554, 575-576 (1958).

7. Referred to in IBRD, Multilateral Investment Insurance, A Staff Report, Annex B pp. 30-37 (March, 1962).

8. Inter-Parliamentary Union, Proceedings of the 47th Conference, Rio de Janeiro 1958, Proposal of Sen. Durand-Reville, pp. 393, 400; Resolution, p. 1070 (1959).

9. See European League for Economic Cooperation, Common Protection for Private International Investments 28-33 (1958).

10. See Council of Europe, Consultative Assembly, Doc. No. 1027, Report on an Investment Statute and a Guarantee Fund Against Political Risks, 8 Sept. 1959, at 20 (Recommendation 211).

11. E.g., the proposals of Messrs. Mafrey and Strauss, IBRD, supra note 7 at 30-37.

12. E.g., the proposal of Mr. Van Eeghen, id.

14. The Bank's files show that the U.S. had enquired whether the Bank would object to a proposal they intended to make in the Development Assistance Group of the OECD that the Bank undertake a study of the desirability and feasibility of an international investment insurance program. The Bank told the U.S. that it would have no objection but requested that steps be taken to make it clear that the Bank's agreement to make a study did not imply that it favored the establishment of such a program. In fact, the then General Counsel of the Bank, Mr. A. Broches, wrote a memorandum dated July 31, 1961 to the Bank's Working Party on International Investment Guarantees in which he concluded that the national schemes provided an adequate answer and that "there seems to be no warrant for trying to establish an international program with all the complications this would entail."

15. Address of Eugene Black, President of IBRD to the Board of Governors at the 1961 Annual Meetings held in Vienna. Press Release No. 4, September 19, 1961.

16. The Report was distributed to the Executive Directors of the Bank on January 25, 1962, [R62-6] and subsequently published in March 1962.

17. Statement dated March 27, 1962 in ICC Doc. No. 111/114, 4.v. 1962, See also IBRD Doc. Sec.M62-91, May 11, 1962.

18. Council of Europe, Consultative Assembly, Report of the Legal Committee entitled "Protection of Private Investment in Developing Countries" dated April 27, 1962.

19. Suggestions of Professor Metzger, Draft Charter of an Inter-Governmental Investment Guarantee Program, 3 December 1963 (mimeo). Discussion of the various schemes led to DAC's conclusion "to proceed further to a study of the feasibility of such schemes." OECD Press Communique (Pres/A(62) 37, 26 July 1962).

20. IBRD Doc. No. R65-97, Annex C. A summary of this Report appears in Annex A of the Report and in a memorandum from the President of the Bank to the Executive Directors dated June 23, 1965 (R65-97). See also, Martin, "Multilateral Investment Insurance: the OECD Proposal," 8 Harv. Int'l L.J. 280 (1966).

21. UNCTAD, Report of the Third Committee E/Conf. 46/133, June 4, 1964, Recommendation E; and Recommendation no. A.iv.12 on "Promotion of Private Foreign Investment in Developing Countries", Proceedings of the UNCTAD 1st Sess. Vol. I Final Act and Report, E/Conf. 46/141, Vol. 1, 8 June 1964.

22. The "principal points" identified in this report, [R65-187. December 6, 1965] without providing definite answers as to the questions raised, included: (a) organizational questions (scope of membership, categories of membership and organizational structure), (b) operational questions (scope of protection; eligible investments; new investments; form of investment; origin and destination of investment; governmental approval; economic development criterion; standards of treatment of foreign investment; settlement of disputes; premiums; reinsurance and nationality of investors), (c) loss sharing, (d) financing of losses, (e) entry into force of the constituent Convention, and (f) other provisions.

23. Discussion of the draft Articles in a Committee of the Bank's Executive Directors or in the Bank's Board rather than in an international plenipotentiary conference was questioned later on by one Executive Director late in 1970. In a memorandum dated December 31, 1970, the Bank's General Counsel explained that the forum for negotiation and formulation of the Articles of Agreement of IFC. IDA and the ICSID Convention was the Board of the World Bank, not a diplomatic conference. In the case of the ICSID Convention, the Executive Directors were assisted in this task by a "Legal Committee" of representatives appointed by member countries. The General Counsel concluded that the Bank was an appropriate forum for the negotiation and formulation of treaties of this kind. See infra p---.

24. IBRD Doc. R66-156, November 30, 1966. See Brewer, "The Proposal for International Guarantees by an International Agency." 58 Am. J. Int'l L. 62 (1964) for commentary on the advantages of a multinational program over the existing international programs.

25. See, IBRD Doc. R67-52. April 20, 1967. See also IBRD Doc. R67-127, August 8, 1967 for the strongly supportive comments of the "Business and Industry Advisory Committee" (BIAC) of OECD.

26. In the course of the Committee's discussions, one Executive Director, Mr. Machado (whose constituency comprised Latin American countries) suggested that the projected agency should have its capital, one half of it to be contributed by the Bank and one half by subscription of members based on their subscription in the Bank (memorandum dated May 17, 1967). The chairman noting, however, that there was a "lack of enthusiasm for the Machado proposal among the countries which would have to subscribe to the fund contemplated" concluded that "it was not, for the moment, a feasible proposition" (Bank Doc. SecM68-54.

March 3, 1968). The U.S. Executive Director, Mr. Merchant, also suggested the implementation of the program under the International Finance Corporation (IFC) (SecM67-284, October 31, 1967). His Alternate, Mr. Bartley, later suggested that IFC might as an experiment test out the demand for investment insurance by undertaking to write insurance within a certain modest limit before a more ambitious scheme could be considered (SecM67-291, November 6, 1967). The proposals were discussed in the Committee of the Whole but received little support, with two Directors supporting it and fourteen preferring a separate institution (Sec68-68, March 20, 1968).

27. UNCTAD Resolution on "Increasing the Flow of Private Capital to Developing Countries." 33 II, 28 March 1968 (paragraph 5). Proceedings of the UNCTAD 2nd Sess. Vol. I Report and Annexes TD/97. Vol. I.

28. The Preamble of the 1966 draft Articles referred, however, to the "desirability of encouraging the flow of new private foreign investment of a developmental character to developing countries" as an objective the achievement of which would be facilitated by establishing the projected agency. This preamble was not discussed by the Committee of the Whole as it was decided to consider it only after reaching agreement on the operative provisions of the Articles. The 1968 and 1972 draft Articles did not include any preamble.

29. Two alternatives were presented regarding the loss sharing provisions of the draft. Under both alternatives. every loss would be divided into two equal tranches, one to be shared by all sponsoring countries and the other by only the countries sponsoring investments in the host country where the loss occurred. In each case, the share of a sponsoring country in each tranche was to be pro rated on the basis of the proportion of the amount sponsored by it to the total amount sponsored by all. The difference between the two alternatives was that under Alternative A reference was made only to the amount of insurance outstanding at the time of the loss, while Alternative B required adjustment of such amount to take account of any payments made by the Agency to meet prior losses and of the way in which such prior losses had been shared: A "Staff Memorandum on Loss Sharing Provisions of Draft Articles of Agreement of the International Investment Insurance Agency, dated February 6, 1967 [R67-15] discussed the pros and cons of the two alternatives and concluded that, as each formula involved certain difficulties, the two should be presented as alternatives for governmental consideration.

30. The draft left it to the Board of Directors to prescribe a minimum maturity of an eligible investment in the form of a loan. A footnote indicated, however, that a five-year minimum maturity would be prescribed.

31. Draft Articles of Agreement of the International Investment Insurance Agency, IBRD Doc. M68-156, August 19, 1968.

32. Resolution issued at the Commission's XI Special Meeting held in Brasilia, February 2-11, 1971.

33. See, IBRD Doc. R67-15, February 6, 1967 (limited circulation).

34. IBRD Doc. SecM72-121, dated March 2, 1972. The text is also published and analyzed in Theodor Meron, Investment Insurance in International Law at 30-37 and 259ff (1976).

35. It should be noted that due to the continuous changes in the membership of the Bank's Board (where each Director has a two-year term of office) and, therefore, of its Committee of the Whole, discussions in the Committee of the various drafts were marked by continuous interruptions and the work of the Committee depended heavily on the chairman's guidance and the staff support.

36. A recent analysis of ICSID arbitration and its relevance to MIGA appears in Shihata, "Towards a Greater Depolitization of Investment Disputes, The Roles of ICSID and MIGA", 1 ICSID Review - Foreign Investment Law Journal 1-25 (1986).

37. At the time of drafting the 1972 draft Articles, Lloyds of London had just started its political risk coverage for direct investment thus launching a new trend in the private insurance industry. On private political risk insurance programs generally, see Brennglass in Brewer (ed.), Political Risks in International Business. pp. 302-305 (1985); and see Svensk in Ghadar-Kobrin-Moran (eds.), Managing International and Political Risk: Strategies and Techniques p.114 et seq. (1983).

38. It should be noted, however, that in the mid-1970s the Bank was involved in a proposal to establish an International Resources Bank (IRB). The proposal had originated in the United States and was presented at the Special Session of the U.N. General Assembly in 1975, and subsequently submitted to the UNCTAD meeting in Nairobi in 1976 and to the Conference on International Economic Cooperation (The North-South Conference) in Paris. The proposal found little support from other governments and finally the U.S. asked the Bank to review the proposal and determine how the proposed functions of the IRB could be best performed within the World Bank Group Structure. The IRB, as proposed by the U.S., was a multilateral insurance scheme to compensate foreign investors in mining and energy ventures in the event of losses sustained as the result of non-commercial causes. The Bank's review [R77-121, dated May 6, 1977] anticipated that the proposed scheme would encounter difficulties of the kind which caused the Bank to abandon its work on the IIIA proposal.

39. See, Address of World Bank President A.W. Clausen, 1981, Joint Annual Meetings of the World Bank and the International Monetary Fund Summary Proceedings 15, 23 (1982).

40. IBRD Doc., R82-225, July 14, 1982.

41. IBRD Doc., R83-190, June 3, 1983.

42. "Multilateral Investment Insurance Agency," IBRD Doc. SecM83-1042, November 10, 1983.

43. Dated January 13, 1984 [SecM84-93, February 1, 1984].

44. Although there was no unanimity in the views of the countries represented by those Directors' large members of their respective constituencies were known for their opposition through the years to any international program of investment insurance linked with the Bank.

45. "Main Features of a Proposed Multilateral Investment Guarantee Scheme," memorandum dated April 30, 1984 (hereafter "Main Features Paper").

46. The new name, replacing the word "Guarantee" for "Insurance", was meant to (i) emphasize the newness of the proposal, thus differentiating it from earlier unsuccessful attempts, and (ii) use a more accurate term, differentiating MIGA's guarantees from typical insurance operations which cover measurable risks according to well established laws of probability.

47. Main Features Paper, supra, note 45, at para. 3.

48. Id., at para. 6.

49. Id., at para. 10.

50. Id., at para. 12.

51. Id., at para. 9. This important and obviously justified limitation was taken from Article 18 of the Convention Establishing the Inter-Arab Investment Guarantee Corporation. The Corporation, which represents the first international program of investment insurance, was established when its Convention entered into force in April 1974 and has been operating successfully since then. See Shihata, "Arab Investment Guarantee Corporation," 6 J. World Trade L. 185 (1972). For further discussion of the limitation mentioned in the text, see Chapter Two at pp. _________.

52. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, March 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (the ICSID Convention) at art. 5.

53. See Articles of Agreement of the International Finance Corporation, May 25, 1955, 7 U.S.T. 2197, 264 U.N.T.S. 117, at art. IV, ss. 2(b), 4(b) and 5(a); Articles of Agreement of the International Development Association, Jan. 26, 1960, 11 U.S.T. 2284, 439 U.N.T.S. 249, at art. VI, ss. 2(b), 4(b), 5(a) and 5(b).

54. Main Features Paper, supra note 45, at para 45.

55. Id., at para 45, n.13.

56. See supra p. ______

57. Main Features Paper, supra note 45, at para 27.

58. Id.

59. These alternatives included: (i) tripartite arrangements involving the investor where the host country's and MIGA's obligations would be tied to fulfillment by the investor of his obligations, (ii) bilateral agreements stipulating substantive rules with respect to the treatment of guaranteed investments, (iii) bilateral agreements whereby host countries abstain from defined actions giving rise to claims of guaranteed investors, (iv) unilateral declarations by host countries about the treatment of guaranteed investment, and (v) bilateral agreements providing for arbitration with respect to subrogated rights under different rules from those provided in the MIGA Convention. Id.

60. See infra pp. -- and details in Chapter Five.

61. IBRD, Multilateral Investment Guarantee Agency, Questions and Answers (July 3, 1984). This paper was updated on May 20, 1985 and March 21, 1986.

62. Draft Outline for the Convention Establishing A Multilateral Investment Guarantee Agency, dated October 1, 1984.

63. See address of Mr. A.W. Clausen to the Board of Governors of the World Bank and The International Finance Corporation, September 24, 1984, Washington, D.C. "To encourage still greater private investment flows to developing countries, we have sought to develop a new plan for the establishment of a Multilateral Investment Guarantee Agency. We are discussing this now with our Executive Board, and we will soon start a process of consultations with our members on its details. Such an agency would guarantee investments emanating from other member countries against non-commercial risks. It would also furnish information on investment opportunities, prepare studies and provide advice on country policies on foreign investment. We see this agency as complementing the array of national and regional investment guarantee agencies which already exist."

64. Western Hemispheric Conference on Social and Economic Order, held in San Jose, Costa Rica, May 22-25, 1984, adopted a recommendation to the World Bank stating that:

> "... the Conference endorses the ongoing efforts of the World Bank towards the creation of a MIGA and notes that such an Agency, operating in the common interest of all its members, would be in a unique position to mobilize foreign private investment for developmental purposes. The Conference recommends that the Agency be given a clear mandate for developmental purposes and that developing countries obtain a significant voice in the political oversight of the Agency."

65. The Report of the US President's Task Force on International Private Enterprises, December 1984, recommended that "The United States should support a multilateral investment guarantee program administered by the World Bank."

66. The International Chamber of Commerce statement entitled "World Bank Proposal for the Creation of a Multilateral Investment Guarantee

Scheme," adopted on February 27, 1985 by the ICC Commission, provided that "The ICC wishes to state at the outset, on behalf of the international business community which it represents, that it strongly supports the objective and purposes of MIGA. ..."

67. Draft Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) (March 11, 1985) reproduced in 24 ILM 692 (May 1985). In addition to drafting improvements, the March 8, 1985 draft was different in several respects from the earlier draft of October 1984. The changes, which were meant to ensure a broader acceptability of the text, included in particular: more emphasis was placed in the preamble and in article 23 on the importance of improving investment conditions and promoting fair and stable standards; guarantee coverage was limited to part of the loss; a provision was added on the use of local currencies received by MIGA after compensating investors; the gearing ratio was limited to 1:1 unless the Board decided otherwise; guaranteeing sponsored investment was authorized even before reaching the limits of ordinary guarantees and subrogation of MIGA to claims of compensated investors became mandatory in all cases. Two alternative texts were also made for the voting structure, the main being the original proposal.

68. The "Development Committee" is the Joint Ministerial Committee of the Boards of Governors of the Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries. The Committee advises and reports to the Boards of Governors of the Bank and the Fund on all aspects of the broad question of the transfer of real resources to developing countries but is not a decision-making organ of either institution. The Committee usually meets twice a year.

69. See supra note 31.

70. A memorandum to that effect, dated March 29, 1985, was sent by the authorities of one government to their Executive Director, copied to the Bank's General Counsel.

71. Memorandum from the President to the Executive Directors, dated March 11, 1985 [R85-63].

72. Article 9 of the 1969 Vienna Convention on the Law of Treaties (Doc. A/Conf.39/27, United Nations Conference on the Law of Treaties Docs. 287-301, U.N. Doc. A/Conf. 39/11/Add.2 (1971)) defines the means through which the text of a treaty may be adopted as either the unanimous consent of all States participating in its drawing up, or, in the case of a treaty adopted at an international conference, a vote of two-thirds of the States present at the conference, unless by the same majority the conference decides to apply a different rule. These provislons, however, do not purport to prevent the adoption of treaties within international organizations in accordance with the established practice of the organization, as Article 5 specifies that the Vienna Convention applies to a treaty which is the constituent instrument of an international organization and to any treaty adopted within an international organization without predudice to anv relevant rules of the organization. The drafting history of the Vienna Convention, as well as a more recent convention dealing with a related

topic, make it clear that the "rules of the organization" include the established practice of the organization. See 1986 Convention on the Law of Treaties between States and International Organizations or Between International Organizations, art. 2(j), United Nations Conference on the Law of Treaties between States and International Organizations or Between International Organizations, (Vienna, 18 Feb.-21 Mar. 1986). U.N. Doc. A/Conf.129/15 (prov. ed. Mar. 20, 1986), published also in 25 ILM 543-592 (1986).

73. A number of representatives of both developed and developing countries expressed their support for the initiative while two representatives of Latin American countries reiterated their reservations.

74. Development Gommittee press communique, dated April 19, 1985.

75. IBRD, Meetings of the Committee of the Whole of the Executive 77 Directors of the International Bank for Reconstruction and Development, held June 10-14, July 18-19, August 6-7 and September 5, 1985. Volume I. p. 3 (limited circulation), to be referred to as COW Records.

76. In response to concerns about the question of additionality, particularly by one Executive Director of a developed country, a detailed note was prepared, entitled "The Prospects of a Multilateral Investment Guarantee Scheme to Enhance the Flow of Resources to Developing Countries." (April 1985) Part A of the note summarized the results of the various studies and reports previously undertaken on this subject. Part B reflected the comments received on the question by business, professional groups and international organizations. The note reported that the studies concurred in the conclusion that there was no methodology to predict the impact of an investment guarantee program on the volume of investment to developing countries but stated that all the comments received, as well as some of the studies, suggested that MIGA could substantially contribute to the reduction of investment barriers due to political risk perceptions.

77. In the IBRD, IDA, IFC, IDB, AfDB and several other international lending institutions, each member has an equal number of basic votes (250 in the cases of IBRD and IFC and 500 in the case of IDA) plus one vote per share. This formula is not adopted in all internanational lending institutions, however.

78. Two differences exist between the constituent treaties of the two institutions, however. The MIGA Convention codifies the principle that the institution enjoys immunity from legal process in respect of personnel matters (article 44) (which is generally recognized but not spelled out in the IFC or IBRD Articles) and, unlike the latter articles, place an obligation on the Agency to waive the immunity of its staff "in cases where in its opinion the immunity would impede the course of justice and can be waived without prejudice to the interest of the Agency." (article 55).

79. See COW Records, supra note 75, Volume II, p. 341. The five-year period in which a special majority would be required was ultimately reduced to three.

80. See details in Chapter Five, at pp. ______.

81. See Chapter Four, at pp. ________.

82. Id., at _________.

83. The final texts of the MIGA Convention and of the Commentary thereon are reprinted in 1 ICSID Review - Foreign Investment Law Journal 145 (1986). The Board of Governors resolution mentioned in the text is reproduced in IBRD, IFC and IDA, 1985 Annual Meetings of the Boards of Governors: Summary Proceedings 244 (1986).

84. See supra notes 21 and 27 and accompanying text.

85. See supra p. _____.

Ch.2

CHAPTER TWO

ELIGIBILITY REQUIREMENTS FOR MIGA's GUARANTEES

Introduction

Pursuant to Article 2 of the Convention, MIGA will "issue guarantees, including coinsurance and reinsurance, against non-commercial risks in respect of investments in a member country which flow from other member countries." This activity of MIGA was not conceived as an end in itself. Rather, it was intended to be one of several functions which will together serve a broader objective. In the words of the Convention, this objective is "to encourage the flow of investments for productive purposes among member countries, and in particular to developing countries."1/

MIGA's guarantee operations will be governed by various instruments. The basic framework is, of course, provided by the Convention. To avoid the need for frequent amendments, the Convention's provisions are cast in broad terms, but envisage that they will be elaborated upon from time to time in regulations, rules and policies to be issued by the Agency's Board of Directors. Operational regulations have already been approved in a draft form by a Preparatory Committee of signatory countries of the Convention and are expected to be issued in due course by MIGA's Board. (These draft regulations are referred to hereafter as the "Regulations".) Once issued in final form, the Regulations will be binding on MIGA's management. However, they may be changed at any time by the Board, thus permitting MIGA's guarantee program to develop in response to the changing needs of member countries and investors.

In accordance with the Convention and the Regulations, MIGA will conclude contracts of guarantee with investors, which will set forth the mutual rights and obligations of MIGA and the holders of its guarantee. These contracts will normally follow a standard form and will precisely specify the scope of coverage, the type of loss to be compensated as well as such matters as the period of guarantee, the amount and currency of guarantee, premiums and claims.2/

Article 16 of the Convention provides that "[c]ontracts of guarantee shall be approved by the President under the direction of the Board."3/ Once a contract of guarantee has been approved, and then concluded by the parties, it will be presumed to be consistent with the Convention and the Regulations. The contract will expressly preclude the parties from challenging that presumption which is established in the Regulations.4/ Before the contract approval stage is reached, however, MIGA will have taken a number of steps relating to its decision to underwrite the investment. The process will normally begin with MIGA's determination that the proposed guarantee meets certain eligibility requirements.

The scope of MIGA's guarantee operations is defined through these requirements which are indeed central to MIGA's character as an institution. Perhaps more vividly than other aspects of the Agency's guarantee operations, they translate its broad objective into practical terms, distinguish it from national investment guarantee programs, and illustrate the flexibility of MIGA's design. The requirements relate to the investor and the host country, the risks against which cover is sought, as well as to the investment itself.

Some of the requirements directly reflect MIGA's developmental objective, while others more obviously seek to protect its financial via-

bility. The two aspects are however interrelated. In keeping with its objective to encourage "productive" investments, for example, MIGA must be satisfied that the proposed investment is economically sound and contributes to the development of the host country.5/ At the same time, it may be assumed that an investment which has these qualities and thus serves the host country's interests is likely to be less vulnerable to host governmental action that might give rise to a claim. To qualify for a guarantee, the investment must moreover conform with the host country's laws, regulations, and declared developmental objectives and priorities.6/ The host country's approval is furthermore required for both the issuance of MIGA's guarantee and the risks designated for cover.7/ The likelihood of claims is also diminished by what may be seen as a general eligibility requirement relating to the host country. This is the requirement contained in Article 12(d)(iv) of the Convention that before initiating guarantee operations in a country MIGA must satisfy itself as to the investment conditions there, including the availability of fair and equitable treatment and legal protection for the investment.8/

Two general requirements relating to eligible risks are set out as exclusions in the Convention. In accordance with Article 11(c), contracts of guarantee will exclude coverage of losses arising from (i) governmental actions or omissions to which the guarantee holder has agreed or for which he is responsible, and (ii) events occurring before the conclusion of the contract of guarantee.9/ Though important, these exclusions simply reflect standard insurance practices. The unique features of MIGA's guarantee operations will however be brought into sharper focus when we examine the eligibility requirements in greater detail, starting with eligible investments, and including eligible investors, host countries and risks.

I. Eligible Investments

Paragraphs (a) through (c) of Article 12 of the Convention set out certain criteria which investments must meet to qualify for coverage in terms of the type and form of investment, and the time at which it is made.

A. Type and Form of Investment

To ensure flexibility, the Convention avoids the enumeration of eligible investments in an exclusive list of the types or forms of investment as such a list could easily become outmoded with the passage of time. Instead, the Convention establishes the principle that any form of medium or long-term provision of assets for productive purposes is eligible for MIGA's cover. Certain forms (equity and other forms of direct investment) are declared initially eligible by an explicit provision of the Convention. But these are merely examples or priorities, for other forms could always be added by a special decision of MIGA's Board of Directors.10/ Article 12(a) thus authorizes MIGA from the outset to guarantee equity interests. It also permits coverage of forms of non-equity direct investment. The Convention leaves the definition of the latter forms of investment to a decision of the Board. Under certain conditions,11/ Article 12(b) further allows the Board, by special majority, to extend eligibility to any other medium- or long-term form of investment. Although such extension may occur at any time the Board deems it appropriate, it is expected to take place as MIGA builds up financial revenues, gains experience and develops its administrative capabilities.

It should already be clear that from the outset MIGA will have at its disposal authority to cover a wide range of different types of investment. The success of MIGA's guarantee program, which will have to be con-

sonant with forms of investment actually used in the market place, will in large measure depend on this freedom of action. Experience has demonstrated the market's ability constantly to generate new forms of investment.12/ By avoiding a definitive enumeration of eligible forms of investment, the Convention enables the Agency to adapt coverage to such innovations. To complement existing insurers, MIGA must also be able to fill gaps in their coverage. This also underscores the need to develop coverage for forms of investment not foreseen in the terms and conditions of national investment guarantee programs.

1. Equity Investment

The Regulations envisage that MIGA's coverage will extend to such varied forms of equity investments as shares in corporations or other entities with juridical personality, partnership rights in joint ventures and ownership rights in the assets of an unincorporated branch or other establishment of the investor in the host country.13/ Unlike most national investment guarantee programs, cover will also extend to portfolio investments, including minority participations in joint ventures, preferred stock and shares resulting from the conversion of debt instruments. Among portfolio investments, preference will be given to those associated with foreign direct investments in the same enterprise.14/ This qualification emerged after some discussion in the Preparatory Committee. The original draft of the Regulations prepared by the World Bank's Legal Department provided for the eligibility of portfolio investments without an indication of preference. However, some Committee members questioned the wisdom of using MIGA's limited guarantee capacity on portfolio investments. In the course of the discussions, I pointed out that portfolio investment

presented a huge source of non-debt creating equity finance which is yet to be meaningfully tapped by developing countries.15/ I also noted that portfolio investors could be encouraged by MIGA's guarantee to invest alongside direct foreign investors. Agreement was then reached on the suggestion that "preference among portfolio investments" should be given to those associated with foreign direct investment.16/

2. Equity Type Loans and Guarantees

In common with national investment guarantee programs, MIGA is authorized by Article 12(a) of the Convention to extend cover to investments which take the form of loans made or guaranteed by holders of equity in the enterprise concerned. Article 12(a) provides that the loans in question should be "medium- or long-term." In this respect, the Regulations envisage that the loans must have "mean repayment periods"17/ of at least three years, but make it clear that the Board may in special circumstances authorize cover even if the mean repayment period falls short of this minimum.18/ The Agency's coverage of such "equity-type" loans will probably apply mainly to intracorporate loans, and is based on the consideration that it matters little from the economic point of view whether a parent company lends to or increases its equity in its subsidiary.

3. Contractual Direct Investment

There are various forms of international contractual arrangements which make the remuneration of the foreign partner dependent on the production, revenues or profits generated by the project rather than being preestablished in the contract with the local partner. Such arrangements, which are somewhat comparable to equity, are particularly prevalent among

developing countries.19/ Only a few of the national guarantee programs appear to offer cover for these forms of non-equity direct investment, and the cover of those that do is usually limited to narrowly defined forms of non-equity investment.20/ MIGA's coverage of such investments will thus be an important means by which the Agency can seek to enhance the flow of investments to and among developing countries. In addition, it will encourage flows on terms which provide for payment to the foreign investor of amounts corresponding to the economic value added by a project, rather than establishing a fixed claim on the host country's scarce foreign exchange reserves, regardless of the project's outcome. It will also provide a way in which the Agency can fulfill the expectation that it will promote investment flows among developing countries in particular.21/ The gap left by national guarantee programs that MIGA could usefully fill was a final consideration behind the Convention's inclusion of non-equity direct investment as eligible for cover and the broad elaboration on such investment in MIGA's Regulations.

During the drafting of the Convention, it was realized that "direct investment" was a generic term whose precise scope would have to be determined by MIGA's Board.22/ As mentioned above, the Convention accordingly leaves it to the Board to identify eligible types of non-equity direct investment. The Commentary on the Convention however suggests that in so doing the Board will specify investments made to acquire a lasting interest in an enterprise, the performance of which will determine the investor's return.23/ The Regulations therefore provide that initial coverage will include production- and profit-sharing contracts, franchising and licensing agreements, turnkey contracts, operating leasing agreements and subordinated debentures issued by the project enterprise.24/ But they

are at the same time careful to liken these forms to direct investment and specify that such arrangements will only qualify for coverage if they have terms of at least three years and depend substantially on the production, revenues or profits of the investment project for repayment.25/ The Regulations also require that special attention should be given in this respect to investment arrangements of "long duration and high developmental potential."26/

4. Export Credits

In the meeting of the Executive Directors' Committee of the Whole where the text of the convention was prepared an understanding was reached that MIGA should abstain from competition with official national export credit insurance programs. Such understanding proved difficult, however, to be recorded in the Convention and was reflected only in the legally non-binding Commentary.27/ By the time the Regulations were discussed, the principle that was so controversial during earlier discussions was readily accepted. To a considerable extent, transactions which would tend to qualify for public export credit insurance coverage are excluded by the Regulations' limitation of cover for non-equity direct investment to arrangements with terms of at least three years. Most export credits extended in practice have terms of below two years. Moreover, export credit insurance agencies normally cover payments which are fixed in advance with respect to the amounts and dates of repayment and rarely extend coverage to payments tied to the success of the project.28/ To leave no doubt, however, the Regulations state that in no case shall the Agency provide coverage for non-equity direct investment which in the Agency's judgment can be obtained from a government or official export credit agency of a member.29/ Such a judgement will have to be made on a case by case

basis. The Regulations envisage that MIGA would undertake "appropriate consultations" to ascertain the availability of coverage from such other agencies.30/

5. Other Forms of Foreign Investment

The March 8, 1985 draft of the Convention provided that, in addition to equity and non-equity direct investment, eligibility could be extended to "any medium- or long-term provision of assets" by virtue of a special majority decision of MIGA's Board. The intention, of course, was to enable MIGA at some point of its activities to extend its coverage in certain circumstances to medium and long-term loans provided by commercial banks - an obviously important feature as developing countries find it increasingly difficult to borrow new money from such banks without external guarantees. In the meetings of the Committee of the Whole, this unqualified language met with objections from some participants who wished to exclude all loans, as well as export credits, from coverage. Others supported the original language, some urging that even from the outset MIGA should be authorized to cover such transactions as medium- and long-term project loans. A consensus finally emerged to the effect that eligibility could be extended to transactions of this type if they were made to finance a specific investment that MIGA had already guaranteed or at least was considering for guarantee, that is, if the loan was related to an investment which was otherwise eligible for MIGA's cover and had either received such a cover or, having applied for it, stood a reasonable chance of being approved along with the loan or soon thereafter.31/

Accordingly, Article 12(b) of the Convention provides that the Board may, by special majority, extend eligibility to any medium- or long-term form of investment which does not qualify as equity or direct invest-

ment under Article 12(a), provided that non-equity-type loans "may be eligible only if they are related to a specific investment covered or to be covered by the Agency."

6. Investment in Kind

The Convention contains no restrictions as to the type of resources to be invested under eligible investments. As the Commentary on the Convention puts it, "it is immaterial whether the investment is made in monetary form or in kind."32/

The Regulations provide that MIGA may underwrite an eligible investment in monetary form if it is made in any "freely usable currency"33/ or in any other currency which is freely convertible at the time of the underwriting decision.34/ The investment need not be in the currency of the investor's home country, for example; it may even be made in the host country's currency if the above requirements of the Regulations are met.

Investments may also qualify for cover if they take the form of contributions to the investment project of any tangible or intangible assets that have a monetary value, such as machinery, patents, processes, techniques, technical services, managerial know-how and trademarks. The value of such investment in kind must, however, be determined in terms of the currency in which the guarantee is to be issued. This is of course necessary to determine the amount of guarantee, i.e., the maximum contingent liability that MIGA will assume under the proposed guarantee. In some cases, investors may be able to furnish MIGA with an objective valuation such as proof of the purchase price of new machinery; in other cases, particularly where it has reason to be concerned about overinsuring the investment, the Agency may have to make its own evaluation or require an independent appraisal.35/

B. Time of the Investment

MIGA's guarantee operations are intended to facilitate investments in developing member countries additional to those investments that would have been made without MIGA's presence. The Agency's underwriting capacity must therefore be reserved for cases where its guarantee could contribute to such additionality. This explains why eligibility is limited to new investments or, as Article 12(c) of the Convention puts it, "to investments the implementation of which begins subsequent to the registration of the application for the guarantee by the Agency." The Regulations explain that implementation of an investment will be deemed to have begun either when resources have been transferred or irrevocably committed to the investment project.36/

Both "preliminary" and "definitive" applications are foreseen in the Regulations. This should avoid any negative impact of the application process on the investment's speedy implementation. Thus an investor may file a preliminary application for a guarantee with the Agency. Such an application need only contain basic information on the investor, the prospective investment and the risks against which coverage is sought. Its registration by MIGA, though not indicative that a guarantee will necessarily be issued, will preserve the investment's eligibility for cover as a new investment, provided that a definitive application follows within three months of the notice of registration.37/ The Agency's power to extend this three-month period38/ provides additional flexibility. The filing of a preliminary application will impose no legal obligation and little effort upon an investor, who may then proceed with his investment and thereafter attend to the full application.

Another element of flexibility introduced by the Regulations is that an investment may remain eligible even if appraisal, planning or exploration costs were incurred prior to the commencement of its implementation.39/ This qualification of the requirement that the investment be new is of particular importance to investment in the extractive and energy sectors where a long exploratory stage usually preceeds the development stage. Moreover, a contribution made to modernize, expand, enhance the financial viability or otherwise develop an existing investment project may be deemed to be a new investment even if the original investment was not guaranteed by MIGA. It is thus envisaged that an investment made to acquire interests in an existing project enterprise may be considered as new if it accompanies an expansion, modernization or other enhancement of the enterprise; serves its financial restructuring, notably the improvement of its debt/equity ratio; or assists the host country in restructuring its public sector.40/ Finally, the objective of additionality is served by the possibility provided for in Article 12(c)(ii) of the Convention and Section 1.13 of the Regulations that the Agency may consider as new investment earnings from an existing foreign investment in the host country (even if not initially covered by a stand-by guarantee) provided that such earnings could otherwise be transferred outside the host country at the time of the underwriting decision. Unlike national investment guarantee programs, MIGA will not require reinvestment of such earnings in the same project from which they were made. As a result, an investor involved in several projects in the host country may obtain coverage for earnings derived from one project and reinvested in another.

II. Eligible Investors and Host Countries

A. Eligible Investors

Article 13 of the Convention sets out the requirements which investors must meet in order to receive a guarantee from MIGA. These relate to the nature, nationality, ownership and mode of operations of the investor.

1. Nature of the Investor

Both natural and juridical persons qualify as potential guarantee holders.41/ The status of an entity as a juridical person is normally determined by the laws under which it is organized. For example, American corporations, French sociétés anonymes and German Aktiengesellschaften all have juridical personality under their respective legal systems. On the other hand, partnerships, unincorporated associations and branches of a foreign investor are generally42/ not endowed with juridical personality. In such cases, the entities as such will not be eligible for MIGA's guarantee. The individual partners, members of the association and owners of the branch may, however, be eligible. If all of them are eligible, MIGA may be able to cover the maximum coverable amount of the investment; otherwise it will have to confine coverage to such portion of the investment as corresponds to the coverable share of the eligible partners, members or owners in the investment project.43/

2. Nationality of the Investor

To qualify for a guarantee, a natural person must, as a rule, be a national of a member country other than the host country.44/ A natural person with more than one nationality will be eligible if one of the nationalities is that of a member country, but not if any of his nationalities is that of the host country.45/ A juridical person will be eligible if it meets the dual test of being incorporated and having its

principal place of business in a member other than the host country.46/ A juridical person failing to meet this test may nonetheless be eligible if the majority of its capital is "owned by a member or members or nationals of a member or members", again provided that the majority owner is not the host country or its nationals.47/ The broad language of this alternative test is intentionally meant to be consistent with Article 13 (a) of the Convention which, as will soon be seen, authorizes MIGA's cover of state-owned external investors. In fact, the language goes further to cover investments by international public enterprises, which are owned by several members of MIGA. It should be noted that an enterprise of this kind is eligible for cover even when the host country is one of its shareholders, provided it is a minority shareholder.

While eligibility is as a rule confined to foreign investors, there is an important exception to this rule. Article 12(c) of the Convention provides that the Board acting by a special majority may, upon a joint application of the investor and the host country, extend eligibility to a natural person who is a national of the host country or to a juridical person which is incorporated in that country or whose capital is chiefly owned by its nationals. This may, however, only be done if the assets to be invested are transferred from outside the host country. The purpose of this innovative feature of MIGA's coverage is twofold. It will enable MIGA to assist in reversing capital flight, a problem of significant proportions for some developing countries,48/ and it will help developing country nationals accumulating savings outside their countries to invest them at home with adequate protection against political risks.49/

We have seen that the eligibility of a corporate investor may depend upon its ownership. In the case of a share corporation, however,

there may be difficulties in determining ownership. For example, there may in some countries be problems identifying the shareholders because the shares are held in trust by brokers or bankers for their customers. In other countries a corporation may issue bearer shares which, by definition, defy easy detection of the nationality of the shareholders. The Regulations address such difficulties by requiring MIGA to determine the investor's ownership with regard to its beneficial rather than record ownership, the former being vested in the person who receives the benefits from the shares and has the right of recapturing them.50/ Thus in the first example given above, the customers rather than the intermediary brokers or bankers will be deemed to be the owners. Identification of the beneficial owners may however be an expensive and time-consuming process. Where this would be the case, the Regulations permit MIGA to presume that the record and beneficial owners have the same nationality.51/ In other cases, as in the case of bearer shares, it may be impossible to determine either record or beneficial ownership without undue cost and delay. The Regulations envisage that in such cases the corporate investor may be presumed to be chiefly owned by nationals of members other than the host country if such nationals held the majority of votes registered at the most recent shareholders' meeting of such investor.52/ These are of course only presumptions upon which MIGA may or may not rely. If in individual cases the Agency has reason to believe that the presumptions do not hold true, it may deny coverage.

3. Ownership and Mode of Operations

It will be recalled that the 1966 draft Articles of Agreement of the IIIA confined eligibility to private investors.53/ This limitation was

somewhat relaxed in the 1968 and 1972 draft Articles of the IIIA, which limited coverage to investors of a "non-governmental character."54/ The first draft of the MIGA Convention, which was circulated to member governments of the World Bank in October of 1984, introduced a provision, now found in Article 13(a) of the Convention, to the effect that a juridical person need not be privately owned to qualify for cover. The Regulations explain that the juridical person may also be owned jointly by a member of MIGA and private persons, wholly by a member, jointly by several members or jointly by several members and private persons.55/ For this purpose, a "member" will include any agency or entity owned or controlled by a member.56/ MIGA may therefore issue guarantees to publicly-owned enterprises such as national energy, mining, transportation or financial institutions, to so-called "multinational pubic enterprises," which are joint ventures among several countries or parastatals usually created by international agreements,57/ and to national and multinational public enterprises whose shareholders also include private persons.

The provision of the October 1984 draft of the MIGA Convention extending coverage to both privately and publicly owned corporate investors was, however, accompanied by the proviso that they carry out the investment in question on a "commercial basis."58/ In the consultations which followed the draft's circulation, it was argued that in most cases the proviso should apply to the investor in determining its eligibility, not merely to the way in which it carries out a given investment. As a result, Article 13(a) of the Convention restricts eligible corporate investors to those which operate on a commercial basis.

The Regulations offer some guidance on determining whether a corporate investor operates on this basis. The investor may be assumed to do

so if the majority of its equity is privately owned, since private shareholders normally pursue commercial purposes.59/ On the other hand, if the majority of the equity in the investor is publicly-owned, MIGA must determine whether it operates on a commercial basis.60/ The draft presented to the Preparatory Committee suggested a number of criteria that could be employed in making this determination. In the end, the Committee decided that it would be better to leave the development of such criteria to MIGA's management in the light of experience. While the Regulations are therefore silent on this matter, MIGA might in determining whether a publicly-owned investor operates on a commercial basis refer to such factors as the degree to which the investor finances its operations from its own revenues or on the strength of its own capital,61/ as investors which rely mainly on state subsidies can hardly be considered as operating on a commercial basis.

To avoid needlessly excluding certain types of corporation, tests emphasizing the nature of investment, rather than that of the investor, survive for special cases in the Regulations which followed in this respect a rather liberal interpretation of the Convention's language. Thus a non-profit corporation may be eligible for cover if it is established that the investment for which coverage is sought will be implemented on a commercial basis. An investor which carries out some operations on a non-commercial basis, but others on a commercial one, may be also eligible in respect of investments carried out on the latter basis.62/

B. Eligible Host Countries

Article 14 of the Convention confines eligibility (for guarantees issued on MIGA's own account) to investments made in the territory of a "developing member country" of the Agency.63/ This limitation reflects

MIGA's objective to encourage the flow of investments to developing member countries in particular.

"Developing member countries" include any of the 128 countries which are listed as such in Schedule A to the Convention and which have joined the Agency. This schedule simply lists, in two categories, the World Bank's members on the date the Convention was finalized plus Switzerland. New members of the Agency whose names do not appear in the Schedule will be classified as developing or other members by decision of MIGA's Council of Governors.64/ The designation of members as developing or otherwise may similarly be changed through a decision of the Council to amend Schedule A.65/

Pursuant to an understanding reached during the preparation of the Convention and recorded in the Commentary thereon,66/ the Regulations provide that a dependent territory for whose international relations a member is responsible may also be designated by MIGA's Board of Directors as an eligible host country. This will only take place at the request of the member concerned and investments by the latter in its dependent territory will be excluded from cover.67/ A second understanding agreed upon by the Committee of the Whole with respect to host countries may be mentioned here, even though it concerns a priority rather than an eligibility requirement. This is the expectation, reflected in the Commentary on the Convention and elaborated on in the Regulations, that MIGA will give particular attention in its operations to the need to encourage investments in the "lesser developed" among its developing member countries.68/ The relative adjective intentionally avoided pre-established definitions such as the UN list of the "Least Developed Countries."

III. Eligible Risks

An examination of the risks eligible for MIGA's cover should begin with Article 2(b) of the Convention, which states simply that the Agency will issue guarantees against non-commercial risks. Though subject to some qualifications, which will be described below, the principle is thus that any non-commercial risk may qualify for MIGA's guarantee. While this is the principle, Article 11 of the Convention, following the same approach described earlier in defining eligible investment, first specifies four types of non-commercial risks as initially eligible for cover, then establishes the power of MIGA's Board of Directors to add any other non-commercial risk "by a decision taken by special majority." The four risks named in the Article are the currency transfer risk; the risk of expropriation and similar measures; the breach of contract risk; and the risk of war and civil disturbance.

Again like the forms of eligible investments, the Convention defines these four risks in broad terms, leaving the details to be worked out in the Agency's regulations and in individual contracts of guarantee. The resulting flexibility will be of great importance to MIGA. It should enhance the scope for MIGA to tailor the definitions of covered risks in contracts of guarantee to the features of the individual project involved. As noted above, MIGA's guarantees will moreover be available for a broader range of forms of investments than can be covered by most national agencies, creating in turn more varied rights and interests to which the definitions of MIGA's coverage will have to be adjusted.

A. Currency Transfer Risk

The first of the four initially eligible risks set out in the Convention, and the one which is perhaps of most practical importance to

investors today, is the currency transfer risk. This is defined in Article 11(a)(i) of the Convention as "any introduction attributable to the host government of restrictions on the transfer outside the host country of its currency into a freely usable currency or another currency acceptable to the holder of the guarantee." Coverage will accordingly include the risk of both inconvertibility and transfer, the former relating to the possibility of converting local currency into a foreign one, and the latter relating to the transfer outside the host country of either the local currency, if convertible, or the foreign currency into which the local currency was converted. However, in all cases the covered restriction must apply to currency which represents returns on, or repatriated capital of, the guaranteed investment.69/

The currency into which conversion is guaranteed will be specified in the contract of guarantee between MIGA and the investor.70/ The contract will likewise specify the basis and the date for determining the exchange rate or rates to be applied in calculating a claim. The Regulations envisage that contracts of guarantee will in this regard refer to a particular category of exchange rate applicable to the investment when the guarantee was issued.71/ This might be the official rate, or one of several official or officially tolerated rates in cases of countries with multiple exchange rate systems, or the market rate, all defined as a category, not as a fixed rate of exchange guaranteed under the contract.72/ A guarantee holder's compensation will normally be calculated on the basis of the selected category according to the rate prevailing in the host country at the date of the latter's denial of conversion and/or transfer.73/ Currency transfer coverage will extend to cases where the host government refuses to allow conversion and transfer except at a rate less favorable

than the lowest exchange rate determined in the manner provided by the contract of guarantee.74/

Article 11(a)(i) of the Convention makes it clear that currency transfer restrictions eligible for cover include "a failure of the host government to act within a reasonable period of time" on the guarantee holder's application for transfer. Thus undue delay, as well as explicit denial, of an authorization for conversion and/or transfer may be covered. The Regulations provide that a host government will be deemed to have introduced such a "passive" currency transfer restriction if it fails to act on conversion and/or transfer within ninety days of the guarantee holder's application or such other period as the contract of guarantee may provide in light of the requirements of each case.75/ The ninety days period is therefore provided as a general guideline, not as a rule to be readily followed unless exceptional circumstances justify a deviation.

In order to qualify for compensation from the Agency, the investor must, if MIGA so requests, transfer his rights to the local currency to the Agency or deposit it in an account of the Agency or of any person designated by MIGA.76/ The Regulations thus contemplate that to have a claim under currency transfer coverage, the investor must be able freely to dispose of the local currency in the host country. Measures of the host government restricting the guarantee holder's use of the local currency in the host country, such as a freezing of his accounts, will not therefore qualify for currency transfer risk coverage. The more general expropriation coverage may however be available for such measures.77/

B. The Risk of Expropriation and Similar Measures

1. Scope of Coverage

In its simplest form, an expropriation is an outright taking of property by a State through an act, such as a nationalization decree, transferring title to the property from the owner to the State.78/ However, it has been observed that a State may also take a variety of measures which "interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner."79/ In the consultations undertaken during the drafting of the MIGA Convention, it became clear that investors were much more concerned about the risk of such indirect or de facto expropriations than about outright or direct takings. This concern was supported by studies showing that since the 1970s oblique forms of expropriation had become more common than direct takings of property.80/ The provision of guarantee protection against a myriad of potential host government measures that could sharply frustrate an investor's expectations and invalidate the assumptions on which he based his investment decision therefore seemed essential to MIGA's ability to encourage investment.

The design of expropriation coverage as protection against a broad range of host governmental measures had at the same time to be reconciled with the need for a clear definition of the limits of such coverage. These limits should address difficult questions such as when a taking might properly be imputed to a government, what point should governmental interferences with property rights pass before they can be considered tantamount to a seizure of the property involved, etc. The delicate balancing of the considerations involved should become apparent as we examine the types of measures and interests included under MIGA's expropriation coverage and the effects such measures must have to substantiate a claim.

The Regulations tell us that the "coverage may encompass, but is not limited to, measures of expropriation, nationalization, confiscation, sequestration, seizure, attachment and freezing of assets."81/ Under Article 11(a)(ii) of the Convention, a covered measure may include any legislative action. The Regulations however explain that such an action may by itself be covered only if the expropriatory legislation is self-executing in the sense that it requires no further legislation or regulation for its implementation.82/ Thus in the case of legislation merely authorizing an expropriatory decree, only the enactment of the decree could give rise to a claim. Such a decree may be an administrative one, and Article 11(a)(ii) of the Convention provides that covered measures may include any administrative action. Administrative omissions may also be covered.83/ However, the Regulations limit the coverage of such omissions to cases where they constitute a breach of a legal obligation to act on the part of the administrative authority. 84/ Such an obligation may arise under the investment contract, the host country's domestic law or under international law. Thus, the refusal to grant certain licenses or facilities as agreed with the investor could be a covered event if such refusal is proven to be the direct cause of the loss. A denial of adequate police protection might in extreme circumstances qualify as an expropriatory omission where the denial amounts to a breach of established international standards of treatment of aliens, regardless of whether the investment is also covered against the civil disturbance risk.85/ Section 1.33 of the Regulations provides that in the case of an administrative omission, a covered measure will be deemed to have arisen 90 days after the date by which the administrative authority had an obligation to act or such other period as may be specified in the contract of guarantee.

Under Article 11(a)(ii) of the Convention, the action or omission must in all cases be "attributable to the host government." This limitation is less restrictive than it might appear to be at first glance. According to the Regulations, a measure may be attributed to the host government not only where the government itself takes or omits to take an action, but also where it approves, authorizes, ratifies or directs the action or omission.86/ Moreover, the term "host government" is defined by the Convention as including "any public authority" of the host country. Expropriation coverage will thus be available for measures taken by, for example, provincial and municipal authorities in addition to measures of the central government. The Regulations further add that the term "host government" may, if the contract of guarantee so provides, encompass a de facto government over the territory in which the investment is located,87/ thus permitting MIGA to maintain effective expropriation coverage in times of civil strife.

2. Exclusions from the Expropriation Risk.

(i) Legislative omissions and judicial decisions:

MIGA's financial viability will in part depend on its ability to recoup payments from host countries in the event of claims.88/ This will in turn depend on the extent to which the Agency as subrogee would have rights against the host country which are congruent with the Agency's contingent liability to the investor under the contract of guarantee. In view of its status as an international development institution, MIGA will at the same time have to avoid conflicts between its financial self-interest and members' legitimate exercise of governmental powers in their territories. These considerations help to explain certain exceptions to

the otherwise broad definition of expropriatory measures eligible for cover. Thus not only legislative omissions, but also measures taken by judicial bodies are excluded from expropriation coverage.89/ Clearly, MIGA would find itself in an untenable position if it were to pay claims on the basis of what local laws should have provided for, or accept claims regarding allegedly deficient decisions of courts and then seek recourse from host governments on such flimsy bases. On the other hand, the exclusion only applies to decisions of truly judicial bodies, i.e. independent courts or tribunals.90/ The purpose of this qualification is to allow guarantee protection to extend to measures of entities which are judicial only in name as well as of judicial bodies when they are required in fact to perform administrative functions unrelated to their judicial duties.

(ii) Bona fide regulatory measures.

Article 11(a)(ii) of the Convention moreover excludes from expropriation coverage "non-discriminatory measures of general application which governments normally take for the purpose of regulating economic activity in their territories." Examples of such regulatory measures given in the Regulations include "the bona fide imposition of general taxes, tariffs and price controls and other economic regulations as well as environmental and labor legislation and measures for the maintenance of public safety."91/ It should be emphasized, however, that the regulatory measures exclusion only applies to governmental measures which meet all of the requirements mentioned in Article 11 (a)(ii) of the Convention, i.e., to measures which (a) do not discriminate against the investor and apply generally, (b) are taken by governments in the normal exercise of their regulatory powers, and (c) are truly taken for the purpose of regulating

economic activities. It is on the basis of the latter requirement in particular that the Regulations introduce the notion of good faith in determining whether a measure falls within the exclusion. A regulatory measure will not, therefore, be excluded from cover if, for example, far from pursuing a public purpose, it is in fact "designed to have a confiscatory effect such as causing the investor to abandon his investment or to sell it at a distressed price."92/ In some cases, such bad faith may be difficult to establish. The motives of a measure might in exceptional cases be inferred, however, from its impact, particularly where the result of the measure appears to be grossly disproportionate or obviously unreasonable in relation to the ostensible regulatory objective.

There may, finally, be cases where the host government imposes a series of measures, the cumulative result of which may be equivalent to an expropriation. The Regulations permit MIGA to extend coverage to such cases of "creeping" expropriation even if each individual measure taken alone would appear to fall within the exclusion for regulatory measures.93/ Instead, the various measures may be judged in their entirety against the above-mentioned standards (non-discrimination, normality and regulatory purpose). If, considered as a whole, the series of measures falls outside the exclusion, it may qualify for cover. In extreme cases, an investor might even be protected against such a normal regulatory power like taxation if a series of increases in taxes add up to a destruction of the investment's financial viability, even though each individual increase could not obviously be characterized as expropriatory in nature.

3. Covered Interests

The interests that qualify for cover against expropriation and similar measures are broadly defined in Article 11(a)(ii) of the Convention to include not only the investor's "ownership or control" of his investment, but also any "substantial benefit" accruing to him from the investment. A wide range of economic interests, as well as title to property and ancillary rights of control, may thus be protected under MIGA's expropriation coverage. The following example may illustrate the importance of this approach. If a guarantee holder has a wholly-owned subsidiary in the host country which is covered against the expropriation risk and the host government confiscates only revenue-producing assets of the subsidiary, the confiscation would represent an interference with the subsidiary's ownership rights, but not those of the guarantee holder. Nevertheless, the guarantee holder could be entitled to compensation from MIGA if the revenues from the assets constitute a "substantial benefit" from the covered investment of which he was deprived.

The Regulations make it clear that expropriation coverage may be provided against measures which prevent the guarantee holder from exercising his rights of ownership or control over his investment as well as measures which interfere with the rights themselves.94/ In the case of equity interests, covered rights may take the form of rights to dividends and profits, the right freely to dispose of the equity interest, as well as rights of control. Coverage may further be so broad as to encompass the equity investor's interests in the operations or profitability of the project enterprise.95/

Non-equity direct investments present a somewhat different set of interests since they establish contractual as opposed to ownership rights such as those enjoyed by shareholders in corporations. The non-equity

direct investor's rights may take the form of claims against the project enterprise for agreed payments, and the rights to enforce such claims and transfer them to third parties. Apart from undertaking to make payments to the investor, the project enterprise may agree to give him rights of participation in the management of the enterprise. In addition, a project enterprise will commonly have a wide range of other contractual undertakings towards the investor, such as the duty not to disclose trade secrets under franchising arrangements. All of the above rights of non-equity investors qualify for MIGA's expropriation coverage.96/ Compensation may thus be available for measures which affect the investor's rights directly, such as seizures of funds received on account of such rights. It may also be available in respect of indirect expropriation measures such as host governmental actions that make it impossible for the enterprise to carry out its obligations towards the non-equity direct investor.97/

4. Effect of Covered Measures

Under Article 11 (a)(ii) of the Convention a covered measure must, to be regarded as expropriatory, "have the effect of depriving the guarantee holder of his ownership or control of, or a substantial benefit from, his investment." In applying this rule, MIGA will have to make certain choices as to the extent of the deprivation that should take place before a claim may be made. To keep their exposure within manageable limits, major national investment guarantee agencies and private political risk insurers generally restrict expropriation coverage to the complete loss of the guaranteed investment.98/ During the consultations between the World Bank staff and business representatives, this "all or nothing" approach was seen as a major flaw of existing guarantee programs. In

elaborating on the Convention, the Regulations therefore refrain from a sweeping application of this principle. Rather, they give MIGA a large measure of discretion to provide coverage in cases of both partial and total loss of the investment.

At the same time, the Regulations identify situations which would normally warrant restriction of expropriation coverage to cases of total loss. These are cases where it is difficult to quantify the investor's loss without reference to his rights and benefits in their entirety. They include cases where the host government's measures prevent the guarantee holder from exercising covered rights or substantially diminish the operations or profitability of the investment project.99/ The limitation of coverage to cases of total loss in this type of situation minimizes the scope for disputes over the amount of compensation and reduces the chance of overcompensation by MIGA.

Where it is likely that a loss can be related to a readily quantifiable portion of the investor's rights and benefits, coverage may be provided for cases of partial as well as total loss. Such coverage may, for example, be made available for cases of deprivations of covered rights, funds and other tangible assets.100/

Where expropriation coverage is confined to cases of total loss, the investor may often find it difficult to demonstrate that a specific host government action or omission has led to the total loss of the investment. The investor's task in this respect will, however, be facilitated by tests set out in the Regulations, which may be incorporated in contracts of guarantee. Thus, a total loss may be deemed to have occurred if the host government measure has prevented the guarantee holder from exercising a fundamental covered right for a specified long period.

Similarly, the investment may be considered as totally lost if, as a result of the measure, the investment project has ceased operations for a specified long period. The Regulations suggest as a guideline in both cases that the relevant period would be 365 consecutive days, but leave it to individual contracts of guarantee to specify any other period that might be more appropriate in the circumstances.101/

As an alternative to requiring the lapse of such periods, Section 1.40 of the Regulations provides that a total loss of the investment may be deemed to have taken place if after the occurrence of the expropriatory event the Agency agrees that the guarantee holder assign to it all his rights, claims or other interests related to the covered portion of his investment. A similar test is used by some national agencies on the assumption that the investor's interest in an ongoing investment will normally exceed his interest in compensation so that he may be prepared to give up the investment only if it has in substance been destroyed by the host government measure. However, these agencies require the investor to assign to them all of his rights related to the guaranteed investment. By contrast, MIGA's Regulations require only assignment of the interests relating to the covered portion of the investment. If MIGA accepted the assignment in all cases, an investor might assign the fraction of his interest guaranteed by MIGA to the Agency but remain with the investment. In addition, the investor's willingness to assign his interests in the investment need not be an indication of the seriousness of the host government measure; it may simply be an indication of the commercial failure of the investment. MIGA should therefore be careful not to agree to such assignments except in the case where the investor is actually withdrawing from an investment which was clearly profitable before the host

government measure. Even then, MIGA should first make a careful assessment of the impact of such an assignment on its relationship with the host country and of the uses open to it of compensation funds not related to the portion covered by MIGA's guarantee.

C. Breach of Contract

1. Justification of Coverage

Both equity and non-equity investors frequently attempt to secure their rights and gain advantages through concession, tax, marketing or other agreements with the host country. They may, for example, try to guard against changes in the host country's laws subsequent to the investment through so-called stabilization clauses in the agreements. To a varying extent, some national investment guarantee agencies extend expropriation coverage against breaches by the host government of such agreements in limited situations.102/ The Regulations also state that expropriatory measures "may take the form of breach of contract"103/ so that MIGA's contracts of guarantee may extend expropriation coverage to some cases of breach of contract. However, MIGA's situation differs from that of national guarantee programs in that MIGA is authorized to provide coverage against breaches of contracts by the host government as a separate coverage in addition to its expropriation coverage. Such a coverage will not be subject to any of the various limitations that apply to MIGA's expropriation coverage. This innovative breach of contract coverage will seek to enhance the reliability of contractual arrangements between host countries and investors. It will strengthen the investor's confidence that his investment agreement will be protected when his bargaining power declines as the investment matures. In the hydrocarbon and mining sectors

in particular, the host government may initially be dependent on the investor for the exploration of indigenous resources. Once a find is made and development begins, the investor's returns may increasingly seem to be exorbitant as the risks originally undertaken will have all but disappeared. The relationship between the investor and the host country may thus appear as an "obsolescing bargain," the investor obtaining highly advantageous conditions in the initial negotiations and the host country later pressing for changes in the agreement104/ Such changes might be unilaterally introduced by the host government without necessarily violating its domestic law or international law.105/ The initial imbalance and subsequent instability of investment contracts are indeed interrelated. While investors may be discouraged from making new investments without receiving long-term assurances from host governments, they should be aware that obtaining excessive protection and advantage through contractual clauses is a fragile remedy. By inspiring investors' confidence in the stability of their agreements with host countries, MIGA may not only help to remove a deterrent to investors but also make a balanced initial deal more acceptable to them.

MIGA's coverage will be available for losses arising from repudiations or breaches by host governments of contracts with guarantee holders in certain defined cases.106/ Such contracts may include joint venture agreements, concession or development agreements relating to the exploitation of natural resources, agreements governing taxes or royalties, sales or purchase agreements relating to inputs or products of the investment project, as well as most of the various forms of non-equity direct investment. To qualify for cover, however, it is essential that the

contract be between the host government (including any public authority of the host country, such as a local governmental authority) on the one hand, and the guarantee holder on the other hand.

2. Restrictions on Coverage

To avoid entangling MIGA in the substance of contractual disputes, breach of contract coverage is confined to three different situations, which are set out in Article 11 (a)(iii) of the Convention. They all represent situations which the Regulations correctly group under the term "denial of justice."

The first, and perhaps the most obvious, situation is where the guarantee holder does not have recourse to a judicial or arbitral forum to determine the claim of repudiation or breach. If the availability of such a forum were established on a purely formal basis, the attractiveness of MIGA's breach of contract coverage would be diminished, since it may rarely be the case that there is no forum at all before which an aggrieved investor can bring his claim. However, access to a forum which either lacks independence of judgement, or does not accord parties any fair hearing, or is clearly powerless to impose a final decision on them may have the same effect as the absence of a forum. Under the Regulations, the investor will therefore only be considered as having access to a forum if it is independent from the executive branch of government, acts judicially and is authorized to make a final and binding decision.107/ The Regulations add that the investor may similarly be deemed to be without a remedy even if in theory he has access to a forum possessing the foregoing qualities but in fact is denied access because, for example, the host government has established unreasonable procedural impediments.108/

The second type of denial of justice provided for in Article 11 (a)(iii) of the Convention is where the judicial or arbitral forum fails to render a decision on the claim of repudiation or breach within a "reasonable period of time." Since the reasonableness of such a period will to a great extent depend on such factors as the complexity of the contractual arrangements involved and the swiftness of the machinery of justice in individual host countries, Article 11 (a)(iii) of the Convention leaves the precise period to "be prescribed in the contracts of guarantee pursuant to the Agency's regulations." In this respect, the Regulations rightly refrain from specifying a specific period and require that the "reasonable period" to be specified in the contracts of guarantee "shall be not less than two years from the initiation of a proceeding by the guarantee holder and the final decision of the forum."109/ Although the two-year period was considered too short by some participants in the meetings of the Preparatory Committee, it was agreed upon with the understanding that it represents the minimum and should not be taken to imply that longer periods would be considered unreasonable. In all cases, it is obvious that a guarantee holder would be precluded from claiming compensation if the decision is not rendered within the period set out in the contract of guarantee because of a delay brought about or agreed upon by the guarantee holder himself. This might be the case where the guarantee holder has, for example, failed to take a procedural step within the time limits set by the forum or where he has asked for or, given the choice, has consented to the forum's postponement of a procedural step.

The third and final type of denial of justice mentioned in Article 11 (a)(iii) of the Convention is the case where the guarantee holder is unable to enforce a decision rendered by the forum in his favor on the

claim of repudiation or breach. The Regulations envisage that contracts of guarantee will specify the measures which a guarantee holder should take to secure the enforcement of such a decision before he can have a claim against MIGA, as well as the periods within which such measures should be taken.110/ If such measures have not resulted in enforcement within 90 days from the date of their initiation or such other period as may be specified in the contract of guarantee, the decision may be deemed unenforceable.111/ However, where in MIGA's judgment the enforcement measures would appear to be futile, it may decide to pay compensation without insisting that the guarantee holder take the measures.112/

A breach of contract claim may be founded upon any of the above three types of denial of justice. Their coverage is meant to guarantee the investor's effective pursuit and enforcement of contractual rights.

D. War and Civil Disturbance Risk

Lastly, MIGA may from the outset guarantee eligible investments against a loss resulting from "any military action or civil disturbance in any territory of the host country."113/ Unlike the MIGA's currency transfer, expropriation, and breach of contract coverages, the war and civil disturbance coverage applies to events which, as the Commentary notes, "are typically outside the control of the host government."114/ MIGA will therefore not normally be able to recoup the payment of a claim on account of this coverage from the host country. Its ability to reduce this type of risk by virtue of its presence as guarantor may also be more limited than in other cases. As a result, MIGA's role with respect to this type of coverage is expected to be confined to the traditional insurance function and its premium rates are likely here to reflect more closely the

actual loss potential under these guarantees.115/ MIGA and investors will thus require sufficient freedom to negotiate in each case the scope of coverage with a view to striking an appropriate balance between comprehensiveness and cost effectiveness of the guarantee protection. Against this background, the Regulations refrain from prescribing the details of this coverage. Instead, they describe the outer limits of MIGA's authority to guarantee war and civil disturbance risks, outline the core of this coverage and, for the rest, indicate options for the design of coverage in individual contracts of guarantee in the light of the circumstances of each case.

1. Military Action

Like national investment guarantee programs, MIGA will provide coverage against losses arising from military action or war.116/ The Regulations explain that this coverage will encompass not only "hostilities between armed forces of governments of different countries" but also cases of civil war, that is, hostilities "between armed forces of rival governments in the same country."117/ Losses resulting from both declared and undeclared wars may be covered.118/ As will become clear when we discuss the place of covered events, the host government need not be one of the belligerents for the war to qualify for MIGA's cover.

2. Civil Disturbance

Coverage against civil disturbance is equally broadly defined in the Regulations to include "organized violence directed against the host government which has as its objective the overthrow of such government or its ouster from a specific region."119/ As examples of covered events, the

Regulations,120/ echoing the Commentary,121/ mention revolutions, rebellions, insurrections and coups d'etat. While offering guarantees against the types of risk commonly covered by national investment guarantee agencies, MIGA may also provide coverage against civil disturbance which takes the form of "riot" and "civil commotion." The Regulations define a "riot" as "an assemblage of individuals who commit public acts of violence in defiance of lawful authority," while "civil commotion" refers to "events which have all the characteristics of riot but which are more widespread without, however, attaining the status of civil war, revolution, rebellion or insurrection."122/ As defined, a riot or civil commotion need not be directed against the host government. Coverage may, for example, include riots aimed at a foreign government, such as the government of the investor's home country, or against certain policies rather than against a government as such. However, the civil disturbance must in all cases have been caused or carried out by groups primarily pursuing broad political or ideological objectives. Acts undertaken to further labor, student or other specific interests, and acts of terrorism, kidnapping, or similar acts directed against the guarantee holder will normally123/ be excluded from cover on the assumption that private insurers adequately meet the demand for coverage against these latter types of risks.124/ On the other hand, MIGA's extension of coverage to riot and civil commotion in particular may fill an important gap left by many national investment guarantee programs. The latter traditionally restrict cover to war, revolution and insurrection, with the result that investors may be unprotected against many facets of politically motivated violence. For example, losses occasioned by civil unrest directed against unpopular policies or the investor's home country are not normally covered under existing programs.

3. Place of Covered Events

The Regulations provide that a military action or civil disturbance occurring primarily outside the host country may be deemed to take place in the host country, and qualify for coverage, if it destroys, injures or damages tangible assets of the investment project which are located in the host country or otherwise interferes in the operation of the project.125/ Thus, for example, cover may be provided against military actions or civil disturbances which occur in a country bordering the host country and which affect an investment project located close to the border between the two countries. In appropriate cases, MIGA's coverage may be available in respect of wars and civil disturbances which, for a period specified in the contract of guarantee, make it impossible to use transportation links which are vital to the operation of the investment project even if the covered events occur in a place at some distance from the host country.126/ For example, the host country may be landlocked and production from the investment project may, as a result, have to be transported by rail through a neighboring country to a port in a third country. If a war or civil disturbance in the neighboring or third country renders use of the railroad or port impossible for the specified period, the guarantee holder might obtain compensation from MIGA for the ensuing loss.

4. Covered Losses

MIGA's war and civil disturbance coverage will normally be restricted to cases where the assets of the investment project have been removed, destroyed, or physically damaged, or where there have been other forms of substantial interference with the operation of the investment

project.127/ Losses arising from a mere reduction in business opportunities or a deterioration of operating conditions as a result of military action or civil disturbance will not be covered, even if the business environment worsens to the extent that the investment's commercial basis is destroyed.128/ Similar limitations are applied by national investment guarantee programs.129/ While the limitations restrict investors' protection, they are necessary to safeguard MIGA's financial viability. Without them, claims could easily be presented in respect of all guaranteed projects in a country affected by war, revolution or civil disturbances.

MIGA's coverage is, however, liberal as compared to that of national programs in that it may extend to any "substantial interference with the operation of the investment project."130/ Most national programs either do not generally cover interferences as such or only do so where the interference has such effects as making it permanently impossible to continue operations on a profitable basis. The Regulations also authorize MIGA to extend coverage to the costs of business interruption. Thus, if a covered event destroys an asset of the investment project, MIGA may not only pay compensation for the value of the destroyed asset, but also for losses arising from a temporary cessation or slowdown of the project's overall operations as a result of the asset's destruction. Extension of coverage to such consequential losses would normally be made against a higher premium. It may, however, cause considerable problems in the valuation of claims. This might readily be the case of business interruptions affecting operations of a concern composed of an integrated chain of production facilities in different countries, one of which is the guaranteed investment project. While agreeing that MIGA might provide business interruption coverage, the Preparatory Committee therefore

properly recommended that MIGA "proceed with caution in underwriting this innovative form of coverage."131/

In order further to reduce MIGA's exposure to risk and thus permit a downward adjustment of premiums, MIGA's contracts of guarantee may incorporate other limitations often applied by national investment guarantee agencies. Other than the mandatory limitation of MIGA's cover to not more than ninety per cent of the investment,132/ the contracts may confine coverage to losses in excess of a specified amount or percentage of the investment or exclude from coverage losses related to assets which are not essential to the operations of the investment project, especially if those assets are valuable and susceptible to damage.133/ In appropriate cases, coverage may be confined to situations where the investment project has been totally destroyed or suffered such substantial damage as to make its continued profitability impossible.134/ To help avoid disputes between MIGA and the guarantee holder on questions of valuation and thus facilitate the swift adjustment of claims, contracts of guarantee might finally confine compensation to losses calculated on the basis of the historical cost of the damaged or destroyed assets.135/ While it is the standard practice of national investment guarantee agencies to apply the above limitations, the Regulations leave it to MIGA's management to decide in the circumstances of each case which of them, if any, it will seek to include in a particular contract of guarantee.

E. Other Non-Commercial Risks; Relationship between Coverages

The four types of eligible risks described above only relate to MIGA's initial underwriting authority. In addition to those coverages, MIGA's Board, acting by special majority, may upon the joint application of

the investor and the host country extend coverage to any other non-commercial risk with the exception of the risks of devaluation or depreciation of currency.136/ The Board may approve such an extension of coverage to acts undertaken to further labor, student or other specific interests and acts of terrorism, kidnapping or similar acts directed against the guarantee holder which, as noted above, would not otherwise be eligible for MIGA's cover.137/ The Board's approval might be limited to a particular case or be issued in terms that MIGA would henceforth be generally authorized to underwrite an additional type or types of risk.138/

The various types of coverage may overlap in that the same event may give rise to a claim under different coverages. This is acknowledged by the Regulations. As mentioned earlier, they state that an expropriatory measure may also constitute a breach of contract. In addition, they recognize that a breach of contract may also constitute a covered currency transfer restriction.139/ In such cases, the guarantee holder will only be entitled to one compensation. For example, MIGA's payment of a breach of contract claim will at the same time satisfy an expropriation claim founded on the same event. However, since every coverage is subject to its own qualifications and limitations, an investor may find it advantageous to purchase the entire risk package offered by MIGA. Coverage against all types of risks will entitle the guarantee holder to the maximum payment under any of the applicable coverages.140/

In addition, distinctions between the different coverages may lead to difficult questions in practice. For example, the seizure of assets of the guarantee holder by insurgents may be deemed to be an act of war or civil disturbance or to be an expropriation by a *de facto* government. In such a case, the investor can be assured of compensation only if he is

covered against both types of risk. To keep the price for legal certainty modest and encourage investors to purchase comprehensive coverage, the Regulations, as will be shown in more detail, contain an innovative provision permitting MIGA to discount the premium rate for packages including all or several of the available coverages.141/

NOTES TO CHAPTER 2

1. MIGA Convention, Article 2.

2. Regulations, Section 2.01.

3. The approval of contracts of guarantee is discussed further at _infra_, Chapter Three, pp. ___.

4. Regulations, Section 2.02. _See_ details in Chapter Five, pp. ---.

5. For the details of this requirement, which is set out in Article 12(d)(i) of the MIGA Convention, _see_ Chapter Four, _infra_.

6. These requirements, which are provided for in Articles 12(d)(ii) and 12(d)(iii) of the MIGA Convention, are dealt with in some detail in Chapter Four, _infra_.

7. MIGA Convention, Article 15. For further details see _infra_, Chapter Three, pp. ___.

8. _See_ Chapter Four, _infra_.

9. With respect to the first exclusion, Section 1.54 of Regulations provides that a guarantee holder will, in particular, be deemed to have been responsible for a governmental action or omission which is reasonably attributable to conduct which is prohibited under the law of the host country or to conduct of persons acting on the guarantee holder's behalf or acting on behalf of the project enterprise to the extent that the guarantee holder could have exercised his rights to prevent the enterprise's conduct. As to the second exclusion, Section 1.57 of the Regulations provides that the exclusion need not affect the validity of contracts of guarantee in cases of events unknown to both the Agency and the applicant for MIGA's guarantee prior to the conclusion of the contract of guarantee, or circumstances at the time of the conclusion of the contract which lead only thereafter to a specific covered event giving rise to a loss.

10. Compare the approach followed in the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 57 U.N.T.S. 159, [the ICSID Convention]. The ICSID Convention does not include any definition of the term "investment" (see Article 25(1) of the ICSID Convention) and to that extent is even more flexible than the MIGA Convention.

11. These conditions are described _infra_ at pp. ___.

12. For an overview, see C. Oman, _New Forms of International Investment in Developing Countries_ (1984).

13. Regulations, Sections 1.04(i)-(ii).

14. Regulations, Section 1.04(iv).

15. Cf. Shihata, "Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guarantee Scheme," forthcoming in 21 Int'l Law. at n.13 (1987). It should be noted in this regard that the International Finance Corporation (IFC), with which MIGA is expected to cooperate closely, is now promoting foreign portfolio investment in the emerging markets of developing countries with increasing success. Such promotion can no doubt be enhanced by MIGA's guarantee.

16. Compare national programs of political risk insurance, where portfolio investment is not eligible under the German program, is probably meant to be excluded under the U.K. program, where coverage is limited to the case where the investor holds at least 10% of the share capital of the project company, but is covered under the U.S. program.

17. According to Section 1.04(v) of the Regulations, the mean repayment period will be determined as follows:

    (a) if the financing involved has a single repayment date, the mean repayment period will be the period from the date of the contract for such financing to the date of the repayment, and

    (b) if the financing involved is to be repaid on more than one date, the mean repayment period will be the average of the periods between (i) the date of the contract for such financing and (ii) the respective dates of repayment of such financing, such periods being weighted by the amount of repayments at the end of the respective periods.

18. Regulations, Section 1.04(v).

19. See generally, L. Wells, Third World Multinationals: the Rise of Foreign Investment from Developing Countries (1983).

20. Production and profit-sharing contracts in the energy sector are covered by the U.S., German and Canadian programs, management contracts are covered by the U.S. program and, if made in conjunction with an equity investment, by the Canadian program. Franchising and licensing agreements as well as turnkey contracts and leasing agreements are covered in the U.S. and Canadian programs.

21. Cf. MIGA Convention, Article 23(c). See also Regulations, Section 3.07.

22. Cf. Commentary, para. 19.

23. Id.

24. Regulations, Section 1.05.

25. Id. Section 1.06.

26. Id.

27. See Commentary, para. 20.

28. According to information obtained by World Bank staff, the export credit insurance agencies of Canada, France, Germany, the U.K. and the U.S., for example, only exceptionally cover such variable components of the insured's remuneration.

29. Regulations, Section 1.06.

30. Id.

31. It should be noted that, although there is no explicit provision to this effect, the MIGA Convention does not preclude the Agency from administering in the future a program of guarantees of commercial bank loans if its members agree to entrust it with such a task, which the Agency could carry out under its ancillary powers provided for in Article 2(iii) of the MIGA Convention. The reference in the MIGA Convention to "assets administered by the Agency" (Article 45(c)) was intentionally made to apply to situations of this kind.

32. Commentary, para. 19.

33. Section 1.09 of the Regulations provides that the term "freely usable currency" will have the same meaning as is assigned to the term in Article 3(e) of the MIGA Convention, namely any currency designated as freely usable by the International Monetary Fund (IMF). At present, the currencies so designated by the IMF are the Deutsche Mark, Japanese Yen, Pound Sterling, French Franc, and the U.S. Dollar. Article 3(e) of the MIGA Convention adds that MIGA's Board of Directors may also designate other currencies as freely usable following consultation with the IMF, provided the country of such currency approves.

34. Regulations, Section 1.09.

35. Id., Section 1.10.

36. Id., Section 1.11.

37. Id., Section 3.20

38. See id.

39. Id., Section 1.11.

40. Id., Section 1.12. See also MIGA Convention, at Article 12.(c)(i). This detail is particularly important in view of pervasive attempts at privatization and debt-equity swaps in many developing countries at present.

41. MIGA Convention, Article 13(a).

42. In some countries, however, certain types of commercial partnerships, thought not incorporated, are in essential respects treated as juridicial persons. Examples are the open partnership (Offene Handelsgesellschaft) and limited partnerships (Kommanditgesellschaft) of German and Swiss law. On the request of the German and Swiss delegations to

the Preparatory Committee's meetings, Section 1.14 of the Regulations permits such partnerships to qualify for MIGA's guarantee.

43. Regulations, Section 1.14. Under Article 16 of the MIGA Convention, a portion of the investment should remain uncovered by the Agency (in order to maintain the investor's interest in avoiding losses). Section 2.09 of the Regulations provides that this "uncovered amount" should be at least 10% of the investment.

44. MIGA Convention, Article 13(a)(i).

45. Id., Article 13(b).

46. Id., Article 13(a)(ii). The intention behind the requirement of this dual test was to avoid coverage of corporations which are incorporated in a member country but have no real business in that country. The language used is broad enough however so as to also cover situations where a company is incorporated in a member country but has its principle place of business in another member country. See the drafting history in 1 C.O.W. Records 88-91 (1985).

47. Convention, Article 13 (a) (ii), Regulations, Section 1.15.

48. See Kahn & Ul Haq, "Capital Flight from Developing Countries," 124 Financial & Development 2-5 (1987).

49. E.g., the massive savings of expatriates residing in the oil-exporting Gulf countries.

50. Regulations, Section 1.17.

51. Id.

52. Id.

53. See Chapter One, p. ___.

54. See id., p. ___.

55. Regulations, Section 1.18.

56. Id.

57. Examples of such multinational public enterprises include Eurochemic, Air Afrique, and the Central African Power Corporation. See C. Figler, Multinational Public Enterprises (1967); I. Shihata, International Economic Joint Ventures: A Study of their Legal Problems and their Application in the Arab World (1969) (in Arabic).

58. Draft outline of the Convention Establishing the Multilateral Investment Guarantee Agency, Oct. 1984, Article 13(a)(iii).

59. Regulations, Section 1.19.

60. Id.

61. This was one of the criteria suggested in the draft presented to the Prepartory Committee. Other criteria which that draft envisaged as relevant to a determination whether a publicly-owned enterprise operates on a commercial basis included "the capitalization of the investor with long term capital, the degree of autonomy of the investor's management, the accountability of the management for financial results and the application of cost controls, the extent to which the investor applies accounting and auditing principles normally followed in private business, and the exposure of the investor to competition." After listing the above criteria, the draft submitted to the Preparatory Committee added that "[t]he generation of profits need not be the main corporate purpose of the investor; it is sufficient that the investor is designed to operate on a self-sustaining basis rather than relying on recurrent subsidies from a public budget." The decision of the Preparatory Committee not to specify such criteria in the Regulation does not, of course, preclude MIGA from developing the same or similar criteria in practice.

62. Regulations, Section 1.19.

63. Coverage under MIGA's "sponsorship window" may however extend to investments in developed as well as developing countries. See Chapter Three, infra pp. ___.

64. MIGA Convention, Article 31(a)(v).

65. Cf. id., Article 59 (b).

66. See 2 COW Records, 355-56 and paragraph 24 of the Commentary.

67. Regulations, Section 1.21.

68. See paragraph 24 of the Commentary and Section 3.07 of the Regulations.

69. Regulations, Section 1.23.

70. Id., Section 1.27.

71. Id., Section 1.28.

72. MIGA's cover cannot be extended to the risk of devaluation or depreciation of currency, by explicit prohibition in Article 11(b) of the Convention. Most national investment guarantee programs, such as those of Canada, Germany, the U.K. and the U.S., primarily apply the official rate. These programs also generally provide for subsidiary rates of exchange if an official rate is not quoted or not actually applied to currency conversions at the time of the loss. Such subsidiary rates include rates prevailing on an effective and legal parallel market, as under the U.S. program, rates agreed with the investor as is the case in the Canadian program, or rates quoted at the national exchange or published by the central bank of the country operating the program, as is the case with the German investment guarantee scheme.

73. Section 1.28 of the Regulations envisages that contracts of guarantee may provide an alternative basis for calculating a claim if there is no such category of exchange rate on the date mentioned in the text above. It may be noted in this respect that the French investment guarantee programs use the category of exchange rate which applied to the investment on the date that its implementation began, regardless of subsequent changes.

74. Regulations, Section 1.24.

75. Id.

76. Id., Section 1.26.

77. Cf. id., Section 1.25.

78. See the discussion on expropriation of the property of aliens under international law in Chapter Three, infra.

79. Starret Housing Corporation and the Government of the Islamic Republic of Iran, Award No. ITL32-24-1 at p.51 (December 19, 1983), reprinted in 4 Iran U.S. C.T.R. 122, 154. See also Dolzer, Indirect Expropriation of Alien Property, 1 ICSID Rev. - FILJ (1986).

80. See, e.g., Korbin, "Expropriation as an Attempt to Control Foreign Firms in LDCs: Trends from 1960-79", 28 Int'l Studies Q, 329 (1984) and M. Minor, Developing Countries and Multinational Corporations: Why Has the Expropriation Option Fallen from Favour? (1986), Dolzer supra note 79 at 41.

81. Regulations, Section 1.29.

82. Id., Section 1.32.

83. MIGA Convention, Article 11(a)(ii).

84. Regulations, Section 1.32.

85. In view of the controversy concerning international law criteria on the standards of treatment of aliens, MIGA should, proceed cautiously in defining what omissions would constitute violations of an obligation to act under customary international law. See further details in Chapter Three, infra.

86. Regulations, Section 1.34.

87. Id., Section 1.35.

88. For a discussion of recoupment by the MIGA, see infra, Chapter Three, pp. ___.

89. Cf. MIGA Convention, Article 11(a)(ii).

90. Regulations, Section 1.32.

91. Id., Section 1.36. Cf. Commentary, para. 14.

92. Regulations, Section 1.36.

93. Id., Section 1.37.

94. Id., Section 1.30.

95. Id., Section 1.31.

96. Id., Sections 130 & 131.

97. Id., Section 1.31.

98. The national agencies of Canada and the U.S. limit expropriation coverage to cases of total loss of the guaranteed investment except for the expropriation of funds constituting proceeds from the guaranteed investment. The German program provides coverage in cases of both partial and total loss, but requires that the expropriatory measures make it permanently impossible to operate the project without loss, while the leading private political risk underwriter of Lloyd's of London requires, with some exceptions, that the expropriatory act cause the "permanent and total cessation of the activities" of the investment project.

99. Regulations, Section 1.41.

100. Id.

101. Id., Section 1.40.

102. For example, the U.S. agency normally does not cover such breaches per se, but extends coverage to breaches which constitute a violation of the host country's domestic law or international law and which substantially deprive the investor of the benefits from his investment.

103. Regulations, Section 1.30.

104. See American Law Institute, Restatement of Foreign Relations Law (Tentative Draft No.3) (1982), Section 712, reporters' note 7; Vernon, Sovereignty at Bay 47 (1971); and Korbin, supra note 80, at 340-41. For a review of the "obsolescing bargain" hypothesis, see Bergston, Horst & Moran, American Multinationals and American Interests (1978).

105. Domestic legal systems normally entitle the State to introduce changes in administrative contracts on the basis of public interest provided that just compensation is paid for resulting damages. See, e.g. G. Mitchell, The Contracts of Public Authorities: A Comparative Study (1954); C. Turpin, Government Contracts (1972). Such changes, if introduced in a contract with a foreign investor, would not amount to a violation of international law unless they contravene a treaty obligation or are otherwise unaccompanied by just compensation and are so flagrant in terms of arbitrariness and discrimination, that they constitute a violation of the rights of aliens secured under customary international law. See commentary on Article 2 of the first draft OECD

Convention on the Protection of Foreign Property, OECD DOC. 15637, Dec. 1962; Lord Shawcross, "The Problems of Foreign Investments in International Law," 102 Recueil des Cours 339, 351-59 (1961-I).

106. See MIGA Convention, Article 11(a)(iii).

107. Regulations, Section 1.44(i). However, a court of law whose decisions are subject to appeal before a higher court is obviously an appropriate forum.

108. Id., Section 1.44 (ii).

109. Id., Section 1.43.

110. Id., Section 1.45.

111. Id., Section 1.44(iii).

112. Id., Section 1.45.

113. MIGA Convention, Article 11(a)(iv).

114. Commentary, para. 16.

115. Premiums for the other coverages will also have to be established in accordance with sound business principles (Cf. Article 25 of the MIGA Convention), but they may be lowered in view of the alleviation of risks brought about by MIGA's presence. Premium rating is discussed further at infra, Chapter Three, pp. ___.

116. Most private political risk insurers do not insure war damages in respect of land-based assets, thus greatly restricting the scope of war coverage from the private market. Private political risk insurers also to not cover any war damage caused by the explosion of a nuclear device or by a war involving China, France, the U.K., the U.S. or the U.S.S.R. Such exclusions do not appear in MIGA's Regulations.

117. Regulations, Section 1.47.

118. Id.

119. Regulations, Section 1.48.

120. Id.

121. Commentary, para. 16.

122. Regulations, Section 1.48.

123. Such acts may however be covered with the approval of a special majority of MIGA's Board. See infra p.___.

124. Private political risk insurers in the U.S. and U.K. offer a broad range of pertinent coverage, such as cover against kidnapping and ransom, hijacking, terrorist attacks, sabotage and violent strikes.

125. Regulations, Section 1.50.

126. Id.

127. Id., Section 1.52.

128. Id.

129. The U.S. program, for example, requires that "political violence is the direct and immediate cause of the permanent loss (including loss of value by damage or destruction) of tangible property of the foreign enterprise used for the project."

130. Regulations, Section 1.52.

131. Report of the Preparatory Committee for the Establishment of the Multilateral Investment Guarantee Agency to the Board of Directors of the Agency, para. 7 (Sept. 19, 1986). While business interruption coverage is offered by several private insurers, the U.S. national investment guarantee program is apparently the only national program which provides such coverage (for an additional premium and then only in cases of hydrocarbons projects).

132. Regulations, Section 2.09.

133. Id., Section 1.51.

134. Id.

135. Id.

136. See supra pp. ___.

137. Section 1.49 of the Regulations states that such acts would have to be politically motivated to qualify for cover. However, since this limitation is only contained in the Regulations to be adopted by the Board, and is not required by the MIGA Convention, the limitation may be seen merely as an indication by the Board to MIGA's management of the basis upon which the Board would be willing to extend coverage to such acts. The Board could, of course, decide at any time to make the extension on a different basis.

138. Regulations, Section 1.53. Cf. Commentary, para. 17.

139. Regulations, Section 1.42.

140. See id.

141. See Chapter Three, infra pp. ___.

Ch.3

CHAPTER THREE

ADMINISTRATION OF GUARANTEE CONTRACTS: UNDERWRITING, CLAIMS, SUBROGATION AND RECOUPMENT

Introduction

Once an investment's eligibility is established to the satisfaction of MIGA, the Agency will have to decide whether it will guarantee such investment. A positive decision on the part of the Agency will be followed by the negotiation of satisfactory terms and conditions of the guarantee contract in each case. After the contract of guarantee is concluded, MIGA will supervise its implementation and may be faced with claims from the other contracting party (the investor) for the payment of the guarantee amount as agreed. Payment by the Agency of such an amount or even its unqualified agreement to pay, will create certain rights for the Agency vis-à-vis the host country and other obligors through subrogation. Normally this will result in a recoupment process between the Agency and the host country. Each of the above processes raises legal and policy issues, most of which are predicted and solved through explicit provisions in the Convention Establishing MIGA (the Convention) and the draft Operational Regulations adopted by the Preparatory Committee for MIGA (the Regulations).

I. Underwriting - The Process and Conditions of the Issuance of Guarantees

The Regulations emphasize that the decision whether to underwrite, i.e., guarantee, an eligible investment will by its nature be a business decision as opposed to the legal determinations on eligibility.1/ At the

same time such underwriting decisions will be based on a series of assessments and determinations by MIGA, most of which ultimately reflect requirements of the Convention. Certain procedures, which are set forth primarily in the Regulations, will also have to be followed by MIGA in reaching underwriting decisions. To a great extent, the underwriting process as a whole will be conditioned by the financial constraints within which MIGA must operate. Foremost among these is the fact that MIGA's financial capacity to issue guarantees will be limited, particularly in the Agency's early years. No guarantee may be issued which would cause the limits of MIGA's guarantee capacity to be exceeded.

A. Limits of Guarantee Capacity

1. Overall Limitation

The general limits on MIGA's guarantee capacity are to be found in Article 22(a) of the Convention. Article 22(a) provides that the aggregate amount of contingent liabilities assumed by MIGA in its guarantee operations must initially not exceed one and one half times the amount of the Agency's unimpaired subscribed capital and its reserves plus such portion of its reinsurance cover as the Board may determine.2/ For a number of reasons, the financial constraint imposed by this very conservative 1.5 to 1 risk-to-asset ratio will be particularly severe at first. While Article 5(a) of the Convention sets the Agency's initial authorized capital at $1.082 billion, the actual capital supporting guarantee operations at the outset may be as little as some $361 million, for the Convention can, in accordance with its Article 61(a), enter into force upon ratification by members whose subscriptions represent only one third of the initial authorized capital. It will also be some time before the Agency can accumulate,

through income accruing from its operations and investments, reserves which may add significantly to its guarantee capacity. Finally, Section 3.50 of the Regulations provides that the portion of the reinsurance cover obtained by MIGA which may be credited to the guarantee capcity will be 90 percent of the reinsurance which conforms with MIGA's exposure under the reinsured contracts of guarantee and does not expire before such contracts or the applicable portions thereof. This condition may greatly restrict the contribution that reinsurance from private sources can make to MIGA's guarantee capacity. The reason is that MIGA will normally issue long-term (three to fifteen year) guarantees,3/ whereas the private market at present offers only short-term (up to three-year) reinsurance. Reinsurance by national agencies could be coterminous with MIGA's long-term guarantees. However, it is also unlikely to augment MIGA's guarantee capacity in the foreseeable future because most national agencies are not authorized to reinsure other insurers of foreign investment, and those which may do so are at present inclined to use their financial capacity on their own underwriting.

On the other hand, the 1.5 to 1 risk-to-asset ratio will, as indicated above, only be an initial ceiling on MIGA's guarantee capacity. Under Article 22(a) of the Convention, MIGA's Board will periodically review the Agency's risk portfolio with a view to determining whether changes in the risk-to-asset ratio should be recommended to the Council. Such a review will be conducted in the light of the Agency's actual experience with claims, the degree of its risk diversification, the extent of its reinsurance cover and all other relevant factors. On the basis of such recommendations the Council may by special majority vote increase the

initial 1.5 to 1 ratio up to a maximum of 5 to 1.4/ Another obvious means by which MIGA's guarantee capacity may be raised is by increases in MIGA's subscribed capital, through subscriptions of new members as they join the Agency. It is also possible to have MIGA's subscribed capital increased through additional subscriptions by existing members. Such additional subscriptions could not be made, however, if the authorized capital stock is fully subscribed until the latter is increased by the Council acting by special majority.5/ MIGA's reserves should also eventually add significantly to the guarantee capacity, as might the Agency's reinsurance cover. While there is thus substantial potential for the expansion of MIGA's own underwriting capacity, such expansion may take place only over a long period of time. Furthermore, it will be dependent on a favorable vote by a very large majority of MIGA's members if it is to come about through a relaxation of the risk-to-asset ratio or a capital increase.

2. Guarantees of Sponsored Investment

It should be recalled, however, that even if the applicable limit of MIGA's guarantee capacity is reached the Agency will still be able to underwrite investments sponsored by member countries under the additional "Sponsorship Trust Fund" facility, the principal provisions on which are set out in Annex I to the Convention. Under this facility, which will not be dependent on the Agency's own funds, MIGA will be acting in fact as administrator of a joint operation on behalf of sponsoring member countries, with each of the latter having a loss-sharing contingent obligation up to the amount of the guarantees issued for investments sponsored by it.6/ Premiums and other revenues attributable to sponsored guarantees will be accumulated in the Sponsorship Trust Fund, which will be

kept separate and apart from the assets of the Agency.7/ The administrative expenses and payments on claims related to sponsored investments will be paid out of this fund. Upon its depletion, remaining liabilities will be shared on a pro rata basis by sponsoring countries only. Each sponsoring country will have a contingent liability to meet losses incurred under sponsored guarantees. Within the respective limit of the amount of guarantees sponsored by each member, such liability will be established in the proportion which the guarantees of investments sponsored by it bears to the total amount of guarantees sponsored by all countries.8/ MIGA will thus incur no liabilities with respect to its own assets under the sponsorship operations.

Apart from having no financial ceiling, MIGA's sponsorship facility will be administered in a more liberal manner than the guarantee operations which MIGA will undertake on the strength of its own resources. The facility will allow coverage of investments "by an investor of any nationality or by investors of any or several nationalities,"9/ and not just investments by nationals of member countries. In addition, the restriction of coverage to investments in developing member countries will not apply to sponsorship operations. Members may sponsor investments made in any member country, whether industrial or developing.10/ In other respects, the Convention's provisions relating to the Agency's own guarantee operations, including the requirement regarding approval of the host country, will apply *mutatis mutandis* to sponsored guarantees.11/ The importance of carrying out sponsorship operations in accordance with the same sound business and financial practices governing the Agency's own operations is particularly emphasized by the official Commentary on the Convention (the Commentary), which notes that "[a]s in the case of underwriting for its own

account, the Agency would not be expected to cover sponsored investment involving unacceptably high risks or that would unbalance its risk portfolio."12/ The characterization of the sponsorship fund as a trust arrangement is also meant to establish MIGA's obligations as a trustee vis-à-vis the sponsoring member countries which would expect it to administer such fund with the same care and prudence as it applies to its own resources.

B. Allocation of Guarantee Capacity

In respect of guarantee operations undertaken on the strength of its own resources MIGA will from the outset have to allocate its limited guarantee capacity equitably and prudently in its underwriting decisions, with a view to achieving a fair distribution of the Agency's benefits among its members and a diversified risk portfolio. The Convention and the Regulations indicate how MIGA might accomplish these objectives.

1. Specific Allocations of Guarantee Capacity

Section 3.54 of the Regulations enjoins the Agency "to endeavor to distribute the benefits of its guarantee capacity among members as broadly as may be permitted by the distribution of investment opportunities, the decisions of investors and host countries, and the Agency's other policies." In this context, Article 22(b)(i) of the Convention authorizes MIGA's Board to prescribe maximum amounts of contingent liability for all guarantees issued to investors of individual member countries. While it is clear that concentration on investors from a few home countries must be avoided, country limits or similar formulas could easily be arbitrary and difficult to implement if fixed without the benefit of experience of the

demand for MIGA's services. The Regulations therefore instruct MIGA's President to submit to the Board, no later than one year after the Agency's establishment, a report on the subject which the Board will then discuss with a view to adopting appropriate guidelines pursuant to Article 22(b)(i) of the Convention.13/ Article 22(b)(i) of the Convention provides that in so doing, the Board will give due consideration to the share of the respective home country in the Agency's capital and the need to apply more liberal limitations in respect of investments originating in developing member countries. It is expected that before the Board adopts its guidelines, MIGA's management will also take these considerations into account.14/ General guidance on the question of allocating the benefits of MIGA's guarantee operations equitably among host countries is also given by the Regulations. Section 3.57 requires the Agency to seek "to encourage investment in as large a number of host countries as possible" subject to its developmental objective and the constraints of prudent risk management. Also, Section 3.54 of the Regulations, echoes the Commentary on the Convention by requiring the Agency to pay "due regard to the needs of the lesser developed among its developing member countries" in distributing the benefits of its guarantee capacity.

2. Portfolio Diversification

In order to avoid an excessive concentration of risks, which could materialize simultaneously and jeopardize the Agency's financial viability, MIGA must also seek to build a diversified risk portfolio. To this end, Article 22(b)(ii) of the Convention authorizes the Board to prescribe "maximum amounts of contingent liability which may be assumed by MIGA with respect to such risk diversification factors as individual projects,

individual host countries and types of investment or risk." With one exception, however, the Regulations defer setting such limits until account can be taken of MIGA's first year of experience.15/ The exception is a limit, set by the Regulations at 5 percent of the Agency's guarantee capacity, on the maximum contingent liability which may be assumed by the Agency in respect of a single investment project.16/

However, in view of the importance of averting undue risk concentrations, MIGA must from the beginning assess the overall implications that its underwriting decisions will have on its risk portfolio, taking into account all of the relevant risk diversification factors. The Agency's portfolio may nevertheless be quite unbalanced in the early period of its operations, reflecting the mixture of investments that happen to be ready at the time and the decisions of particular investors and host governments as to MIGA's involvement. In order to achieve a balance as quickly as possible, the Regulations call upon MIGA to accelerate the growth of its portfolio through such means as actively promoting selected investments, joining other agencies in providing support for investments, and reinsuring eligible investments insured by others.17/ MIGA's ability to write a broad "book" of business through reinsurance will however be limited by provisions of the Convention and Regulations intended to ensure that MIGA will concentrate on primary underwriting. Pursuant to Article 20(a) of the Convention, Section 3.51 of the Regulations provides that no more than 25 percent of MIGA's guarantee capacity may be used for the issuance of reinsurance. Within these limits, the great majority of reinsurance operations will be reserved for relatively new investment. Article 20(a) of the Convention provides that no more than 10 percent of MIGA's total contingent liabilities may be incurred on account of reinsurance issued in

respect of investments which have been completed more than 12 months prior to the Agency's receipt of the application for reinsurance. This provision is of course intended to limit the availability of MIGA's reinsurance in the cases where the investor could have obtained insurance cover from others irrespective of MIGA's involvement.

C. Amount of Guarantee

The extent to which a particular guarantee operation will utilize MIGA's guarantee capacity will of course depend on the amount of the guarantee in question. According to Section 2.07 of the Regulations, this amount will in each case be agreed upon between MIGA and the investor and specified in the contract of guarantee between them. However, Article 16 of the Convention provides that the Agency shall in no case "cover the total loss of the investment." As the Commentary explains, this provision is designed to discourage possible irresponsible conduct by investors relying on total loss cover.18/ This so-called "moral hazard" is addressed by the Regulations in terms which attempt to assure that MIGA's guarantee holders will have a genuine interest in loss containment throughout the period of guarantee. Pursuant to the Regulations, MIGA's contracts of guarantee will require investors during this period to retain a portion of the risk on their own account, with no insurance cover (other than casualty insurance) from any source.19/ Section 2.09 of the Regulations provides that this "uncovered amount" may in no case be less than 10 percent of the investment.20/ The result is to set an upper limit on the amount of guarantee which may be agreed upon between MIGA and an investor, namely 90 percent of the investment. In this context, the investment will be (a) the amount contributed by the investor to the project (plus any earnings actually included in the coverage) if it is an equity investment; (b) the

value of the resources contributed by the investor to the project if a non-equity direct investment is involved; or (c) the principal plus the interest to be accumulated over the loan's lifetime if the investment takes the form of a loan or loan guarantee.21/ The maximum amount of guarantee will be 90 percent of (a), (b) or (c), as the case may be.

In calculating the maximum amount of guarantee of an equity investment, MIGA will be able to benefit from the experience of existing investment insurers to evaluate the amount of the investor's contribution.22/ However, MIGA will have to innovate with respect to the valuation of non-equity direct investments since these are only covered by existing insurers to a limited extent. The Regulations provide that the value of the resources contributed by a non-equity direct investor may be any fixed fees or royalties plus the value of the share of the project's production, revenues or profits to which the investor may be entitled.23/ By way of general guidance, the Regulations add that such fixed and variable returns should be "appropriately adjusted so as to make [the] valuation comparable to that used for equity interests."24/ A study commissioned by the World Bank suggests how MIGA might thus equate the value of a profit-sharing non-equity investment, which may involve intangible contributions such as know-how, to the value of an equity investor's contribution, which is objectively determinable.25/ The study calls for such non-equity investments to be translated into comparable or "shadow" equity investments as follows. On the assumption that the shares of both equity and non-equity investors in future profits will correspond to the value of their contributions, the Agency would first assign a value to the non-equity investor's share on the basis of a comparison between it and the share of the equity investor. The valuation would then be adjusted to take into

account such factors as the time element, for an equity investor assumes the right to a share of profits in perpetuity while non-equity investments are usually of finite duration. Similar techniques may be applied for the valuation of revenue- or production-sharing arrangements. The demands upon MIGA to innovate for its valuations may be greater, however, in the latter cases as the non-equity investor may not be exposed in such cases to the same type of risk as the equity investor.

The amount of guarantee specified in the contract may change during the period of guarantee. It may be increased by the guaranteed investor's exercise of a "standby" option if the contract of guarantee provides for such an option. A standby option will entitle the investor to bring under the coverage additional contributions to the project and earnings retained in the project if they qualify as "new" investment.26/ The resulting increase should normally not exceed 100 percent of the initial amount of guarantee.27/

The amount of guarantee specified in the contract may also be reduced during the period of the guarantee. If the Agency pays a claim under the contract of guarantee, the amount of guarantee must be reduced by the amount of the payment.28/ When practicable, contracts of guarantee will provide for periodic reductions of the initial amount of guarantee on a fixed schedule (e.g. by a certain percentage of the initial amount) or in accordance with established accounting principles to reflect depreciation of assets, amortization of loans, disinvestment and the like.29/ The Regulations further envisage that contracts of guarantee may entitle guarantee holders to reduce the amount of guarantee on each contract anniversary date.30/

Depending on the course of events and decisions of the guarantee holder, the amount of guarantee may over time be subject to both increases and reductions. These changes will probably often reflect changes in the value of the guaranteed investment. As we will see, compensation may exceed neither the value of the investor's loss nor the amount of guarantee. To avoid paying premiums on an amount which exceeds his guarantee protection, an investor may be expected to avail himself of any provision in the contract of guarantee allowing him to reduce the amount of guarantee in line with the depreciation or amortization of his investment, unless such reductions are to be effected automatically under the contract.

D. <u>Project Assessment</u>

In making its underwriting decisions, MIGA will also have to observe provisions of the Convention and Regulations on the assessment of the investment projects concerned.

It will be recalled that pursuant to Article 12(d) of the Convention MIGA must, in guaranteeing an investment, be satisfied that the investment is economically sound, contributes to the development of the host country and is consistent with the host country's laws, regulations, and declared developmental objectives and priorities. Only investments which meet these standards will be eligible for MIGA's guarantee. The provisions of the Regulations on project assessments indicate how MIGA will ascertain that an investment proposed to be underwritten by the Agency complies with the required standards. The next Chapter discusses these standards in some detail. However, certain practical considerations which will have to be taken into account in MIGA's application of these standards in its project assessments may best be discussed at this stage.

National investment guarantee programs, while often directed to pay due regard to host countries' development needs, typically seek to promote the interests of the home country, notably through export promotion and the protection of the interests of the covered investors.31/ Because of the premises upon which it is based, MIGA's project assessments will focus more exclusively on the developmental considerations. Merely by associating itself with a project, a development finance institution such as MIGA can also raise expectations about the project's quality. Both of these factors may in practice lead host governments with limited administrative resources to rely on MIGA's assessment for the appraisal of the costs and benefits of a specific foreign investment. The quality of the projects that MIGA will be able to attract and select for its guarantees will thus be of great importance to the Agency's credibility and long-term success. There will, as a result, be a need for a thorough and comprehensive project assessment by MIGA. The Regulations thus prescribe a wide-ranging assessment of an investment's economic soundness and contribution to development, which will have regard to "all relevant economic and financial factors."32/

In making such assessments, however, MIGA will have to keep its projects appraisal expenditures within reasonable limits and, more importantly, maintain an ability to respond speedily to applications for guarantees. In its formative years, the amount of a typical MIGA guarantee will be rather modest. As noted above, the Agency's exposure in a single project initially may not exceed 5 percent of its guarantee capacity, which might in these early years translate into project ceilings of about $50 to $60 million.33/ To achieve some risk diversification and a fair geographic distribution of its guarantees, MIGA will at first have to seek to keep the

medium amount of its guarantees much smaller, perhaps $10 million or less. If one assumes an annual average premium of 0.9 percent of the guarantee,34/ MIGA may expect revenues from a typical contract of guarantee to be less than a hundred thousand dollars annually. Application fees, a one-time charge, will not be a significant source of revenues.35/ MIGA's project appraisal expenditures will obviously have to bear a sensible relationship to these financial factors. The need for speed will also affect MIGA's approach to project assessment because MIGA's attractiveness to investors will largely depend upon the promptness of its underwriting decisions. MIGA simply cannot afford to assess projects in the same manner as, say, the World Bank or even the International Finance Coproration (IFC) where the appraisal of a project normally takes months, if not years.

The Regulations place great emphasis on the importance of speedy underwriting decisions, and command MIGA's President to institute procedures to expedite the processing of applications for guarantees and the taking of decisions thereon.36/ In particular, the Regulations require decisions on the issuance of guarantees to be made promptly, within 120 days of the Agency's receipt of a complete "definitive application" if possible.37/ To facilitate such promptness, and also to save costs, the Regulations permit MIGA to rely to a certain extent for its project assessments on information provided by other parties. In defining the circumstances under which this may be done, the Regulations seek to identify situations where the Agency may safely rely on such information for a proper project assessment and confine time-consuming and costly appraisal missions to projects which are large or present special problems. Thus the Regulations provide that MIGA may in making its assessment rely to the extent appropriate on statements of the investor.38/ The investor would be

required to warrant in the contract of guarantee the statements' accuracy and completeness and, if they turn out to be untrue or misleading, could forfeit his guarantee protection.39/ MIGA may therefore be assured that in most cases investors will state the facts correctly in order to avoid jeopardizing their coverage. The Regulations also provide that if the proposed amount of guarantee is less than $10 million (as may be common in MIGA's initial years), the Agency may base its assessment of the investment project on appraisals or documents of other "reliable institutions."40/ These institutions might include other international financial agencies, such as the World Bank, IFC or the regional development banks, or commercial banks which may happen to be involved in financing the project under consideration.

E. Risk Assessment

Article 25 of the Convention envisages that MIGA will operate on a self-sustaining basis, "maintaining under all circumstances its ability to meet its financial obligations." As a result, the Agency will have to ensure that its overall revenues exceed its payments on claims. This will in turn require MIGA, in addition to its project assessments, to undertake risk assessments evaluating the likelihood and potential magnitude of a claim under each proposed guarantee. The Regulations require MIGA to "apply sound business and prudent financial practices"41/ in making such risk assessments with a view to reaching "an independent business decision made only on the basis of the investment's vulnerability to covered risks."42/ As will be shown below, the Regulations seek to ensure that this approach to risk assessment, inspired by MIGA's need to preserve its financial viability, will not needlessly detract from the Agency's developmental mandate.

1. <u>Relevant Factors: Project Specific and Country Specific Factors</u>

While most national investment guarantee agencies focus on country risk in their underwriting decisions, the Regulations envisage that MIGA will assess risks primarily from the perspective of the individual investment under consideration. In appropriate situations, this should enable MIGA to guarantee investments with acceptable risk profiles in spite of difficult country environments such as those which may prevail in the poorer or highly indebted countries most in need of investments that could be stimulated by MIGA's guarantee. Indeed, it would be inconsistent with the Agency's nature as a cooperative international institution financed by all its members, if it were to take an excessive posture and generally deny the benefits of its services solely on the basis of country risk. Moreover, there is substantial historical evidence that non-commercial risks to foreign investments depend more on the project than on the particular host country concerned. For MIGA, a focus on factors relating to the individual investment project constitutes a particularly sound approach to risk analysis because of the length of the periods of MIGA's guarantees. It was mentioned above that these periods will normally range from three to fifteen years, and while MIGA's risk analysis will have to extend over these periods, it is generally recognized that host country political or economic trends cannot be confidently forecast over such long periods. However, MIGA's risk assessment will naturally have to cover the relevant aspects of the country situation, as detailed in Chapter Four, as well as factors which can have an impact on the particular project's loss potential.

The Regulations refer to certain project-related factors and certain country-related ones which may be expected to affect all types of

risk and should therefore be taken into account in all of MIGA's risk assessments. Such generally relevant project characteristics include the economic sector of the project; the project's size relative both to that sector and to the host country's gross national product; the investor's experience and reputation; participation in the project of other investors, foreign or domestic; and the nature, including the mobility,43/ of the assets contributed to the investment project.44/ Similarly, the Regulations require MIGA, in the assessment of all risks, to take into account certain factors relative to the host country, namely the investment conditions there, including the availability of fair and equitable treatment and legal protection for the investment. It will be seen in the next Chapter that MIGA may only guarantee an investment if it finds such conditions in the host country to be satisfactory, and the Agency will accordingly take them into account in the assessment of all risks.45/

Much of MIGA's risk assessment will, however, have to be carried out in the context of the specific risk proposed for cover. Like the generally relevant risk factors mentioned above, the specific risk factors will include factors relating to the project and factors relating to the host country.

(i) For the currency transfer risk, the Regulations suggest that project characteristics of particular relevance to MIGA's risk assessment may include the investment project's potential to earn freely usable currency through exports; any arrangements for the accumulation of export proceeds in accounts outside the host country or in free accounts in that country; and any agreements with the host government giving the investor guaranteed or preferential access to foreign exchange.46/ In assessing the currency transfer risk, MIGA may also focus on such country-related factors

as any relevant record of transfer delays in the host country, for investment in general and in particular for the type of investment under consideration; and the potential for recovery, including MIGA's ability to use the local currency.47/ The transfer risk may be expected to be determined not so much by predispositions of the host government as by its ability to reconcile the investor's transfer needs with competing demands on scarce foreign resources. The Regulations thus envisage that currency transfer risk assessment will also have regard to the foreign exchange position of the host country, including its likely development over the proposed period of guarantee.48/

(ii) By contrast, the expropriation and breach of contract risks may more typically arise from deliberate acts on the part of the host government. The various project and country variables to be considered in assessing these two types of risk will therefore be similar. Relevant project characteristics suggested by the Regulations include the degree to which the investment project's continuity and profitability is dependent on actions or omissions of the host government, such as the provision of infrastructure or the allocation of export or import quotas.49/ If the investment project's success is dependent on the investor's continued participation, because for example he controls key technologies or marketing channels which cannot be easily replaced, an expropriation or breach of contract may be less likely. The extent of such dependence on the investor is therefore another characteristic of the project which the Regulations indicate MIGA will consider in its risk assessment.50/ The nature of any agreement between the host country and the investor, and in particular its fairness and flexibility, will be another important factor in the risk assessment.51/ A one-sided or rigid investment agreement often creates

unfavorable reactions toward the foreign investor which may ultimately end in an expropriation or breach of contract. The inclusion in the investment agreement of provisions for the settlement of disputes by international arbitration, particularly arbitration under the auspices of the International Centre for Settlement of Investment Disputes (ICSID), is also mentioned by the Regulations as being of possible relevance to such assessment.52/ The availability of such mechanisms for the settlement of disputes may not only facilitate the investor's pursuit of compensation in the event of an expropriation or breach of contract but may also serve as a deterrent against such events.53/ The Regulations (Section 3.14) refer to the likelihood that the project will generate earnings, particularly foreign exchange earnings, out of which the host government will be able to pay compensation for an expropriation, as a further project-related factor of possible relevance to MIGA's expropriation risk assessment.

The country risk profile will also be of relevance to the expropriation and breach of contract risks to be covered by MIGA. In their assessment of the expropriation risk, national investment guarantee agencies traditionally concentrate on the legal standards accepted by the host country for the treatment of foreign investment.54/ It will be seen in Chapter Four that this will also be an important part of MIGA's concerns. However, since MIGA's expropriation coverage will be available in respect of indirect and "creeping" expropriations, which may not clearly violate such legal standards, the Agency's assessment of the expropriation risk may be expected to be more wide-ranging and have regard to the host country's practice as well as its legal obligations. Similar considerations will apply to the breach of contract risk assessment. Thus the Regulations provide that in the assessment of both risks, MIGA should

have regard to such country-related factors as the country's relevant record (if any) of interventions in foreign investments and defaults on contracts of the type proposed to be guaranteed; the relevant record of the country on the settlement of expropriation and breach of contract claims; and any relevant pending disputes, in particular disputes involving the Agency, national investment guarantee agencies or private political risk insurers.55/

(iii) As for the war and civil disturbance risk, it was noted in Chapter Two that this risk applies to events which are typically unrelated to specific actions of the host government regarding the investment. The current circumstances of the host country may therefore be expected to influence MIGA's assessment of such risk to a greater degree than would be the case with other risks, while such factors as the legal protection afforded to foreign investment in the host country may be of lesser importance. MIGA's risk assessment may therefore emphasize such country-related factors as the existence or likelihood of an insurgency or of an armed conflict involving the host country and any internal tensions which might lead to civil disturbance.56/ However, MIGA's risk assessment will not focus solely on the existence or probability of these events in the abstract but on their possible relevance to and consequences on the investment. As explained in Chapter Two, MIGA will provide coverage against the loss of or physical damage to tangible assets of the investment project and against substantial interference with the project's operations if such loss, damage or interference is due to a war or civil disturbance. MIGA's risk analysis should concentrate on the likelihood that a war or civil disturbance will have such effects on the particular investment project. In this respect, the Agency could refer to such characteristics of the

project as its strategic importance, which might in turn determine whether it is likely to become a military target or be actively defended by the host government in the event of war.57/ Other project-related factors to be considered during risk assessment may include the location of the project, particularly its proximity to areas of insurgent activity or to the border of a country involved in hostilities; the vulnerability of the project to physical damage, through, for example, fire or explosions; and the security arrangements for the project.58/

Although they are presented as separate categories, risk factors relating to the investment project and risk factors relating to the host country will often be related. For example, a currency transfer risk might be acceptable despite the unfavorable foreign exchange position of the host country if the investment project can earn freely usable currency through exports. The Regulations rightly enjoin MIGA not to overlook such relationships in its risk assessments.59/

Moreover, the distinction drawn above between risk factors that apply to all types of risk and those which relate to specific types of risk will only be a matter of degree. Characteristics that normally ought to be examined in the assessment of each type of risk may nevertheless have different weight in regard to different types of risk. For example, it was mentioned above that the sector of the investment project will normally be relevant to each type of risk. Yet, it may be expected to be a factor of special importance in considering the expropriation and breach of contract risks, particularly if the sector is one which commonly attracts government intervention, as is the case with the energy and mining sectors. Factors which typically apply to one type of risk may also have an impact on other risks. While mentioned as a factor to be taken into account in the assess-

ment of the expropriation and breach of contract risks, the degree of the host government's dependence on the investor may also be relevant to the transfer risk. We have seen that the latter risk may be a function of the priority which the host government assigns to the investor among competing demands on its foreign exchange resources. This may in turn depend on the importance to the government of the investor's continued cooperation. In addition, one risk might engender others. For example, a host government might delay currency transfer in order to stimulate disinvestment. The possibility of expropriation might thus translate into the currency transfer hazard.

For these reasons, the various risk assessment factors suggested in the Regulations will only be the starting point of MIGA's risk analysis. Such analysis will have to be an overall assessment of the investment to the perils to the investment against which MIGA intends to provide guarantee protection. In refining its assessment, MIGA might carry out so-called "sensitivity analyses" to test the resistance of the investment project to particular risks. For example, it might analyze the severity which host governmental interference in the project must take in order permanently to undermine the project's viability where it intends to guarantee the investment against total loss only.

2. Enhancement of Risk Profile

Inspired by MIGA's nature as a cooperative institution and its intended impact on its developing member countries, the Regulations envisage that if MIGA's initial risk assessment is negative, it will not deny coverage before attempting first to lessen the investment's loss potential in order to make such coverage possible. Various possible steps to be

taken by MIGA towards this end are set out in the Regulations. Which of these steps, if any, MIGA will take will of course depend on their feasibility in a given case and on the reason or reasons for the Agency's initial concern about the risks related to the investment under consideration.

Section 3.32 of the Regulations provides that, if warranted, MIGA will in the first instance seek to advise the host government or the investor on the measures they might take to improve the investment's risk profile so as to allow coverage by the Agency. With a view to a diminution of the investment's vulnerability to the risk or risks to be covered, MIGA might for example advise the host government on the possibility of giving the investor special assurances regarding import or export licences, or advise the investor on restructuring the projected investment by including other partners whose presence could contribute to decreasing the likelihood of a covered event. Since such advice by MIGA could be regarded by the host government or the investor, or both, as an interference in their negotiations, the Regulations provide that in these matters MIGA will consult with one side before offering its advice to the other to the extent that it would deem such consultations appropriate.60/ Both the host government and the investor will have an obvious interest in cooperating with MIGA in its efforts to diminish the investment's loss potential as it may facilitate coverage and, hence, the investment's implementation. Even where coverage would be possible, the host country and the investor may wish to obtain MIGA's advice on the ways in which the investment's risk profile may be improved as this could reduce the cost of coverage which the investor will bear, some or all of which he may feel obliged to pass along to the host country in the investment arrangement.

The Regulations provide that, after considering the possibility of such advice, MIGA may alternatively seek to design coverage in a manner which diminishes the scope of its exposure but still encourages the investor to proceed with the investment. Section 3.34 of the Regulations suggests a number of ways in which coverage may be modified to this end. They include reductions of the period or amount of guarantee; provision for the termination or adjustment of the contract of guarantee within specified limits; the exclusion of certain risks or types of risk from coverage; the restriction of coverage to specific types of loss; provision for additional or extended periods before payment of a claim; the incorporation into the contract of guarantee of specific obligations of the investor on loss avoidance and loss minimization; limitation of the compensation to be paid within stated time periods for currency transfer losses; and provision for the exclusion from cover of losses falling below a certain amount (first-loss deductibles).

Especially where the expropriation risk is involved, MIGA may instead seek to enhance its ability to issue a guarantee by entering, in accordance with Article 23(b)(ii) of the Convention, into an agreement with the host government on the treatment of guaranteed investments. Similarly, MIGA may seek to reduce the potential for losses under its currency transfer coverage in particular by concluding an agreement with the host country on the Agency's use of the local currency it might acquire as subrogee of an indemnified investor. Under both types of agreement, rights will be vested in MIGA itself which will increase the likelihood that the Agency will be able to recover payments made by it on the investors' claims.61/

An agreement reached between MIGA and a host country on the treatment of investment guaranteed by the former will assure that with respect

to such investment MIGA is accorded treatment at least "as favorable as that accorded by the host government to the most favored investment guarantee agency or State in an agreement relating to investment."62/ With respect to the local currency MIGA receives as subrogee of a guaranteed investor, MIGA will have certain rights secured by the Convention, without the need for a special agreement with the host country. In accordance with Article 18(c) of the Convention, such local currency will receive treatment by the host country at least as favorable as that which it would have received in the hands of the investor, and may in any case be used by MIGA for the payment of the Agency's administrative expenditures and other costs. To the extent that the local currency is not freely usable, however, MIGA may have to reach an agreement with the host country on the use of the local currency it receives as subrogee before it can safely underwrite a currency transfer risk. Inspired by paragraph 27 of the Commentary, Section 3.33 of the Regulations suggests that under such an agreement the host country might consent to the sale by MIGA of local currency to international lending or other institutions or to foreign investors in, or importers of goods from, the host country. Alternatively, the host government could undertake under such an agreement to redeem the local currency for a freely usable one within a specified period and at a specified rate of exchange.63/ To the extent consistent with its financial viability, such arrangements may enable MIGA to underwrite the currency transfer risk even in heavily indebted host countries. In such a situation, if the investor is denied the conversion and transfer of certain covered amounts, MIGA will be in a position to pay him compensation in freely usable currency, accept local currency from him, and eventually recover its foreign exchange position under the process agreed upon with the host country.

3. Coinsurance and Reinsurance

If the size of the Agency's exposure in a single project or host country is the impediment to the guarantee's issuance, the Regulations require MIGA to ascertain whether this impediment may be overcome through coinsurance or reinsurance arrangements.64/ The Convention authorizes MIGA, and in fact encourages it, to enter into such arrangements with "national entities of members and regional entities the majority of whose capital is owned by members,"65/ as well as with private insurers in the Agency's member countries.66/ Under a coinsurance arrangement, MIGA and other insurers would jointly cover the same risk, each guaranteeing an agreed percentage, or underwrite different types of risk pertaining to the same investment project. Under a reinsurance arrangement, MIGA could refinance its exposure by reinsuring all or part of its guarantee with other insurers who would, in effect, share with MIGA the premiums on account of the guarantee and in turn reimburse MIGA for payments of claims arising under the guarantee. Conversely, MIGA could itself reinsure risks assumed by other insurers.67/ In addition to providing a means for MIGA and other insurers to enhance risk diversification, such arrangements may enable MIGA to leverage its underwriting capacity by attracting additional cover for investments in member countries. Coinsurance and reinsurance arrangements between MIGA and private insurers in particular may encourage the latter to reverse the declining trend of their political risk coverage and to commit larger underwriting capacities on more favorable terms and to projects of higher developmental value than would be the case without MIGA's presence. Through such arrangements with national and regional investment insurance entities, MIGA could further its mandate to complement their operations.68/ For example, the maximum duration of a guarantee

issued by such an entity might be ten years.69/ If the investor seeks coverage for a longer period, it might be possible under a coinsurance arrangement for the coinsuring agency to provide coverage for the earlier part of the period while MIGA's coverage would be made available for the later part.70/ Coinsurance and reinsurance arrangements may moreover enable MIGA to enhance its effectiveness and achieve administrative economies by giving the Agency greater access to information on underwriting and claims experience and to the appraisal capacity and expertise of its partners.

While it would thus make sense for MIGA to make use of its authority to enter into coinsurance and reinsurance arrangements to the maximum extent permitted by its rules, the practicability of such operations will depend on a number of factors. A major issue will be the extent to which MIGA and other insurers will be able to harmonize or reconcile their terms, conditions and overall objectives in individual cases. From the point of view of the investor contracting with two or more coinsurers this will be an issue of immediate practical concern, for he might find himself subject to terms and conditions which are not only different but also contradictory. However, national investment guarantee agencies in particular may find it difficult to make adaptations to terms and conditions which are embedded in their home countries' legislation. Where private underwriters are concerned, it may prove difficult to reconcile for individual underwriting decisions MIGA's developmental objectives and the underwriters' purely commercial interests.71/ This may be expected to be particularly true in the case of reinsurance operations undertaken by MIGA. In such a case the primary underwriter would be able to obtain reinsurance only in respect of investments which meet all of the Agency's eligibility criteria.

MIGA's reinsurance operations will also be subject to the quantitative constraints that we noted in discussing the Agency's capacity to issue guarantees. The foregoing factors should not, of course, be seen as negating the value of MIGA's coinsurance and reinsurance authority. On the contrary, they indicate that MIGA should exert a special effort to make use of that authority in view of the major challenges it is likely to face in seeking to do so effectively.

F. Premiums and Fees

Under Article 25 of the Convention, MIGA will charge premiums and fees in respect of its guarantees. The establishment of these charges will be an aspect of MIGA's underwriting decision of importance not only to investors, but also to their host countries, whose economies might ultimately absorb such charges, as part of the investment cost. From MIGA's perspective, the level of these charges must be such as to permit the Agency to become financially viable and self-sufficient.72/ In this respect, the Regulations emphasize that the Agency's premiums and fees should, "pursuant to Article 25 of the Convention, be established in accordance with sound business and prudent financial management practices and with due regard to the need to (i) cover the Agency's administrative expenditures and (ii) build up sufficient reserves to pay claims without recourse to the callable portion of the Agency's capital."73/ For a conventional insurer underwriting typical insurable risks, these principles usually call for the establishment of premiums that reflect the size and probability of underwriting losses as calculated on the basis of probability mathematics. However, this approach cannot be applied to non-commercial risk guarantees of the type which MIGA will issue, if only

because the limited number of risks to be guaranteed by MIGA, and the diversity of the host countries, investments and investors involved, render probability mathematics inapplicable. Moreover, non-commercial risks differ from conventional hazards (such as fire and casualty) in that they tend to be associated with a common contingency or interdependent contingencies. As a result of a revolution, pervasive expropriation risks in a host country can materialize; war risks can be transformed into losses in several countries simultaneously; and international recession can lead to the concurrent development of currency transfer losses in many countries. On the other hand, MIGA's presence as guarantor may be expected to stimulate host governments' cooperation towards controlling the potential of non-commercial losses. The resulting enhancement of investments' risk profiles may be passed on to investors without prejudice to MIGA's financial viability.

Both the non-actuarial nature of non-commercial risks and the mitigating effect on such risks of MIGA's guarantee protection preclude mathematical determination of adequate premiums rates, especially without the benefit of operational experience. The Regulations therefore set out a tentative system of premiums and fees to be applied on an experimental basis. MIGA's Board will then "annually review the levels of premiums and fees to determine whether they are consistent with the Agency's purpose of encouraging investment and its obligation to maintain a sound financial position."74/

1. Premiums

The Regulations provide for two types of premium: premiums proper, to be charged for actual coverage, and standby premiums for coverage which is committed only in principle and is not yet utilized. Both premiums and

standby premiums will be calculated on an annual basis as a percentage of the amount of guarantee or standby coverage respectively.75/ The reliance on the amount of guarantee rather than on the amount of the investment reflects the fact that MIGA will agree with investors on the portion of the investment which will be covered by MIGA and which therefore will leave an uncovered amount that may vary from case to case.76/ Premiums and standby premiums will normally be payable in advance in annual instalments, starting on or before the conclusion of the contract of guarantee.77/ However, MIGA could agree with individual investors on alternate payment schedules providing, for example, for quarterly or semi-annual payments.78/

MIGA will offer the investor a choice between purchasing cover against individual types of initially eligible risk (currency transfer, expropriation, breach of contract, war and civil disturbance) and coverage of all or several of such types of risk as a package.79/ For each individually obtained type of risk coverage, the Regulations establish a premium range of between 0.3 and 1.5 percent per annum of the amount of guarantee.80/ Within this range, the actual premium will be determined in each case on the basis of an evaluation to be undertaken by MIGA of the actual risks to be assumed by it under the contract of guarantee.81/ For packages including all or several types of risk, MIGA may give a discount of up to fifty percent of the sum of the individual rates determined to be appropriate for the investment concerned.82/ Under this system, rates for packages comprising all four types of risk may thus range from 0.6 percent (0.3 percent times four, with the maximum discount) to 6 percent (1.5 percent times four, with no discount). Given MIGA's potential to contribute to loss avoidance and to recoup most of its guarantee payments,83/ its rate quotations may be expected to fall towards the lower end of this wide range.

Standby premiums will range from 25 to 50 percent of the premiums determined by MIGA for the actual coverage of the same type of risk in the guaranteed investment, or risk package as the case may be.84/ The resulting relatively broad range of standby premiums allows for the imposition of higher standby premiums than is usual in the national agencies' practice which in turn is intended to encourage MIGA to use the bulk of its underwriting capacity for actual coverage.85/

The Regulations require MIGA's President to institute administrative procedures to ensure the objectivity, thoroughness and consistency of premium rating undertaken in the framework of the above system.86/ Such procedures are also to facilitate the efficiency of the rating process, protect the confidentiality of information entrusted to the Agency for underwriting and rating purposes and ensure that the rating process will not result in explicit judgements about host countries.87/ Further safeguards will include reviews of premium rates recommended by MIGA's underwriting staff before they are submitted for final decision to MIGA's President or, if larger investments are involved, to a rating committee to be appointed and chaired by the President. In formulating their recommendations as to premium rates, MIGA's underwriting staff will be guided by a list of rating factors similar to the risk assessment factors set out in the Regulations.88/ The Regulations provide that this list, which appears in an annex to the Regulations, may be amended from time to time by the President.89/ They further emphasize that the rating factors should be applied flexibly with a view to arriving at a premium rate which reflects a sound overall assessment of the probability and likelihood of an underwriting loss.90/

Overall, MIGA's system of premium rating will give it substantial flexibility in setting premiums which are responsive to the circumstances of individual cases and its future experience in claims, payments and recoupments. By offering investors a choice between coverage of individually rated types of risk and risk packages at discounted rates, the system can take into account investors' needs in very different situations while reflecting the insurance economies inherent in package coverage and encouraging investors to opt for the latter. In appropriate cases, MIGA may offer package coverage only.91/ In addition, contracts of guarantee may within specified limits provide for adjustments of premiums in the light of claims experience in particular. In accordance with Section 3.41 of the Regulations, a contract of guarantee may entitle the Agency to increase premiums five years after the conclusion of the contract and thereafter at each contract anniversary date. Such increases cannot, however, single out a specific risk, investment or host country. They may only be applied to broadly defined types of risk, forms of investment or groups of host countries.92/ The increases will also be subjected to an aggregate maximum of 100 percent of the initial premium rate.93/ Similarly, premiums may be adjusted downwards on an annual basis starting with the fifth contract anniversary date.94/ But the reduced rates must remain within the authorized premium ranges and total reductions may not exceed 50 percent of the initially applicable premium rates.95/ Because premiums will primarily be set within the established ranges according to actual risk-taking, investors, as well as their host countries, will have an incentive to minimize guaranteed risks. Furthermore, the flexibility of premium ranges should facilitate cooperation between MIGA and other insurers, as it will add to the Agency's ability to harmonize its terms and conditions with diverse coinsurers and reinsurers.

The Regulations might have adopted simpler systems of setting premiums, such as the establishment of flat rates applicable to all types of risks and forms of investment, or ascribing fixed rates to risk categories, such as country risks.96/ However, these systems would lack the advantages associated with the flexibility of premium ranges. Flat rates in particular would also result in cross-subsidization of high risk investment by low risk investment which penalizes the latter and could jeopardize the Agency's financial viability. Also, rates established only according to the risk profile of each host country would be undesirable as they would tend to politicize MIGA and might conflict with its developmental objective. An alternative to premium ranges might be base rates which would be varied on a case by case basis within certain limits.97/ However, such rates would connote the existence of average rates which might inhibit the setting by MIGA of high premiums where, warranted by high risks assessed according to the above explained complex factors related to the investment project and the host country. The broad premium ranges established in the Regulations encompass rates typically charged by both national and private political risk insurers. This breadth may not only be useful but necessary in view of the potential diversity of MIGA's coverage, the desirability of facilitating coverage of difficult projects and the need for MIGA to develop its premium structure in the light of experience without disruptive policy changes.

2. Fees

In addition to premiums, MIGA will charge a fee for every "definitive application" for a guarantee filed with the Agency, while the filing of "preliminary applications" will not be subject to any charge.98/ The

fee may not be less than $250 or more than $10,000 for each application. Within these limits, it will equal 0.05 percent of the requested amount of guarantee, including any standby coverage.99/ In addition to contributing to the financing of MIGA's appraisal costs, the fee is intended to deter frivolous applications. In principle, it will therefore be non-refundable if MIGA denies coverage. If such denial is due to MIGA's own portfolio considerations, however, all or part of the fee may be returned to the investor.100/

MIGA may also charge fees for special services rendered in conjunction with a guarantee.101/ Such services might, for example, include technical assistance to the applicant investor in structuring a planned investment with a view to reducing its loss potential.102/ A small fee may also be added to provide an additional source of funding of MIGA's extensive complementary operations directed towards the general improvement of investment conditions in its host member countries.103/

G. Required Approvals - Host Country Approval and Approval of Contracts of Guarantee

1. Host Country Approval

As explained in Chapter Two, MIGA may conclude a contract of guarantee only after the host government has previously approved the Agency's issuance of the guarantee against the risks designated for cover.104/ Both MIGA's involvement, i.e. the issuance of the guarantee, and the scope of any such involvement, i.e. the risks designated for cover, will thus be subject to the host government's approval. The host government may, for example, limit its approval to a coverage of a certain type of risk such as the transfer risk, and MIGA will be obliged to reflect the limitation in the contract of guarantee.

The Regulations set out procedures designed to assure that obtaining the host government's approval will not unduly delay underwriting decisions.105/ Thus MIGA may seek from individual host countries advance approvals for the coverage of all or certain types of investments or risks. In the absence of such an advance approval, MIGA will seek the necessary approval if it has not been obtained by the investor.106/ MIGA is expected to specify in its requests for approval a period of time for a response in accordance with standing arrangements to be established in agreement with the host government concerned. If the host government present no objection to the request within this period, MIGA may, in accordance with Article 38(b) of the Convention, deem the approval to have been given.107/ The Regulations provide that the period to be agreed upon, which the Convention requires to be a "reasonable" one, shall be not less than thirty days and shall be extended at the request of the host government.108/

2. Contract Approval

In addition to the host country approval, it will be necessary to obtain the approval of the contract of guarantee from the competent authority within MIGA before a guarantee may be issued. In this respect Article 16 of the Convention provides for the approval of contracts of guarantee "by the President under the direction of the Board."109/ In the draft Regulations presented to the Preparatory Committee, this provision was interpreted to mean that the Board could issue guidelines and directives but would not normally be involved in the approval of specific guarantee operations. As a result, such involvement was confined to the cases where the guarantee would require Board approval under the Convention or Regulations because, for example, it would cover investments or risks other than those specifically enumerated in the Convention as eligible.

This interpretation of Article 16 was supported by a number of practical considerations, including the need to safeguard the confidentiality of information provided by investors and to shield the objectivity of risk assessment against national commercial or political influences. Moreover, unlike such institutions as the World Bank, where every loan is considered by the Executive Directors in a formal meeting, MIGA would (at least initially) not have a resident Board of Directors.110/ If it were necessary to convene a meeting of MIGA's Board to act on every guarantee proposal, the Agency's administrative costs would be increased while its ability to make speedy underwriting decisions would be greatly curtailed.

However, in the meetings of the Preparatory Committee several delegations objected to the approach suggested in the draft on the grounds that MIGA's member countries, through the Directors, must be given a greater opportunity to assert continuous oversight over the Agency's specific operations. One delegation in the Preparatory Committee's meetings went so far as to insist that MIGA's Board, rather than its President, should be responsible for approving every contract of guarantee. As Chairman, I pointed out that this would be precluded by the clear language of Article 16 of the Convention which reserved such responsibility to the President. The solution which the Preparatory Committee adopted at my suggestion, after a lengthy debate over this point, was to accommodate members' interest by increasing the scope for the Board's direction of the President's approval of contracts of guarantee within a framework designed to maintain the ability of MIGA's management to negotiate contracts promptly and reliably.

Thus Section 3.35(c) of the Regulations requires the President to circulate to the Directors a report on each guarantee he plans to approve

including information on the host country, the investment as well as the amount, terms and conditions of guarantee. Each such report will also contain a statement by the President to the effect that the proposed guarantee is consistent with the Convention, the Regulations and the policies approved by the Board. In addition, the report will indicate whether the proposed guarantee raises any new policy issues. If the guarantee covers an amount exceeding $25 million, the President may only approve the guarantee after the Board has specifically concurred "that the guarantee is within the guidelines and policies approved by the Board."111/ Guarantees in lesser amounts will not require Board concurrence except in the cases when three Directors request within 21 days of the dispatch of the President's report that the matter be submitted to the Board "for consideration of the policy issues involved."112/ When the Board is seized of the matter under any of these situations, it may give the President guidance on the issues involved, which may include a directive not to proceed with the issuance of the guarantee.113/

The Regulations supplement this system of Board supervision of the issuance of guarantees by providing for Board review of quarterly reports of the President on guarantees approved by the latter.114/ The system is summed up in a provision of the Regulations which emphasizes that, since the President will be acting under the direction of the Board, he may "only approve contracts of guarantee which are consistent with the limitations and priorities approved by the Board in these Regulations and in future guidelines which the Board may issue from time to time."115/ As in the originally proposed draft Regulations, the Regulations list a number of cases in which such limitations could not be exceeded without Board approval, notably in matters related to eligibility requirements for MIGA's guarantee.116/

Though significantly different from the proposal presented to the Preparatory Committee, the provisions of the Regulations on the approval of contracts of guarantee maintain the basic distinction between the respective roles of the Board and the President. In keeping with Article 16 of the Convention, the decision whether to issue a guarantee and, if so, in what amount and on what terms and conditions, is basically the decision of MIGA's President to be taken in the framework provided by the Convention and the Regulations issued by the Board. If the President decides to deny coverage, that will be the end of the matter; the decision will not be subject to review by the Board. If on the other hand the President decides to issue a guarantee, the Board may become involved, as a rule in large contracts and by exception in small ones. Such involvement will essentially be confined to policy issues. In particular, the Board's review will not extend to the business assessment underlying the President's decision, notably the risk and portfolio assessments, or to the specific details of the guarantee operation, including the amount of the guarantee and the rate of premiums, except in so far as they indicate departure from established policies.

H. Interaction in the Underwriting Process

While MIGA's project, risk and portfolio assessments, its premium rating, and the required approvals can be discussed as separate steps in the underwriting process, they are in fact closely interrelated. Thus although the project assessment will focus on the merits of the project and the risk assessment on its vulnerability to the risks to be assumed, inadequacies of the project will tend to increase the likelihood of host governmental actions against it and might therefore give rise to claims

under MIGA's guarantee. For example, failure of a project to contribute adequately to developmental objectives could prompt the host government to take an expropriatory measure. And if the project is not economically viable, the host government may find it necessary to intervene in order to avert disruptive consequences on its economy.

It will also be recalled that MIGA will determine premium rates within the prescribed ranges primarily with a view to reflecting its actual exposure to loss under the proposed guarantee. As a consequence, the evaluation of risks to be assumed by MIGA will underlie not only its decision to issue the guarantee but also its determination of the premium rate. The Regulations furthermore provide for possible adjustment of the premium indicated by a risk assessment in order to take into account MIGA's interest in balancing its portfolio of guarantees. MIGA might thus reduce the indicated premium rates for projects in host countries or sectors inadequately represented in its portfolio and it might charge modest surcharges where it is already heavily exposed.117/ To the extent permitted, MIGA might also adjust the premium based on its risk assessment to the terms of coinsurers and reinsurers in order to facilitate coinsurance and reinsurance arrangements.

The host country's approval and the terms in which it may be given will obviously be important to other stages of the underwriting process, particularly the risk assessment. Moreover, many features of the process owe their existence to the need for speedy decisions on the issuance of guarantees, a consideration which, as we have seen in discussing the approval of contracts of guarantee, particularly underlies the final decision-making stage.

II. Claims Administration

A. Prescribed Procedures

The Regulations set out procedures for MIGA's administration of the claims for compensation that the Agency may be called upon to pay under its contracts of guarantee. These procedures are designed to meet three objectives: to protect the Agency's financial position, to ensure that it will inspire and maintain investors' confidence in its guarantees, notably through prompt and well-informed decisions on claims, and to facilitate the Agency's encouragement of negotiated settlements of disputes relating to guaranteed investment.118/

Pursuant to the Regulations, MIGA's contracts of guarantee will require the guarantee holder promptly to notify the Agency of an event which may give rise to a covered loss or significantly increase the likelihood of such an event. After a loss has occurred, the investor must file his claim with the Agency within a prescribed period if he is to preserve his right to compensation. The Regulations provide that the Agency may deny payment if the claim is filed more than three years after the occurrence of a covered event, but provide that individual contracts of guarantee may specify a different period for this purpose.119/

As under other investment insurance programs, holders of MIGA's guarantee will bear the burden of proving and documenting their claims. The Regulations envisage that the guarantee holder will, in particular, be required to furnish the Agency with evidence as to the occurrence of any covered event giving rise to a loss and the amount of such loss.120/ However, MIGA is to offer guarantee holders several types of assistance with respect to claims. Upon receiving a claim, MIGA will normally undertake a preliminary examination of the claim and advise the guarantee holder of any evidence that may be needed to sustain the claim.121/ MIGA

will also enter into consultations with the host government concerned as to the accuracy and completeness of the information on the claim provided by the guarantee holder.122/ Disagreements between MIGA and the guarantee holder on the valuation of assets may be resolved through impartial appraisals.123/ Furthermore, MIGA may pay compensation on the basis of preliminary information where a claim is established in principle but conditions in the host country (for example, civil war) prevent the Agency from ascertaining within a reasonable period all facts necessary to determine the precise amount due.124/ In the light of subsequently received information, compensation payments may be recalculated and reclaimed or increased accordingly.125/ MIGA may also in any case reserve the right to reclaim a payment within a period of up to five years if new evidence is discovered which shows that there was an error in determining the payment.126/

The Regulations require MIGA to determine its liability on a claim expeditiously within certain time limits after receipt of all of the evidence necessary to substantiate the claim.127/ These time limits will be specified in the contract of guarantee.128/ According to the Regulations, they will normally range from 30 to 90 days for both the currency transfer and war and civil disturbance risks and from 60 to 365 days for both the expropriation and breach of contract risks.129/ These periods will be in addition to those required in some cases for the establishment of a claim. Thus in the case of a passive currency transfer restriction, the cumulative period between the investor's application to the host government's foreign exchange authority and the payment of a claim by MIGA may range from 120 to 180 days.130/

Final decisions on claims will be made by MIGA's President on the recommendation of a Claims Committee to be appointed by the President and chaired by MIGA's chief legal officer.131/ While the Board will be kept informed of claims and their settlement, it will not participate in decisions on individual claims.132/ This important feature of MIGA's operations is meant to ensure both depoliticization and promptness in the decision-making process related to the payment of claims.

The Regulations provide a framework for the determination of the amounts of compensation to be paid in respect of claims which MIGA's management determines to be valid. As indicated earlier, such amounts will normally neither exceed the amount of guarantee nor the value of the investor's actual loss. In other words, MIGA may at a maximum pay the lesser of these two amounts.

B. Valuation of the Loss

The Regulations provide general guidance with respect to the valuation of losses for the purpose of calculating compensation, leaving the details to be specified in individual contracts of guarantee which will for this purpose "provide or refer to rules and principles, including appropriate accounting principles."133/ The provisions of the Regulations on this topic distinguish between "equity interests," "non-equity direct investment" and "loans and loan guarantees," the three principal categories of investments eligible for coverage.

For equity interests, the Regulations refer to the "value of the investment immediately before the loss" and state that, depending on the contract of guarantee, this value could be the net book value, the fair market value or either value subject to certain adjustments.134/ The Bank-

commissioned study referred to earlier recommends that MIGA's contracts of guarantee should, in line with the practice of most investment insurers, refer to the investment's net book value because it is more readily verifiable than the alternatives.135/ Because MIGA will operate in a variety of different countries, the study further suggests that the relevant value be determined in accordance with internationally accepted accounting principles, including the guidance provided by the International Accounting Standards Committee. This would enable MIGA to impose consistent accounting standards without appearing to favor the standards of a particular national accounting system.136/ Similar approaches could in fact be followed by MIGA in valuing the investment for the purpose of setting the amount of guarantee. In the context of calculating compensation, mere agreement on the rules and principles to be applied in determining the relevant value "immediately before the loss" may not be sufficient. There may well be doubts as to the date of the occurrence of loss in individual cases, particularly where "creeping" expropriations are involved. MIGA's contracts of guarantee may however resolve such doubts by, for example, providing that the relevant value should be ascertained as of the time immediately before the first of the series of measures which taken together have an expropriatory effect.137/

With respect to "non-equity direct investments," the Regulations distinguish between fixed and variable portions of the investor's remuneration under such investments. For any fixed portion, reference will be made to the fixed fees earned by the investor and not received at the time of the settlement of the claim by MIGA.138/ As regards the variable portion, the Agency is to ascertain "the adjusted value of the guarantee holder's remaining rights to a share of the [project's] production, revenues or

profits... as assessed immediately before the covered event."139/ In making this assessment, MIGA could follow the approach used to fix the amount of guarantee. Thus if MIGA has established a "shadow equity value" of the investment for the purpose of setting the amount of guarantee, the value of the loss could be calculated by applying the relevant accounting standards as to depreciation. Finally, for loans and loan guarantees, the Regulations refer to the amount of principal and interest outstanding at the time of the payment of the claim.140/

In all of the above cases, an amount representing the uncovered portion of the investment will be deducted from the value of the loss determined in accordance with the foregoing principles.141/ In the case of non-equity direct investments MIGA is also to deduct any future expenses which the investor would have otherwise incurred but which were averted as a result of the covered loss.142/ Compensation may not exceed the relevant value of the loss after such deductions or the applicable amount of guarantee, whichever is lower.

Provided that compensation remains within those limits, MIGA may offer compensation for damage to tangible assets at their replacement value if the investor agrees to reinvest any such compensation in the project.143/ As pointed out in Chapter Two, MIGA may also extend compensation for losses arising from an interruption in the operation of the project, again provided that compensation does not exceed the above limits.144/ These innovative forms of coverage permit MIGA to expand its coverage of partial losses with a view to encouraging investors to continue operations in spite of some hazards.

C. Loss Avoidance and Minimization

With the availability of compensation in cases of loss, an investor might remain passive in the face of a covered risk that might otherwise be averted or mitigated. To help ensure that this will not be the case, the Regulations provide that contracts of guarantee will require the investor to exercise due diligence to avoid and minimize covered losses. Section 2.14 of the Regulations lists a number of obligations to be assumed by the investor in this respect under the contract of guarantee. These include obligations to exercise appropriate control over the project enterprise and to seek available remedies under the law of the host country.145/ A breach by the investor of such obligations may result in a proportionate forfeiture of guarantee protection to the extent that a loss could have been avoided or minimized through the exercise of due diligence.146/

Neither of course will MIGA be merely a passive administrator of claims. Contracts of guarantee will require investors promptly to notify the Agency of any event which might give rise to a covered loss.147/ Upon receiving such a notice, or upon learning of the event by other means, MIGA will, where appropriate, consult with both the investor and the host government on ways to avert or minimize a claim.148/ After receiving an actual claim, the Agency is also expected normally to consult with the investor on steps which may facilitate withdrawal or minimization of the claim.149/ More generally, MIGA is, as we shall see in Chapter Five, mandated by the Convention to facilitate the amicable settlement of investment disputes. In carrying out this function with respect to guaranteed investment, it should contribute further to loss containment.

III. Subrogation and Recoupment

Article 18(a) of the Convention provides that "[u]pon paying or agreeing to pay compensation to a holder of a guarantee, the Agency shall

be subrogated to such rights or claims related to the guaranteed investment as the holder of a guarantee may have had against the host country and other obligors." As paragraph 26 of the Commentary notes, subrogation is an accepted principle of insurance law, and MIGA will in this respect be no different from other investment insurers. The provisions of the Convention on subrogation constitute the legal basis for the obligation of the host country to accept the Agency's subrogration to the claims of the investor. As to the investor himself, subrogation will obviously be based on the provisions of the contract of guarantee, not on the text of the Convention to which the investor is not a party.150/ The importance of Article 18(a) of the Convention is that it establishes subrogation as a right for the Agency under international law vis-a-vis the host country and all other members. The details of subrogation as a relationship between the Agency and the covered investor is a different matter to be dealt with in the contracts of guarantee. The Regulations give an indication as to the content of the main terms and conditions of subrogation that will appear in such contracts.

Repeating the Convention, Section 4.15 of the Regulations states that MIGA's contracts of guarantee will provide for MIGA's subrogation to the investor's rights or claims. When it takes place, such subrogation will be the automatic result of MIGA's settlement of a claim.151/ While MIGA's succession to the investor's rights or claims will therefore take place independently of any action by the investor, Section 4.15 of the Regulations also envisages that under MIGA's contracts of guarantee indemnified investors will be required on settlement to assign to the Agency all rights or claims subject to subrogation. The purpose of such assignments is to assure that MIGA's succession to the investor's rights

and claims through subrogation will be complete and not open to doubt. Reflecting the practice of other investment insurers, MIGA's contracts of guarantee will also require indemnified investors to assign to the Agency all funds or assets related to the guaranteed investment which are received or deposited for the investors' account after the occurrence of the covered event.152/ As a further precaution, MIGA is to be assigned any securities, titles, contracts or other documents which evidence or are otherwise relevant to rights, claims or assets subject to subrogation.153/

Article 18(a) of the Convention provides that the Agency will be subrogated to the relevant rights or claims "upon paying or agreeing to pay" compensation. Such subrogation would reasonably take place when, after controversial matters are settled between the Agency and the investor, the Agency actually pays the compensation due or agrees without reservation to pay such compensation. The Regulations accordingly permit subrogation and assignment to take place in certain cases within such period following the Agency's notice of its decision to make a payment as the contract of guarantee may provide.154/ Such will be the case when the Agency's decision to pay the investor is made subject to certain conditions which can be met only over a certain period of time.

It may in this connection be noted that the Regulations permit MIGA to make reimbursable advance payments on claims which, because of the tentative nature of such payments, would not trigger subrogation. The rights or claims to which MIGA might succeed as subrogee may be subject to an agreement between the investor and the host government providing for arbitration in a forum which may not be available to the Agency. ICSID arbitration, which is only available for disputes between States and nationals of other States, is a case in point.155/ In such cases, the

Agency may notify the investor of its decision in principle to pay the claim, but defer actual payment and require the investor to pursue his rights or claims in the forum available to him.156/ An advance partial payment on the claim may be made while the arbitration is pending, subject to the Agency's right to reimbursement under conditions agreed upon with the investor (which might, for example, provide for reimbursement if the arbitral tribunal does not decide in the investor's favor).157/ Because such arrangements may be financially onerous for the investor, the Regulations provide that in such cases MIGA may reimburse the investor for the expenses he incurs in the arbitration.158/

As the subrogee of an indemnified investor, MIGA will acquire the portion of the investors' rights, claims and other interests that corresponds to the portion of the investment which is covered by the guarantee.159/ Thus if the guarantee covers fifty percent of the investment, MIGA will be subrogated to (and assigned) fifty percent of the relevant rights, claims or interests. Under agreements with an investor or coinsurer or both, MIGA may agree to the assignment to the Agency of the remaining portion of such rights, claims or interests in order to be able to pursue the investor's underlying claim vis-a-vis the host country in its entirety.160/ Such agreements will help to avoid parallel claims negotiations with the host country concerned and will be subject to that country's approval.161/ The Regulations direct MIGA, in deciding whether to enter into such agreements and in pursuing rights under them, to pay due regard to the need to maintain its ability to reach a negotiated settlement with the host country.162/

In some cases, rights acquired by MIGA as subrogee may entitle it to recovery in excess of the payment made by the Agency to the guarantee

holder. For example, the calculation of MIGA's compensation may be based on the investment's net book value while recovery may be obtained from the host country on the basis of the frequently higher fair market value. In such cases, MIGA will, like most investment insurers, normally pursue its rights as acquired and pay the investor any such excess, less expenses.163/

Through subrogation, MIGA will succeed to the same substantive rights or claims as those of the indemnified investor. This principle is reflected in Article 45(b) of the Convention which provides that while the Agency's property and assets will in general be free from restrictions, regulations and moratoria, property and assets acquired by the Agency as subrogee will only be free from foreign exchange restrictions, regulations and controls in the host country to the extent that the indemnified investor was entitled to such treatment. On the other hand, the Convention protects such rights and claims as MIGA may acquire as subrogee. As noted earlier, Article 18(c) of the Convention ensures that amounts in the currency of the host country obtained by MIGA through subrogation will be entitled to treatment as favorable as the treatment to which such funds would be entitled in the investor's hands. Moreover, Article 18(b) of the Convention requires all members of the Agency, and not just the host country involved, to recognize the Agency's rights as subrogee. As a result, no member country will be in a position to raise objections to MIGA's standing as subrogee. In addition, MIGA may, as also noted earlier, enhance its position as subrogee by concluding agreements with individual host countries, pursuant to Articles 18(c) and 23(b)(ii) of the Convention, on the use of local currencies acquired by MIGA as subrogee and on the treatment of MIGA with respect to guaranteed investment. Finally, it should be pointed out that property and assets acquired by the Agency as

subrogee of an indemnified investor will benefit from the general immunity from taxes and customs duties conferred upon the Agency's property and assets by Article 47(a) of the Convention. During the preparation of the Convention, one participant in the meetings of the Committee of the Whole questioned whether this should be the case, on the ground that it would appear to give the Agency greater rights as subrogee than those enjoyed by the indemnified investor, particularly if in the process of subrogation physical assets were transferred to the Agency. Speaking from the Chair, I explained that the Agency would be subrogated to assets net of any taxes or customs duties owed by the investor, but that it would not be practicable to provide that after the Agency had become the owner of a net asset the asset should receive a different tax treatment from the Agency's other assets. Being fungible, assets in the form of cash funds could not be isolated in that way. Moreover, it was not expected that the Agency would acquire non-cash assets through subrogation, as it would claim compensation from the host country only for amounts paid to the investor. If in an exceptional case MIGA did as subrogee acquire a physical asset such as a factory it would have to convert the asset into cash as soon as possible for the management of such physical assets would be outside the Agency's mandate. With this understanding, which is recorded in paragraph 71 of the Commentary, the Committee of the Whole agreed that once the Agency had acquired assets through subrogation they should be accorded the exemptions set out in Article 47(a) of the Convention.164/

In keeping with Article 25 of the Convention, the Regulations require MIGA to seek recovery of payments from host countries in accordance with sound business practices. As will be seen in Chapter Five, the Regulations entrust MIGA's President with the responsibility of deciding

whether to seek recoupment of payments from the host country. In so doing, the President will act on the recommendation of the claims committee mentioned earlier. Negotiations with the host country may lead the Agency to accept partial compensation in an amicable settlement. Any settlement involving a write-off of more than $1 million, must, according to Section 4.20 of the Regulations, be approved by the Board.

MIGA's substantive rights as subrogee should be distinguished from the procedures open to the Agency to pursue such rights. It will be seen in the concluding Chapter that MIGA may under the Convention seek to recoup payments on claims through negotiation, conciliation and, ultimately, international arbitration, unless the Agency's Board authorizes alternate arrangements for dispute settlement with individual countries. It will also be seen that MIGA is expected in most cases either to facilitate negotiated settlements between the host country and the investor or reach such settlements with the host country itself. This expectation is supported by the record of national investment guarantee agencies which have generally succeeded in limiting cases of non-recovery of payments on claims to a small proportion of their accumulated premium revenues without instituting arbitral or judicial proceedings.165/

NOTES TO CHAPTER THREE

1. Regulations, sec. 3.01.

2. Under this formula, capital and reserves are multiplied by 1.5, but not the portion of reinsurance cover. Such portion will be determined by the Board according to the criterion prescribed in the Regulations and elaborated on above.

3. Under Paragraph 2.04 of the Regulations, the period of MIGA's guarantee may even exceed the fifteen year period, extending up to twenty years in special circumstances.

4. Convention, art. 22(a). Although the language of this Article may give the impression that the ultimate ceiling would be an amount equivalent to five times the Agency's subscribed capital, reserves and the determined portion of reinsurance cover, it is neither intended, nor would it be reasonable, to calculate five times the determined reinsurance cover for this purpose. The ceiling therefore would consist of 5 (capital + reserves) + 90% of eligible reinsurance, not 5 (capital + reserves + 90% of eligible reinsurance).

5. Id., art. 5(c).

6. See id., Annex I, art. 1(b).

7. Id., Annex I, art. 2.

8. Id., Annex I, art. 3.

9. Id., Annex I, art. 1(a).

10. Id., Annex I, art. 6. This was an important point of controversy during the preparation of the MIGA Convention. Representatives of capital exporting developing countries asked for it on the basis that it gives their investments in industrial countries the opportunity to be covered without adversely affecting the Agency's capacity to cover investments in developing countries. Some representatives of industrial countries objected to it, however, on the basis that it deviates from the purpose of the Convention. Such objection as well as the objection by one participant to the sponsorship system as a whole were withdrawn in the later stages of discussions as explained in Chapter 1, supra.

11. Id. Paragraph 6.01 of the Regulations similarly provides that "[t]o the extent they do not conflict with any provision of the Convention regarding the Sponsorship Trust Fund... these Regulations shall apply mutatis mutandis to operations under such Fund." However, Paragraph 6.02 of the Regulations adds that "[w]ithin one year of the Agency's establishment, the President shall prepare and submit to the Board

for its approval regulations for operations under the Sponsorship Trust Fund, with due regard to the need to protect the special interest of sponsoring members and of host countries of sponsored investments in these operations."

12. Commentary, para. 51.

13. Regulations, para. 3.55. Clearly, while the President should submit the required report within the prescribed deadline there is no obligation on the Board to act on this matter immediately; it may find for instance that further time would be required before any specific criteria could be imposed in this sensitive area.

14. A footnote to Paragraph 3.55 of the Regulations stated that this would be the case.

15. Regulations, sec. 3.59.

16. Id., sec. 3.60. This limit is characterized by Paragraph 3.60 of the Regulations as an "interim" one, to be applied pending the Board's consideration of the Agency's initial year of operations.

17. Id., sec. 3.58.

18. Commentary, para. 10.

19. Regulations, sec. 2.14(vii).

20. National investment guarantee programs (as well as private political risk insurers) also generally provide for an uncovered amount which, depending on the scheme, may vary from 5 percent to as high as 30 percent.

21. Regulations, sec. 2.07.

22. For details on the possible approaches MIGA may follow for such evaluations, see the discussion on loss valuation at p. __ infra.

23. Regulations, sec. 2.08.

24. Id.

25. Reference is to a preliminary study by Price Waterhouse entitled: Multilateral Investment Guarantee Agency's Measurement of Contractual Guarantees and Compensation and dated September 12, 1986 (limited circulation).

26. Regulations, sec. 2.12. See Chapter Two, p. __ for details as to the requirement that the investment be "new."

27. Regulations, sec. 2.12.

28. Id., sec. 2.10.

29. Id.

30. Id.

31. While it is unusual among national investment guarantee agencies to clearly define such priorities, the Compagnie Francaise d'Assurance pour le Commerce Exterieur (COFACE) provides a striking exception. COFACE requires applicants for its guarantee to submit a detailed export plan with precisely defined targets, showing that the investment will, within its first years, lead to exports from France to the host country. The plan is incorporated into the guarantee contract and closely monitored. If the investor fails to meet these targets, penalties are applied, ranging from a reduction of coverage and/or an increase in premiums to cancellation of the guarantee.

32. Regulations, sec. 3.05.

33. The figures in the text are based on the assumption that total guarantee capacity will then be in the range of roughly $1 to 1.2 billion, that is, 1.5 times a subscribed capital of about $700 to 800 million. As noted at p. __ supra, reserves and reinsurance cover are unlikely to contribute significantly to MIGA's guarantee capacity in its initial years.

34. For details on MIGA's premium rating, see p. __ infra.

35. See p. __ infra.

36. Regulations, sec. 3.26.

37. Id.

38. Id., sec. 3.27.

39. Id., secs. 2.13, 2.15 and 3.27.

40. Id., paras. 3.27.

41. Under Article 25 of the Convention, the Agency must in fact apply "sound business and prudent financial practices" to all of its activities.

42. Regulations, sec. 3.11.

43. The term "mobility" is used by the Regulations in this context to refer to the extent to which the assets can be easily moved to avert their exposure to a covered event.

44. Regulations, sec. 3.13.

45. Id., sec. 3.15. See Chapter Four, pp. __.

46. Regulations, sec. 3.14(i).

47. Id., sec. 3.18(i).

48. Id.

49. Id., sec. 3.14(ii).

50. Id.

51. Id.

52. Id.

53. Cf. Shihata, "Towards a Greater Depoliticization of Investment Disputes: the Roles of ICSID and MIGA," 1 ICSID Rev.-FILJ 1, 10 (1986).

54. Although this is true of most agencies, the U.S. agency and, to a certain extent, the Australian and Canadian ones seek to analyze the host country's actual practice as well as the legal standards it accepts.

55. Regulations, sec. 18(ii).

56. Id., sec. 3.18(iii).

57. Id., sec. 3.14(iii).

58. Id.

59. Id., sec. 3.19.

60. Id., sec. 3.32.

61. See p. __ infra for details on subrogation and recovery of payments.

62. Convention, art. 23(b)(ii).

63. Regulations, sec. 3.33.

64. Id., sec. 3.32.

65. Convention, art. 19. Reference to regional agencies is meant to cover in particular the Inter-Arab Investment Guarantee Corporation and, if established, the projected program of the European Community, provided they meet the condition mentioned in the text.

66. Id., arts. 21(a) and (b).

67. Id., art. 20(a).

68. See Convention, art. 19.

69. This is the maximum period of guarantees of the Inter-Arab Investment Guarantee Agency, the only regional investment insurance agency in existence at present.

70. This suggestion was made by the Inter-Arab Investment Guarantee Corporation in a paper entitled "The Inter-Arab Investment Guarantee Corporation: Its Role and Possibilities for Future Cooperation with MIGA" (Undated) (limited circulation). It is consistent with the cofinancing B Loan Program of the World Bank where it offers financing (loans and guarantees) to fund the later maturities of loans otherwise financed by commercial bank. See Cofinancing (World Bank Publication, 1983).

71. It may be recalled in this respect that a joint public-private underwriting experiment between the U.S. national agency, the Overseas Private Investment Corporation (OPIC), and private insurers, did not turn out successfully. OPIC's developmental and political objectives and private underwriter's commercial interests could not be reconciled for underwriting decisions and the experiment, which was initiated in 1975, lasted only two years.

72. Cf. Commentary, sec. 54.

73. Regulations, sec. 3.36.

74. Id., sec. 3.37.

75. Id., secs. 3.38 and 3.40.

76. See p. __ supra. While some national investment guarantee agencies, such as that of the U.S., similarly base their calculation of premiums on the amount of guarantee, most (such as the German agency) relate it to the higher amount of the investment.

77. Regulations, sec. 3.38.

78. Id.

79. Id., sec. 3.39.

80. Id., sec. 3.43.

81. Id., sec. 3.42.

82. Id., para. 3.43. While most national investment insurance programs offer only package cover, the three that provide separate coverage of categories of risk (the Australian, Canadian and U.S. schemes) generally simply add up the rates for individual coverages without offering package discounts. By contrast, private political risk insurers usually offer discounts for risk packages.

83. See p. __ infra.

84. Regulations, sec. 3.40.

85. National investment guarantee agencies calculate premiums for standby coverage directly as a percentage of the standby option. Under Paragraph 3.48 of the Regulations, a high proportion (50 percent) of any standby coverage will be deemed to utilize MIGA's guarantee capacity. A concentration on actual, rather than standby cover may serve to stimulate greater additional investment in MIGA's developing member countries than the devotion of substantial portions of the limited guarantee capacity to standby coverage which may or may not be activated.

86. Regulations, Annex, para. 2.

87. Id. As to the question of confidentiality, Paragraph 3.30 of the Regulations requires the Agency generally to safeguard information received on a confidential basis and in particular to safeguard information of a proprietary character received from investors so as to avoid its disclosure to actual or potential competitors.

88. Regulations, Annex, paras. 3 and 4.

89. Id., Annex, para. 3.

90. Id.

91. Id., sec. 3.39.

92. Id., sec. 3.41.

93. Id.

94. Id. By contrast, to the extent that national investment guarantee agencies provide for adjustments of premiums, only upward adjustments are permitted by them.

95. Id.

96. Flat rate systems are employed by most national investment guarantee agencies, though the Canadian and Japanese agencies have recently replaced flat rates with premium ranges.

97. A base-rate system is employed by the OPIC, U.S. national investment guarantee agency.

98. Regulations, sec. 3.46. For further details on MIGA's system of "preliminary" and "definitive" applications for guarantees, see Chapter Two, p. __.

99. Id.

100. Id.

101. Id., sec. 3.47.

102. This, it will be recalled from the discussion at pp. __ supra, is only one of the means by which MIGA may seek to enhance an investment's risk profile so as to facilitate coverage by the Agency.

103. As indicated in Chapters One and Two, MIGA will not merely be an investment insurance mechanism. It will also perform a range of investment promotion functions, a number of which are specified in Article 23 of the Convention. These include research, investment promotion and dissemination of information on investment opportunities in developing member countries, with a view to improving the environment for foreign investment flows to such countries, and, upon a member's request, the provision of technical advice and assistance to improve the investment conditions or strengthen the relevant institutions of that member. The Agency may also exercise the residual powers given to it by Article 2(c) of the Convention to carry out investment promotion activities not specifically mentioned in Article 23, so long as they serve the Agency's broad objective of encouraging the flow of investments for productive purposes among member countries, and in particular to developing member countries. Part II of the Regulations, which deals with MIGA's advisory and technical programs, sets forth a number of general principles in accordance with which MIGA will carry out these programs. For example, the technical programs are to be conducted so as to be mutually reinforcing, serving both the needs of the guarantee program and drawing evidence from experience in guarantee operations applicable to the Agency's technical programs. The Agency's technical assistance, advisory information and research programs are also to concentrate on aspects of investment issues in which it has a comparative advantage and which are not adequately served by other institutions. (Regulations, secs. 7.03 and 7.04).

104. See Convention, art. 15. It appears that no national investment guarantee agency has a similarly comprehensive approval requirement. The U.S. agency requires the host government's approval of both the investment and its guarantee by the agency, but does not extend the requirement to the risks designated for cover. The Canadian, French, Japanese and U.K. agencies require the approval of the investment but not that of the guarantee, with the result that the host government will not necessarily learn of the agency's involvement. The German agency normally limits itself to determining that the investment was properly admitted by the host government without necessarily requiring a specific approval. Private political risk insurers moreover require investors to keep the coverage confidential, on the questionable assumption that host governments might more readily take adverse measures against investors if they know that losses may ultimately be borne by a private entity to which they have no relationship.

105. Delay in the underwriting process of national agencies is reported to have been foten caused by this requirement.

106. Regulations, sec. 3.22. National agencies generally require the investor to obtain the approval. If MIGA requests the approval, it will, under Paragraph 3.31 of the Regulations, be required to incorporate in its request appropriate safeguards to prevent disclosure to competitors of information provided by the investor.

107. Id., sec. 3.25.

108. Id.

109. The March 8, 1985 draft of the Convention which was considered by the World Bank Executive Directors' Committee of the Whole severely confined the Board's involvement with respect to the approval of contracts of guarantee. Article 16 of that draft provided that "[c]ontracts of guarantee shall be approved by the President unless the Board, by special majority, decides that particular categories of investment shall require its approval." Following a discussion which centered on the desirability of having more general language, Article 16 was changed to read as quoted in the text above. See 1 C.O.W. Records 102-103.

110. Cf., Convention, art. 32(c). See also, Commentary, para. 58, which notes that "during the formative years of the Agency, the volume of business might not justify a Board sitting in continuous session. This would reduce administrative costs since, under these circumstances, the Directors and Alternates would receive compensation only for attendance at the meetings and the discharge of other specific functions."

111. Regulations, sec. 3.35(c).

112. Id.

113. Id.

114. Id., sec. 3.35(d).

115. Id., sec. 3.35(a).

116. See id., para. 3.35(b).

117. Private political risk underwriters similarly tend to increase their premiums in countries in which they are already heavily exposed.

118. See Regulations, sec. 4.01.

119. Id., sec. 4.06.

120. Id., sec. 4.05.

121. Id., sec. 4.01.

122. Id.

123. Cf. id., sec. 1.10.

124. Id., sec. 4.41.

125. Id.

126. Id.

127. Id., sec. 4.07.

128. Id.

129. Id.

130. 90 days will be normally required to lapse before the investor requesting a transfer can establish a claim that the host government has, through its inaction, refused his request. See Chapter Two, supra at p. __.

131. Regulations, sec. 4.08.

132. Id.

133. Id., sec. 4.11.

134. Id., sec. 4.11(i).

135. Price Waterhouse, supra note 25. For a discussion of some of the difficult issues that may arise in the valuation of investment where countries with different forms of economic organization are involved, see Buxbaum, "Legal Issues Concerning the Financial Aspects of Joint Ventures with Nonmarket Economy Firms," 2 ICSID Rev.-FILJ 66 (1987).

136. Price Waterhouse study, p. 9.

137. For a discussion of MIGA's coverage of "creeping" expropriation, see Chapter Two, p. __.

138. Regulations, sec. 4.11(ii).

139. Id.

140. Id., sec. 4.11(iii).

141. Id., secs. 4.11(i) - (iii).

142. Id., sec. 4.11(ii).

143. Id., sec. 4.12.

144. See Chapter Two, p. ___.

145. Regulations, secs. 2.14(v) and (vi). Cf. Convention, art. 17.

146. Id., sec. 2.15.

147. Id., sec. 2.14 (iv).

148. Id., sec. 4.04.

149. Id.

150. See Seidl-Hohenveldern, "Subrogation under the MIGA Convention," 2 ICSID Rev.- FILJ 111, 113 (1987).

151. Cf. id., at 113-114.

152. Regulations, sec. 4.16.

153. Id.

154. Id., sec. 4.17.

155. During the drafting of the ICSID Convention, there was in fact extensive discussion of the question whether a State or a "public international institution" which had indemnified an investor could be a party to an ICSID arbitration as the investor's subrogee. A provision which would have permitted this was ultimately deleted from the text of the ICSID Convention in the final stages of its preparation. See ICSID, 2 Documents Concerning the Origin and Formulation of the Convention 1018 (1968).

156. Regulations, sec. 4.10.

157. Id.

158. Id.

159. Id., sec. 4.18.

160. Id.

161. Id.

162. Id.

163. Id., sec. 4.19.

164. See C.O.W. Records 288-95, 525.

165. In 1984, the most recent year for which figures are available, this proportion averaged less than 12 percent for the national agencies.

Ch. 4

CHAPTER FOUR

MIGA AND THE STANDARDS APPLICABLE TO FOREIGN INVESTMENTS

Introduction

The standards for the treatment of foreign investments by their host countries constituted one of the main items covered by the World Bank's Executive Directors throughout their discussions on the MIGA draft Convention. From the beginning, the Bank's management, following the example of the OECD Proposal of 1965,1/ refrained from covering this subject in the successive Draft Articles of Agreement of the International Investment Insurance Agency (IIIA) of 1966, 1968 and 1972, as well as in the Multilateral Investment Insurance Agency (MIIA) outline of 1982.2/ The draft Convention discussed by the Executive Directors' Committee of the Whole in June 1985 was likewise silent on this issue, and intentionally so. A few participants in the Committee felt, however, that the draft Convention should include provisions on such standards or, as a minimum, should provide some broad guidelines similar to those incorporated for instance in the Lome III Convention.3/ As the chairman of the Committee, I maintained, consistently with the Bank's earlier position on this matter, that the MIGA Convention was not the appropriate place for the incorporation of the applicable standards. Such standards are to be found in the domestic laws of the host countries,4/ in the bilateral agreements which may exist between them and the home countries of the investors5/ and in the few multilateral agree-

ments and declarations which have attempted to list such standards in varying degrees of detail.6/ Reference was made also to the on-going discussions of the "Code of Conduct" at the United Nations7/ and to the fact that it was neither realistic nor desirable to try to undermine such discussions through provisions in the MIGA Convention. Furthermore, the participants were reminded that, given the history of the protracted attempts to reach agreement on multilateral conventions dealing with this issue, it was not advisable to tie the fate of the MIGA initiative to an exercise where a meaningful consensus, if reached at all, would have taken years to achieve.

While the majority of the Bank's Executive Directors readily accepted that position, two of them took a different position until the final stage of the discussions. Neither the Bank management nor the majority which appreciated its position were arguing against the importance of the availability of fair and stable standards as a necessary element in any attractive investment climate. The importance of this element is in fact recognized by both the investors' community and countries which wish to attract foreign investment. MIGA itself has also a stake in the availability of fair and stable standards; the flow of foreign investments and therefore the demand for MIGA's services and its own financial viability would depend in large measure on whether such standards exist and the extent to which they are honored in practice. The question, however, was whether this issue would best be addressed in detail in the MIGA Convention or whether the Convention should avoid prescribing the standards to be followed and only recognize their importance. As it turned out, the MIGA Convention, although it does not include provisions on the applicable standards, gives great prominence to this issue and recognizes the importance of adequate standards. It addresses the issue squarely in its Preamble and refers to its operational implications in Articles 12(d) and 23(b).

I. Treatment of the Standards Issue in the MIGA Convention

1. Preamble of the Convention

The Preamble of the MIGA Convention is written, and must be read, in line with the broad objective of the Agency which, according to Article 2 of the Convention, is "to encourage the flow of investments for productive purposes among member countries and in particular to developing member countries." With this objective in mind, the Preamble strikes a balance between the interests of the host countries and the protection required for stimulating a greater flow of foreign investments. It thus recognizes unequivocally that "the flow of foreign investments to developing countries would be facilitated and further encouraged by alleviating concerns related to non-commercial risks." And it records the mutual desire of the MIGA members to "enhance the flow to developing countries of capital and technology for productive purposes" under two balanced requirements. On the one hand, enhancement of the flow is desired "under conditions consistent with the developing countries' development needs, policies and objectives." On the other hand, the flow will be enhanced "on the basis of fair and stable standards for the treatment of foreign investment." The availability of appropriate standards and their "fairness" and "stability" are thus recognized from the outset as prerequisites for the implementation of MIGA's mandate of encouraging the flow of investments under conditions consistent with the aspirations of developing countries.

2. Article 12(d): Satisfactory Standards as a Prerequisite for MIGA's Guarantees

Article 12(d) of the MIGA Convention provides that:

"In guaranteeing an investment, the Agency shall satisfy itself as to:

(i) the economic soundness of the investment and its contribution to the development of the host country;

(ii) compliance of the investment with the host country's laws and regulations;

(iii) consistency of the investment with the declared development objectives and priorities of the host country; and

(iv) the investment conditions in the host country, including the availability of fair and equitable treatment and legal protection for the investment."

The provisions of this Section, especially subsection (iv), were added to the text of the draft Convention in the last stage of the discussions, along with the revised provisions of Section (b) of Article 23, after considerable debate. Originally, the Draft submitted to the Executive Directors on March 8, 1985, after referring to fair and stable standards in the Preamble, provided in Article 23 that the Agency "shall seek to enter into bilateral and multilateral agreements for the encouragement of foreign investments" and "may, upon the request of a member, provide technical assistance and advice to improve the investment conditions in the territories of that member." A footnote to Article 23 of that Draft summarized the outcome of previous consultations and explained the limited scope of the Article as follows:

"Some countries suggested incorporating in the Convention substantive standards for the treatment of guaranteed investments and directing the Agency to promote the conclusion of bilateral investment protection treaties among its members. Other countries expressed concern about the prospect that the Agency might pressure members to enter into such treaties. Some countries emphasized the need for an understanding that agreements concluded by the Agency would be consistent with international standards. One country also suggested that the Agency be directed to encourage the settlement of disputes directly between the investor and the host country concerned, preferably under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.

"The revised text tries to balance these views on the assumption that an incorporation of substantive investment protection standards is definitely beyond the scope of this Convention. The text also empowers the Agency to enter into agreements with its capital exporting members to encourage a greater flow of

> investment. It might be useful to consider the addition of the following clause: 'The Agency shall also encourage the conclusion of investment protection and promotion agreements among its members.'"

The original version of Article 12 was limited to stating the conditions of eligibility of investments for MIGA's coverage, the subject-matter stated in the Article's heading, without dealing with the "investment conditions" in the host country which were referred to only in the context of Article 23 covering the Agency's role in investment promotion. Of the requirements listed in the present text of Article 12(d), only the condition limiting coverage to investments "serving a developmental purpose" existed in the original text. In the first round of discussions on the March 8 draft Convention (June 10-14, 1985) a suggestion was made for the addition only of the requirement that the investment should also be "economically efficient." Although this suggestion did not receive support in the beginning, it led to agreement in the second round of discussions (July 18-19, 1985) that eligible investments should be "economically sound investments which contribute to the development of the host country." The text of Article 12 did not undergo other changes in this respect in the third round of discussions (August 6-7, 1985). Following these discussions, however, the chairman submitted, on September 4, 1985, a number of suggestions to resolve the few remaining issues where consensus had not been reached, including the "standards issue" hitherto discussed in the context of Article 23. These suggestions, which were based on consultations with individual participants and on proposals received from them, included a revised text of Article 12 which added a new Section (d) introducing for the first time reference to the investment conditions in the host country as a factor in guaranteeing investments by the Agency.8/ This particular suggestion, coupled with changes in the text of Article 23, which are explained

later on, paved the way for agreement on the slightly stronger text of the present Article. Compared to the present text which requires the Agency to "satisfy itself as to" the fulfilment of the conditions mentioned in the four above-quoted subsections of Article 12(d), the September 4 suggestion required that the Agency "shall pay due regard" to three considerations; the two now mentioned in subsections (i) and (ii) as well as "the investment conditions in the host country and the legal protection to be received by the investor."

As it stands, Article 12(d) requires that the Agency must be satisfied that two types of conditions have been met before it guarantees an investment. The first type relates to the investment to be guaranteed and the second to the investment conditions in the host country.

(i) Conditions Related to the Investment

In addition to the other eligibility requirements listed in Sections (a) to (c) of this Article,9/ the investment must, in the judgement of the Agency, satisfy four other conditions. First, it has to be a "sound investment," a requirement which, according to the official Commentary on the Convention, is meant "to serve [the Agency's] objective without undermining its financial viability" and necessitates a general review by the Agency of the economic, financial and technical feasibility of each investment.10/ Second, the investment must be developmental in character. This requires the Agency to ascertain the economic and social effects of each investment and to deny cover to investments which do not "contribute to the development of the host country."11/ Third, the investment must comply with the host country's laws and regulations. Although the requirement under Article 15 of the Convention, regarding the prior approval by the host country of "the

issuance of the guarantee by the Agency against the risks designated for cover," may serve the objective of this condition, it is not sufficient in itself to meet the independent requirement of Article 12 (d)(ii). The Agency is thus to ascertain that this condition is categorically satisfied and may best do so by requesting a confirmation from the host government to that effect at the time the government issues its approval of the guarantee operation.12/ Fourth, the investment must be consistent with the "declared development objectives and priorities" of the host country. This condition may also best be met through a statement to that effect from the host government. All these conditions are meant to serve the dual objective of emphasizing the developmental character of MIGA's operations and of minimizing the occurrence of losses to the investors and eventually to MIGA. Hostile action by host governments has, in practice, been associated in many cases with flaws in the investment or inconsistencies between the investment and the host country's legal requirements or development objectives.

(ii) Conditions Related to the Investment Environment in the Host Countries

In addition to the above requirements, which are all related to the specific investment under consideration, Article 12(d) requires the Agency to ascertain that other requirements related to the investment environment in the host country have been met.13/ The Agency must thus be satisfied with the "investment conditions" in the country, a term which is broad enough to cover the institutional, physical, financial and legal aspects of the investment climate.14/ In particular, two elements of such investment conditions are mentioned: "the availability of fair and equitable treatment" and the adequacy of "legal protection." This clear reference to the standards applicable to foreign investment is limited to the investments to

be guaranteed by the Agency, since it is listed as a condition precedent to the issuance of guarantees rather than as a general obligation of the parties to the Convention regarding investments made by other parties or their nationals. It also uses familiar terms in such a broad manner as to allow the Agency enough discretion to judge the investment conditions on a case by case basis. Under the Convention the conditions regarding "fair and equitable treatment" and "legal protection" may thus be found by the Agency to be satisfied under the domestic legislation of the host country or under binding international agreements.15/ In either case, standards acceptable to the Agency must exist in law and in fact in a given country before the Agency can undertake guarantee operations in this country. If in the judgement of the Agency no such standards exist, other steps must be taken before the Agency can issue guarantees for investors in the country concerned.

3. Article 23(b): MIGA's Role in the Promotion of Satisfactory Standards

Article 23 of the MIGA Convention deals with the non-guarantee operations of MIGA which are mentioned in Article 2, in addition to the guarantee activities, as another means by which the Agency is to serve its broad objective. After stating the promotional activities of MIGA alluded to earlier, Article 23 provides in Section (b) that:

"The Agency also shall:

(i) encourage the amicable settlement of disputes between investors and host countries;

(ii) endeavor to conclude agreements with developing member countries, and in particular with prospective host countries, which will assure that the Agency, with respect to investment guaranteed by it, has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement relating to investment, such agreements to be approved by special majority of the Board; and

(iii) promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments."

As mentioned earlier, the text of the March 8 draft of Article 23 was far more limited in its scope. During the first round of discussions of this draft, two Executive Directors expressed strong disagreement with its limited scope. They maintained that there should be an emphasis on the need for clear and stable conditions as stated, for instance, in the Lome III Convention and that there should be a reference to "the basic standards for the treatment of foreign investment that are reflected in bilateral investment protection treaties and have developed under customary international law." In particular, they felt that the parties to the MIGA Convention should mutually affirm the need to promote and protect the investments of their nationals in the territories of other parties and should agree to accord such investments "fair and equitable treatment," "national treatment," "most favored nation treatment," "compensation in case of expropriation which is equivalent to the value, effective, and freely transferable," "free transfer of payments related to an investment" and "international arbitration of investment disputes, e.g. through the International Centre for Settlement of Investment Disputes (ICSID)."16/ Some other Executive Directors adopted a completely different view. They objected to the inclusion in the Convention of any language related to the standards to be applied. In an attempt to help the Committee reach agreement, the chairman submitted during the June discussions the following text of draft Article 23(b):

"(b) The Agency shall:

(i) encourage the amicable settlement of disputes between investors and host countries;

(ii) when required, enter with interested members into agreements for the encouragement of flows of capital and technology for productive purposes to developing countries, including agreements with interested host countries on such appropriate standards for the treatment of investments guaranteed by the Agency as would contribute to the improvement of investment conditions. Such agreements shall require the approval of the Board; and

(iii) promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments."

However, this text was acceptable only to a majority of the participants. A minority consisting of two groups opposed it; one on the basis that it went too far, the other on the basis that it did not go far enough.

The second round of discussions, in July 1985, did not yield further progress on this issue in spite of the submission of a proposal from the chairman to the effect that when the Agency is not satisfied that existing standards are adequate for its purposes, it shall enter into an agreement with the member concerned, prior to initiating operations in its territory, on the standards to be applied to investments covered by the Agency.

When discussions were resumed in August 1985, the participants had before them, in addition to the June Draft, the following alternative text of Article 23(b)(ii):

"The Agency shall:

....

(ii) When required, enter into agreements with interested member countries for the encouragement of flows of investments to developing countries, including agreement on the standards of conduct to be followed by foreign investors and the standards for the treatment of foreign investments by their host governments. In all cases, such standards shall be fair and equitable. Agreements concluded under this Section shall apply only to investments guaranteed by the Agency, shall not be less favorable than those otherwise applicable under bilateral investment treaties, and shall require approval of the Board acting by special majority."

Reference in the above text to the "standards of conduct of foreign investors," and not only to those for the "treatment of foreign investment," was meant to provide a greater balance between the interests involved, although it was realized that the standards applicable to foreign investors were being actively discussed under the auspices of the "United Nations Commission on Transnational Corporations." The proposed text did not, however, receive much support and the issue remained one of three major points defying consensus. Before the last round of discussions, in September 1985, a number of the participants, in an attempt to forge a compromise, presented a draft whereby a new article would provide that the rules adopted by the Board of the Agency regarding its underwriting policies "shall require the Agency to have regard to the investment climate in the host country concerned and to issue a guarantee only provided that the investment under consideration is assured fair and equitable treatment and legal protection by the host country." The proposal suggested that an investment would be regarded as having adequate legal protection if it were protected under the terms of a bilateral investment treaty and, in the absence of such treaty, when an investment is accorded protection "comparable to the standards in those treaties." The proposal also included revisions of the text of draft Article 23 to the effect that: (a) promotional activities would include improving the policy environment in developed countries toward foreign investment flows to developing countries and would be guided by the principles in existing agreements among developed and developing countries including bilateral investment treaties; (b) the Agency would seek to remove impediments in both developed and developing member countries to the flow of investment to the latter; and (c) the Agency would endeavor to conclude agreements with developing members which would

assure that it would have, with respect to investments guaranteed by it, treatment "at least as favorable as that agreed by the member concerned for the most favored national, regional or international investment guarantee agency or partner to a treaty relating to investment."

The debate on the above proposal led to agreement on the present text submitted by the chairman. Instead of the proposed new article, Article 12 was revised as explained earlier. In addition, Article 23 was substantially revised to reflect a number of the points in the new proposal. A new paragraph was also added to the Commentary on the Convention which spelled out the linkage between Articles 12(d) and 23(b). The Commentary, in its paragraph 21, after listing the requirements of Article 12(d), includes the following important statement:

> "In case no such protection is assured [for the investment] under the laws of the host country or under bilateral investment treaties, the Agency will issue the guarantee <u>only after</u> it reaches agreement with the host country pursuant to Article 23(b)(ii) or otherwise on the treatment to be extended to the investments covered by the Agency." (Emphasis added)

The important requirement that an agreement between the Agency and the prospective host country on the applicable standards will precede any guarantee operations by the Agency in the country where no satisfactory standards exist, is thus not explicitly mentioned in the Convention (although it was suggested by the chairman in his July proposal). It could, however, be inferred from the requirement of Article 12(d)(iv) coupled with the assumption that the Agency would ordinarily seek to enter into an agreement with a member on the applicable standards only if it were not satisfied with the adequacy of the prevailing standards. This meaning is further confirmed by the following comment which appears in paragraph 44 of the Commentary:

> "Agreements under Article 23(b)(ii) require the Board's approval by special majority. It is anticipated that these agreements would be concluded when the investments covered by the Agency would not otherwise benefit from existing bilateral treaties or when the standards provided in such treaties are deemed by the Agency to be inadequate."

It is clear that there is nothing in the Convention which limits the exercise by the Agency of its treaty-making power to the cases where the member country concerned has not entered into bilateral investment treaties or does not otherwise have satisfactory standards applicable to the investments to be covered by the Agency. The latter "shall endeavor to conclude agreements with developing member countries and in particular with prospective host countries" whenever this is deemed appropriate to further the Agency's purposes. The Convention states that these agreements "will assure that the Agency, with respect to investment guaranteed by it, has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement relating to investment." An agreement may, therefore, be concluded for this particular purpose, either restating the provisions of the most favorable agreement in place or simply incorporating them by reference. The Commentary (paragraph 44) states that "[i]n determining the most favored agency or State [under an agreement], the Agency will consider agreements as a whole, and not their individual provisions." But the agreement to be entered into by the Agency with a member country need not be limited to the treatment of the Agency itself (as a subrogee to investors) as may be concluded from a strict reading of the text of Article 23(b)(ii). The discussions of this text in the _travaux preparatoires_ and the explicit language of the Commentary (paragraphs 21 and 44) clearly confirm the Agency's authority to conclude agreements with interested members on the treatment of the _investments_ to be guaranteed by the Agency whenever it finds this necessary to carry out its

guarantee operations or useful for the fulfillment of its broad objective of encouraging investment flows for productive purposes in the country concerned. Article 2(c) explicitly confirms the general capacity of the Agency to "exercise such other incidental powers as shall be necessary or desirable in the furtherance of its objective."

In addition to the agreements which the Agency may conclude regarding the standards applicable to the investments covered by it or applicable to the Agency with respect to such investments, Article 23(b)(iii) confers on the Agency the duty to "promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments." Thus, far from undermining existing bilateral and multilateral investment treaties or future attempts to conclude such treaties, the Agency is to play a catalytic role in enhancing such attempts. "For example"--notes the Commentary (paragraph 43)--"it could undertake studies on existing agreements and assist member governments in the analysis of the implications of and benefits from such agreements." It may also help in bringing to fruition the on-going but protracted efforts to conclude a multilateral "Code of Conduct" under the auspices of the United Nations.17/ The specialized expertise which the Agency is meant to develop, its proximity to the investors' community and the expected cooperation among its member countries of both categories in achieving its objective should all contribute to the Agency's ability to play a successful catalytic role in enhancing the chances of agreement. Through the agreements it concludes with its members and promotes among them, the Agency could also contribute to the progressive development of international law in this important area where universally agreed rules remain scarce.

The standards to be agreed upon by the Agency with a member or to be promoted in agreements among members include both the substantive rules of the treatment of foreign investment as well as such procedural rules as may be required, including the procedures for the admission of investments and the method for the settlement of disputes. The MIGA Convention does not address the latter subject, which is amply covered by the 1965 Convention on the Settlement of Investment Disputes (the ICSID Convention), also concluded under the auspices of the World Bank. There is a role for MIGA, however, in assisting investors and host governments to avoid disputes and, when such disputes arise, to reach amicable settlements, as explained in detail in the following Chapter.

II. Treatment of the Standards Issue in the Draft Operational Regulations

MIGA's draft Operational Regulations (the Regulations) elaborate on the Convention's requirements stated above, maintaining again the balance between the standards to be observed in conditions relating to the specific guaranteed investment on the one hand and in general investment conditions of the host country involved on the other hand.

1. The Specific Investment

While repeating the four conditions required under Article 12(d) of the Convention to be met by an eligible investment before it qualifies for the Agency's guarantee, the Regulations provide further details on two of these conditions in particular. These are the economic soundness of the investment and its contribution to the development of the host country. For the other two conditions (consistency with the host country's laws and with its declared development priorities) emphasis is placed on the fact that the

Agency may reach its conclusion on these matters either as a result of an assessment by its own staff, by explicit confirmation of the government of the host country itself or, for the requirement of consistency with the host country's laws, on the strength of independent legal advice.18/ Reliance on statements by the competent authorities of the host government regarding these two requirements at the time the government approves the Agency's issuance of the guarantee seems to be the most practical way for MIGA to assure itself that they have been met.

(i) The requirement that the investment be economically sound

The determination of the economic soundness of an investment could be carried out in several ways ranging from simple reliance on the investor's or the host country's assessment to a very detailed project appraisal of the type made by the World Bank before it agrees to finance a specific project. MIGA is meant to strike a reasonable balance between the requirement for a proper assessment and the need for prompt underwriting decisions as would be expected by its potential clients. The Regulations reflect these two concerns both in their general requirements (Section 3.05) and in the practical ways they seek to lessen the administrative burden of project assessment. Thus, Section 3.05 provides that:

> "[In determining whether an Investment Project is economically sound], the Underwriting Authority shall assess the Investment Project's technical feasibility and its financial and economic viability over the proposed period of guarantee. Such assessment shall have regard to all relevant economic and financial factors, including the need for a reasonable economic rate of return regardless of external factors such as trade concessions or subsidies. In carrying out such assessments, the Agency shall have due regard to the need for prompt underwriting decisions."

To meet the above requirements, while respecting the guideline provided in Section 2.26 of the Regulations (that "to the extent possible the [underwriting] decision shall be made within one hundred twenty days of receipt by the Agency of a definitive application"), Section 2.27 provides for the following procedures:

> "To facilitate a prompt underwriting decision the Underwriting Authority may, in making its assessment of the Investment Project, rely to the extent appropriate on statements of the Applicant, the accuracy and completeness of which the Applicant shall be required to warrant in the contract of guarantee... Where the proposed amount of guarantee is less than $10 million, the Agency may base its assessment of the Investment Project on appraisals or documents of other reliable institutions."

The explicit reference to a reasonable <u>economic</u> rate of return for the investment, and not just the financial rate of return pursued by private investors, was introduced by the Preparatory Committee upon the insistence of the U.S. delegation. The draft submitted to the Committee was equally clear, however, on limiting the Agency's guarantee to investments which are deemed to be feasible independently of any government subsidies.19/ Section 3.05 is more specific in its requirement that a reasonable economic rate of return be established for the investment on the basis of its respective costs and benefits regardless of any distortions due to trade, tax, pricing or other concessions offered by or agreed with the host government.

(ii) The requirement that the investment contribute to the <u>development of the host country</u>

Section 3.06 of the Regulations provides that:

> "In determining whether an Investment Project will contribute to the development of the host country, the Underwriting Authority shall have due regard to such factors as the Investment Project's potential to generate resources for the host country; the contribution of the Investment Project to

maximizing the host country's productive potential, and in particular to producing exports or import substitutes and reducing vulnerability to external economic changes; the extent to which the Investment Project will diversify economic activities, expand employment opportunities and improve income distribution; the degree to which the Investment Project will transfer knowledge and skills to the host country; and the effects of the Investment Project on the social infrastructure and environment of the host country."

The factors mentioned in the above text, along with the overall assessment of the economic soundness of the project on its own merits, leave no doubt as to the importance attached to the developmental impact required of a MIGA-guaranteed investment. It is also clear that possible multiplier and substitution effects should be taken into account in determining the investment's impact. Thus, attention will have to be paid to the project's potential to stimulate local economic activities as well as its impact on existing local producers and the local capital market. As already seen, such detailed assessments need not be made by the Agency for small projects the cost of which does not exceed $10 million. Appraisal made by "other reliable institutions" such as the World Bank and regional development banks may be readily relied upon by the Agency in the case of such small projects. Certain types of investment are also specifically excluded by the Regulations from MIGA's cover. These include investments of a military or highly speculative nature or in legally prohibited activities such as narcotics production. Such exclusions should not however be unreasonably interpreted. For instance, oil or other mineral exploration projects may be included in spite of their speculative character.

In part echoing provisions in the Convention[20/] and Commentary,[21/] the Regulations also direct MIGA to recognize certain priorities in the investments to be covered. Specifically, the Agency is to "give particular attention to the need to encourage" (i) investments in "lesser developed

countries" among the Agency's members, an expression which intentionally does not limit the priority treatment to countries on the U.N. list of "Least Developed Countries," (ii) investments originating in developing member countries, and (iii) "joint ventures freely agreed between foreign investors and domestic investors." Obviously, the priorities attached to these types of investment assume that they otherwise meet all the standards described earlier. Their priority would thus become relevant in determining the allocation of MIGA's underwriting capacity among eligible applications.

2. Host Country Investment Conditions

The Regulations repeat the Convention's requirement that the Agency should "satisfy itself as to the investment conditions in the host country, including the availability of fair and equitable treatment and legal protection for the investment." However, in elaborating on this requirement, the Regulations include reference to international law as the criterion to be followed in judging the law and practice of the host country. This is particularly interesting in view of the fact that no consensus was reached on this matter when it was raised in the discussions on the MIGA Convention only a year earlier.22/

Originally, the draft Regulations prepared by the Bank staff directed the Agency to assess the risks to be covered taking into consideration "legal, institutional and other relevant aspects of the investment conditions in the host country." In doing so, the Agency was specifically directed under Section 3.16 to have regard to (i) the domestic law and practice of the host country, (ii) any agreement between the applicant and the host country with respect to the investment project, (iii) any agreement between the investor's home country and the host country which applies to

the investment to be covered, and (iv) any relevant agreement between the host country and the Agency. Finally, the original draft (Section 3.17) reflected the requirement of Article 23 (b) (ii) of the Convention as interpreted above. It required the Agency, in case it was not satisfied that the host country investment conditions met the requirements of "fair and equitable treatment" and "legal protection," to deny cover until it had concluded an agreement with the host country on this issue. While this last requirement was maintained in the final text of the Regulations, the provisions of Section 3.16 were altered by the Preparatory Committee which followed a different approach in part to accommodate the German delegation in particular which proposed again that some broad substantive standards be incorporated in the Regulations. Section 3.16 of the Regulations now directs the Agency to ascertain the adequacy of legal protection of the investment by international law standards. Applicable treaty law is deemed sufficient. In its absence the Agency would judge the adequacy of domestic law protection by the standards of customary international law. According to Section 3.16:

> "An investment will be regarded as having adequate legal protection if it is protected under the terms of a bilateral investment treaty between the host country and the home country of the investor. When there is no such treaty, adequate legal protection should be ascertained by the Agency in the light of the consistency of the law and practice of the host country with international law. Such assessment shall be conducted in strict confidentiality and its outcome shall be shared only with the government concerned with a view to enabling it to improve the investment conditions in its territory."23/

Unlike the earlier draft, this text clearly encourages host countries to enter into bilateral investment treaties as the existence of such a treaty between the investor's country and a host country would obviate the need to question the adequacy of legal protection under the laws of the host

country. It places, however, a formidable burden on the Agency in case no such applicable bilateral treaty exists. By requiring the Agency to ascertain in this latter situation whether the law and practice of the host country is consistent with customary international law, the text assumes that such law is clearly defined. Absent such well defined law, it in fact gives the Agency a mandate to develop the standards of this law for the purpose of its operations. While the Agency's efforts in this respect would be relevant to the general development of customary international law, it cannot of course substitute for the will of the members of the international community which make that law through their behavior and their legal convictions. MIGA's task in ascertaining international law standards for the purposes of its guarantee operations is certainly made easier, however, by the fact that the great majority of MIGA's developing member countries have entered into investment treaties with the other members from which investments are likely to flow.

III. "Consistency with International Law" as the Test of Adequacy of the Law and Practice of the Host Country in the Absence of an Applicable Bilateral Investment Treaty

Despite recent assertions to the contrary,24/ the precise content of customary international law regulating the treatment by states of foreign investment in their territories has been and remains to date one of the most controversial aspects of international law. The argument that, absent a treaty obligation, the issue falls in its entirety within the exclusive domestic jurisdiction of each state, is neither new nor confined to theoretical writings.25/

The Supreme Court of the United States once noticed that "there are few if any issues in international law today on which opinion seems to be so divided as the limitations of a state's power to expropriate the property of aliens."26/ Unfortunately, the International Court of Justice has not had an occasion to give its authoritative view on the limitations imposed by customary international law in this area. For more than ten years, the U.N. Commission on Transnational Corporations, which is not a judicial body, has tried but failed to reach agreement on this matter. The current situation is best summarized in a recent issue of the Encyclopedia of Public International Law, as follows: "[t]he opinions expressed by industrialized States and developing States with respect to the rules of international law are widely divergent, and the conduct of States in actual practice coincides with none of these expressed views."27/ It is important therefore to try to ascertain here the status of customary international law on this issue and to offer some suggestions on how MIGA may best be able to deal with it.

In order for MIGA to satisfy itself that the law and practice of a host country is consistent with customary international law, it must have a clear notion of the requirements of such customary law in the field of treatment of foreign investment by their host countries. Much as an international tribunal cannot, under the principle prohibiting a finding of non liquet, abstain from rendering justice due to alleged gaps in the law,28/ MIGA, for obvious operational reasons, cannot avoid making a judgment on this matter due to the present controversy surrounding it. It must recognize, however, the great sensitivity of this subject which in view of its direct bearing on political and economic interests of states has become a central issue in the "North South dialogue" and a bone of contention among states and publicists alike. MIGA should in particular avoid taking the partisan positions of the

writers who have addressed this issue from the vantage point of the interests of their respective states. Rather, it should try to identify applicable rules of international law through an objective search in the sources of this law, while recognizing the difficulty of such search under the present stage of development of the law.29/ Inevitably, the "law" identified by MIGA for this purpose may not be universally accepted as such by all its members. It is likely, however, to have a strong impact on the behavior of its member countries and more generally on future decisions of international tribunals. Such "law" should, therefore, be identified with the greatest degree of caution and impartiality. In particular, in the specific process of identifying international law requirements for the purposes of Section 3.16 of its Regulations, MIGA should not be influenced by its self-serving views on what this law should be or by its interest in securing maximum protection for the investment to be guaranteed.

In an attempt to assist in the objective search for applicable rules of international law in this area, the rest of this chapter will focus on the most relevant issue, i.e., the extent to which customary international law requires a state to compensate for alien property taken by it.

1. The Traditional View

There is little disagreement that under customary international law a state is bound to respect the property of aliens but that such respect does not deprive the state of its general regulatory powers or hinder it from introducing social reforms which may entail interference with private property.30/ The result is that the taking of a lawfully acquired and operated property of an alien by his host state is likely to be deemed unlawful under international law in certain circumstances: when it is

obviously arbitrary (i.e., when it occurs in an unjustifiable discriminatory context); when it is clearly not for a public purpose; or when it constitutes a breach by a state, for governmental rather than commercial reasons, of a specific obligation undertaken in relation to the property in question.31/ Western sources (government spokesmen, and some scholarly writers and individual arbitrators) also argue that whether the taking of property is lawful or not, customary international law requires that it must be accompanied by full compensation reflecting the equivalent value of the property taken and must be paid, without delay, in convertible currencies. As early as 1796, United States Secretary of State Adams wrote that "[t]here is no principle of the law of nations more firmly established than that which entitles the property of strangers within the jurisdiction of another country in friendship with their own to the protection of its sovereign by all efforts in his power."32/ In 1938, United States Secretary of State Hull stated his government's position more specifically in a famous letter to his Mexican counterpart where he contended that the expropriation of property of American citizens in Mexico ought to entail "adequate, effective and prompt compensation."33/ This position, later to be known as the Hull formula or rule, came to represent the view of traditionalist writers symbolizing as it does liberal concepts of individual rights and personal property. Although it is still held to date in official statements of western governments,34/ it was by no means the only view expressed even in early writings35/ and it has been diametrically opposed by the practice of socialist and developing states and in the doctrines advanced by their writers.36/

The "full compensation" required under customary international law covers in the traditional view both the genuine economic value of the

nationalized property at the time and place it was taken (damnum emergens), and, in the case of a going concern, compensation for lost future income as well (lucrum cessans). This view was guardedly reflected in the 1965 Restatement of the Foreign Relations Law of the United States which required payment of "prompt, adequate and effective" compensation but qualified it by "what is reasonable in the circumstances" and recognized exceptions to it in some situations.37/ Recent revised drafts of this Restatement have abandoned the Hull language, however, for the "just compensation" formula, but still define the latter "in the absence of exceptional circumstances" to be "an amount equivalent to the value of the property taken, paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and...in a form economically usable by the foreign national."38/ Some western writers are definite, however, in their conclusion that the Hull rule is "not sustained by the prevailing doctrinal opinion within the international community" and that "recent practice, prevailing legal opinion and the development of national property orders all speak against [this rule],"39/ which at any rate "was not firmly established" in international custom.40/ Such a view should not be seen merely as a modern deviation from an established doctrine.41/ No less a traditional source than Oppenheim's treatise on International Law notes the diversity of attitudes and views on this matter and concludes that "[t]he only rule which is unanimously recognized by theory and practice is that out of an international delinquency arises a right for the wronged State to request from the delinquent State the performance of such acts as are necessary for reparation of the money due" and that such acts would differ according to the merits of each case.42/ In particular, Oppenheim finds that the taking of the property of aliens in the context of far-reaching

social reforms (such as the ones which prompted the Hull letter) requires a solution where the granting of partial compensation for the taken property would probably be consistent with legal principle.43/

2. U.N. Resolutions

In 1962 the U.N. General Assembly adopted Resolution 1803 on "Permanent Sovereignty over Natural Resources" which stiplulated that:

> "Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law".44/

This resolution was adopted by a nearly unanimous vote, including that of the United States, and clearly reflected the consensus of the world community at the time of its adoption. However, following the rise of economic power of oil exporting developing countries and the resulting aspiration of Third World countries for a "new world economic order," a series of resolutions were subsequently issued by the U.N. General Assembly which departed from this consensus. These included the 1973 Resolution on Permanent Sovereignty over Natural Resources,45/ the Declaration on the Establishment of a New Economic Order46/ and, more notably, the Charter of Economic Rights and Duties of States.47/ The latter resolution, adopted by a majority of one hundred and twenty states over the objection of six industrialized countries (and with the abstention of ten others) stated in particular that every state has the right to:

> "nationalize, expropriate or transfer ownership of foreign property in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the

> State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals ..."48/

While the legal value of this latter resolution is strongly questioned by most western writers49/ and has more recently been discarded by the Iran-United States Claims Tribunal,50/ the successive declarations mentioned above certainly indicate that a majority of the members of the world community do not consider as binding law the Hull rule or anything close to the traditional view explained above. True, a majority of states cannot impose a new customary rule by simply stating it in a U.N. declaration against the objection of the states most likely to be affected by it. Yet, the relevant U.N. declarations stand as a strong evidence that the Hull rule does not exist in present day customary international law as a binding rigid formula applicable to all cases of expropriation. At a minimum, the position taken by a large majority of states during the debate over these declarations and the conclusions codified in their provisions suggest that, whether or not such rule existed in the past, its binding character is by
However, this should not exclude the possibility that in certain situations full compensation with the three characteristics described in the Hull letter could be the most appropriate compensation to be imposed by a court of law under the circumstances of a particular case.52/

3. A Treaty-Based Customary Law?

Proponents of the traditional view have relied on the texts of more than two hundred bilateral investment treaties53/ to argue that, in spite of differences in detail, these treaties reflect a general customary rule which limits the right of host countries to expropriate the property of aliens and requires them to pay full compensation when they do so. On their

part, opponents of the traditional view also rely on the fact that more than a hundred fifty bilateral "lump sum" agreements and compensation settlement agreements were concluded between states54/ where the home countries of investors accepted a settlement of the claims of their nationals for less than full value. While the principle that a repetitive pattern of conduct expressed in international agreements may harden with time into a customary international rule is certainly valid,55/ this is obviously confined to the case where it could be determined that the states involved in the later treaties were acting under the conviction that their behavior was required by law (opinio juris). It is clear, however, as the award in the AMINOIL case noticed, that "both kinds of agreements [mentioned above] involve bargaining in a context to which opinio juris seems a stranger."56/ Neither type of agreement could therefore be correctly considered as declaratory of a preexisting customary law.57/

It is significant to note, however, that most bilateral investment treaties include in varying degrees of detail reference not only to the principle of compensation for taken property but often also to the modalities of the compensation formula.58/ Of the 211 such treaties known to the ICSID Secretariat, 47 treaties, mainly involving the United States or the United Kingdom, include the Hull rule's requirements; 62 others, mainly involving Germany, have similar requirements; 59 treaties, mainly involving Switzerland or Scandinavian countries include some but not all the requirements of the Hull rule; 35 treaties, mainly involving France, require "just compensation" while 5 treaties speak of "full compensation" and 3 are silent on the issue. This demonstrates the importance of this issue in the promotion of foreign investment which is presumably the primary reason for concluding these treaties. It also proves that at least for the countries

which wished to encourage a greater flow of private foreign investment into their territories, acceptance of a standard identical or close to the traditional rule has been rather common in the overall context of the mutual benefits expected from these treaties. While lump sum settlements may be of a lesser significance in the evolution of general international practice,59/ they also prove that the investors' states have often been willing to accept compensation below the level required by the traditional rule. In doing so, they are presumed to have considered the agreed settlements as a reasonable or just solution and not merely as practical or convenient under the circumstances of each case.60/

4. International Case Law

Until the recent wave of awards by the Iran-U.S. Claims Tribunal, there was a marked absence of clear pronouncements by international judicial and arbitral tribunals on the precise requirements of customary international law in the case of expropriation of alien property. In spite of the importance of the issue, "no case testing the persistence of the [Hull] rule has made it past the jurisdictional barriers of the International Court of Justice since 1945."61/ Its predecessor, the Permanent Court of International Justice, had the chance to address the issue in a celebrated *obiter dictum* only on one occasion.62/ The Court found that *unlawful* expropriation results in a duty on the expropriating state to effect restitution in kind or, if this is not possible, payment of a sum corresponding to the value which restitution in kind would bear together with the award, if need be, of damages for loss sustained "which would not be covered by restitution in kind or payment in place of it."63/ In contrast, the Court suggested that a lawful expropriation requires "payment

of fair compensation."64/ Such payment should cover "the just price of what was expropriated" and "the value of the undertaking at the moment of dispossession, plus interest to the day of payment."65/ While this language recalls the "just compensation" formula adopted in the recent drafts of the Restatement of the U.S. Foreign Relations Law and may imply a "full compensation" requirement, it fails to endorse the three requirements of the Hull rule (prompt, adequate and effective compensation). The latter rule does not seem to have been endorsed either in any of the several international arbitral awards which have addressed the issue.66/ Most of these awards recognized instead the need to pay "just," "fair," "appropriate" or "equitable" compensation whose detailed parameters varied according to the case.67/ Although they were generally close to the "fair market" or "full compensation" formula, no general rule along the lines of the Hull formula could be deduced from these awards. As Schachter has rightly concluded:

> "What the cases show is that when a dispute over compensation for a particular taking reaches a court or arbitral tribunal, the property owner is quite likely to get fair market value and a satisfactory award even though the magic words of the Hull formula are not invoked. But in some cases, he may not receive that amount if, for example, his legitimate expectations did not warrant it or if his operations were contrary to accepted good practices and diminished the value of the property."68/

The above reading of the case law in this field is not universally accepted, however.69/ The Iran-United States Claims Tribunal in particular has clearly stated on several occasions that under customary international law "full compensation" should be awarded.70/ Needless to say, the Tribunal's unqualified contention that this conclusion is overwhelmingly supported by the "opinions of international tribunals and of legal writers"

hardly reflects the complexities and differences prevalent in previous awards of other tribunals and more so in legal literature in general.71/

5. Comparative Domestic Law Practice

The norms of domestic legal systems which govern the practice of states in the matter of taking of property of aliens is also relevant to an understanding of customary international law in this area. Such norms may be ascertained through constitutional and legislative requirements and the pronouncement of domestic courts.

According to Dolzer, "at the domestic level, the Hull rule is today a "maximum standard" which is not fully observed [even] in the major capital-exporting countries."72/ In fact, in many such countries, the constitutions typically include a broad principle (e.g., just compensation) rather than imposing the requirement of adequate, effective and prompt compensation.73/ Given the lesser and varied requirements of the legal systems of several developing countries, let alone socialist countries, it is correct to state that no homogeneity exists in domestic legal systems which would warrant the conclusion that the traditional view is universally codified in their provisions relating to the taking by the state of private property, be it owned by nationals or aliens.74/ It should be noted in this context that some U.S. legislation strongly assumes that international law requires compensation which is prompt, adequate and effective.75/ Domestic courts in the United States have shown awareness, however, that the issue is far from being settled and that "[i]t may well be the consensus of nations that full compensation need not be paid in all circumstances."76/ In its application of the Fifth Amendment constitutional requirement of "just compensation" in a domestic context, the U.S. Supreme Court was also careful "not to reduce

the concept of just compensation to a formula" and stated that "the Amendment does not contain any definite standards of fairness by which the measure of 'just compensation' is to be determined."77/ Nationalization of property of nationals, accompanied with partial compensation or deferred payment was actually found by the courts of several industrial countries to be constitutionally valid under certain circumstances.78/ The European Court of Human Rights also found, in cases not involving aliens, that "legitimate objectives of 'public interest,' such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value."79/ Also, a compensation which is "reasonably related to the value of the property taken," and not necessarily "full compensation," was deemed acceptable (under Article 1 of the European First Protocol on Human Rights).80/

6. Recent Attempts at "Codification"

As mentioned earlier, the U.N. Commission on Transnational Corporations has been trying since 1976 to reach agreement on what international law requirements in the area of "nationalization and compensation" are or should be. No such agreement has been reached or seems to be in sight, however. Different formulae reflecting the positions of different groups within the "Working Group on the Code of Conduct" were drafted in 1983. Given the wide differences between these formulae, none of them should be read as representing a codification of a generally accepted international law rule. Rather, each represents an articulation of a different position held by certain members of that Working Group and the different groups of states they represent. The four formulae presented are as follows:81/

(1) "In the exercise of its right to nationalize or expropriate totally or partially the assets of transnational

corporations operating in its territory, the State adopting those measures should pay adequate compensation taking into account its own laws and regulations and all the circumstances which the State may deem relevant. When the question of compensation gives rise to controversy or should there be a dispute as to whether a nationalization or expropriation has taken place, it shall be settled under the domestic law of the nationalizing or expropriating State and by its tribunals."

(2) "In the exercise of their sovereignty, States have the right to nationalize or expropriate foreign-owned property in their territory. Any such taking of property whether direct or indirect, consistent with international law, must be non-discriminatory, for a public purpose, in accordance with due process of law, and not be in violation of specific undertakings to the contrary by contract or other agreement; and be accompanied by the payment of prompt, adequate and effective compensation. Such compensation should correspond to the full value of the property interests taken, on the basis of their fair market value, including going concern value, or where appropriate other internationally accepted methods of valuation, determined apart from any effects on value caused by the expropriatory measure or measures, or the expectation of them. Such compensation payments should be freely convertible and transferable, and should not be subject to any restrictive measures applicable to transfers of payments, income or capital."

(3) "In the exercise of its sovereignty, a State has the right to nationalize or expropriate totally or partially the assets of transnational corporations in its territory, and appropriate compensation should be paid by the State adopting such measures, in accordance with its own laws and regulations and all the circumstances which the State deems relevant. Relevant international obligations freely undertaken by the States concerned apply."

(4) "A State has the right to nationalize or expropriate the assets of transnational corporations in its territory against compensation, in accordance with its own laws and regulations and its international obligations."

More recently, the "Bureau" of the Commission which is a steering committee composed of leaders of various groups, suggested the following formula as a possible basis of agreement:

> "It is acknowledged that States have the right to nationalize or expropriate the assets of transnational corporations operating in their territory, and that compensation is to be paid by the State concerned in accordance with the applicable legal rules."82/

This formula, which avoids rather than provides a definition of the compensation criteria, was subject to various criticisms in the comments of Bureau members. The "Expert Advisors" of the Working Group have also recently made an attempt which, although considered by them "an adequate intermediate concept between the contending views," falls short of providing a satisfactory guideline. The formula reads as follows:

> "It is acknowledged that States have the right to nationalize or expropriate the assets of transnational corporations operating in their territory and that appropriate compensation is to be paid by the State concerned."83/

7. MIGA's Proposed Approach

Although the above analysis is too brief to do justice to the complex subject of compensation for expropriated property under international law (not to mention the broader area of international law rules applicable to the treatment of foreign investment), it amply demonstrates two facts. There are considerable differences among states and publicists on what the customary international rule in this field is or should be. And the variety of principles, interests and situations involved is such that the Hull rule cannot readily represent an undisputed expression of the present status of international law in all cases. As William Rogers points out in his foreword to a three volume work which explains in depth the different viewpoints on this subject:

> "In fact, easy resort to generalities such as 'prompt, adequate and effective' or 'national patrimony' are far more likely to obscure thought, comfort the parties with notions of ideological certainty and moral perfection, and inspire them to dig their trenches deeper. The actual issues in real

> life are too complex, the cases to be decided, and the precedents of decision, too disparate and unique for easy, simple principles."84/

MIGA will, therefore, be ill-advised to start its operations with an attempt to establish a rigid definition of the international law criteria against which the adequacy of legal protection under the law and practice of host countries should be measured. In addition to the immense difficulty of formulating such criteria in an objective manner, the exercise is likely to be so divisive in MIGA's councils as to obstruct rather than facilitate its operations. MIGA is best advised to avoid in its formative years imposing a codification of customary law in this controversial matter. Instead, it should confine itself to the less ambitious task of elaborating flexible guidelines to be used only for the operational purposes of Section 3.16 of its Regulations. Through the policy dialogue it is meant to encourage among its members pursuant to Article 23 of its Convention, MIGA should eventually be able to build a new consensus among them based on their mutual interest. Through this process, it may gradually be able to develop more precise standards which its members would readily accept as representing customary international law.

The initial guidelines to be established by MIGA should obviously recognize that the subject does not fall exclusively within the domestic jurisdiction of each state. In my view, they should judge the adequacy of protection afforded by domestic law and practice against the following criteria which broadly, though not universally, reflect accepted relevant parameters under customary international law:

1. Does domestic law and practice allow the host country to take the property of aliens in an arbitrary manner which discriminates against them for no justifiable reasons?

2. Is it permissible under the law or practice of the host country to take the property of aliens, directly or indirectly, for the private interest of a ruling individual or party or is the taking allowed only for public purpose?
3. When the taking occurs, can it be done without the payment of compensation in each case or is such compensation required by the law of the country concerned?
4. Is the compensation payable in the case of taking of property under domestic law and practice generally based on the value of the property taken and approximates such value or is it determined arbitrarily and without paying due regard to the value of the property taken and other relevant factors?
5. Does the affected alien have in each case resort under domestic law and practice to an independent judicial forum where he can dispute the adequacy of the compensation paid to him by the State?

An unsatisfactory answer to any of these questions will naturally cast doubt on the adequacy of the law and practice of the host country for purposes of Section 3.16 of MIGA's Regulations. It would also weaken the viability of MIGA's operations in the country concerned unless prior agreement is reached with the Agency on appropriate safeguards. A satisfactory answer to all the above questions should, on the otherhand, satisfy the requirements of MIGA's Regulations as to the consistency of domestic law and practice with international law. However, it does not obligate the Agency

to issue its guarantee in a given case. The issuance of a guarantee is a business decision which MIGA may decline to take due to other limitations or simply on the basis of its overall assessment of the risks involved in spite of the consistency of local laws and practice with the requirements of international law.

IV. Conclusion

The provisions of the MIGA Convention do not include a list of the substantive and procedural standards which should apply to the investments of nationals of parties in the territories of other parties. However, the Convention attaches great importance to the availability of standards which are both fair and stable and to the adequacy of the legal protection accorded to foreign investors.

Recognizing that such standards provide an appropriate framework for achieving a greater flow of foreign investment to developing countries, which is the raison d'être of MIGA, the Convention requires the Agency to satisfy itself that such standards prevail before it launches its guarantee operations in a given country. It also calls on the Agency to assist its members in establishing better investment conditions which are more conducive to attracting the foreign investments they wish to have. For this purpose, and to protect its own interests, MIGA is to promote agreement among its members on applicable standards and to enter into agreements with its members on the treatment that the Agency or the investors insured by it will receive in the host country.

With a view to achieving the wide membership needed for the success of the Agency, the MIGA Convention avoids the creation of obligations on members which may conflict with their constitutional or legislative require-

ments and maintains a careful balance between the respective rights of the host country, the investors and the Agency itself. MIGA's draft Regulations assume that the legal protection accorded to foreign investments will be adequate for the Agency's purposes when there exists an applicable agreement between the investor's state and the host country. In view of the great and increasing number of such agreements, the issue of legal protection is not likely to raise many problems in practice. In case no bilateral investment treaty exists between the state of the applicant investor and his potential host country, MIGA is directed by its draft Regulations to ascertain that domestic law and practice is consistent with international law. Given the controversy surrounding the state of customary international law in this field, MIGA is best advised in its formative years to apply broad guidelines which are likely to be generally acceptable to its members rather than to impose a partisan codification of a maximal lex ferenda. Should the law and practice of the host country be deemed to provide inadequate protection, according to the broad guidelines adopted by MIGA, it is enjoined from issuing guarantees for investment in that country until the deficiency is corrected either unilaterally by the country or through a bilateral agreement between it and the investor's country. Alternatively, MIGA may enter into a satisfactory agreement or arrangement with the host country on the standards applicable to the investments to be covered.85/

The objective of MIGA, as clearly stated in Article 2 of the Convention, is the encouragement of investment flows among its members and in particular towards its developing members. All the provisions of the Convention were written with this objective in mind and, according to the same Article, "the Agency shall be guided in all its decisions" by this objective. The "standards requirement" should not be viewed as an encroach-

ment on the rights of host countries. Rather, it should be seen as a useful instrument in the stimulation of increased flow of foreign investment and in the general improvement of the investment conditions in host countries.

NOTES TO CHAPTER FOUR

1. See IBRD Doc. No. R65-97, Annex C. See also Martin, Multilateral Investment Insurance: The OECD Proposal, 8 Harv. Int'l L.J. 280 (1966) and chapter I, supra at ________.

2. These documents were issued in IBRD Docs. R66-156, November 30, 1966; M68-156, August 19, 1968; Sec.M72-121, March 2, 1972; and R82-225, July 14, 1982. See a brief description of the contents of these Drafts in chapter I, supra, at ________.

3. See Article 240 of the Third ACP-EEC Convention, published in 24 ILM 571 (1985) and The Courier, Africa - Caribbean - Pacific - European Community, No. 89 (Special Issue), January-February 1985.

4. For a collection of such laws, see [ICSID] Investment Laws of the World, vol. I to X (Dobbs Ferry, New York: Oceana Publications, Inc. 1973 - loose leaf).

5. At present, some 200 of such treaties are in force. For a collection of such treaties, see [ICSID] Investment Treaties, vol. I and II (Dobbs Ferry, New York: Oceana Publications, Inc. 1984 - loose leaf). [International Chamber of Commerce], Bilateral Treaties for International Investment (1977-updated).

6. For example, the Arab Unified Investment Code, approved at the Eleventh Arab Summit Conference in Amman in November 1980: see Sharaf Eldine "Stability and Investment Relations (Application of the Unified Agreement for the Investment of Arab Funds in Arab Countries)", in 2 ICSID Rev-FILJ __ (1987). Other examples include the Unified Agreement on the Promotion, Protection and Guarantee of Investment among Member States of the Organization of the Islamic Conference, approved in 1980, 1 ICSID Rev.-FILJ 407 (1986); the Declaration on International Investment and Multinational Enterprises of the Governments of OECD Member Countries of 1976 as well as the Decision of the Council of the OECD on National Treatment of 1976 (both published in OECD, International Investment and Multinational Enterprises (1976)); the Andean Foreign Investment Code adopted by Decision No. 24 of the Commission of the Cartagena Agreement (especially Articles 7 and 8: right to repatriation of investment capital) published in 11 ILM 126 (1972).

7. For the most recent account of these discussions, see United Nations Economic and Social Council (ECOSOC), "Outstanding Issues in the draft Code of Conduct on Transnational Corporations" (E/C. 10/1985/S/2) and "Solutions to Principal Outstanding Issues in the draft Code of Conduct on Transnational Corporations" (E/C. 10/1986/S/2); for the text of the most recent draft Code, see 23 ILM 626 (1984).

8. It should be recalled that the 1966 IIIA Draft Articles of Agreement (Article III, Section 3(vi)) provided that the Agency may prescribe other considerations including the effect on foreign investment of the laws and policies of host countries. Reference to this particular test did not appear in the subsequent Draft Articles prepared in the Bank. See chapter I, supra, at ___ and note 10 infra.

9. See Chapter II, supra, at ___.

10. See Commentary on the Convention, para. 21.

11. See Section 3.06 of the draft Operational Regulations.

12. In addition to the requirement related to the laws of the host country, both the Commentary (para. 25) and the draft Operational Regulations (Section 3.10) direct the Agency to deny coverage in case the investor's government notifies it that the investment would be financed with funds transferred from the home country in violation of its laws. This does not require the Agency, however, to initiate any investigation in the consistency of the investor's actions with the laws of any country other than the host country.

13. Compare Article 12, Section III(vi) of the Draft Articles of Agreement of the IIIA, prepared by the staff of the World Bank in July 1966, which requires an eligible investment to meet in addition to five specific tests, "such other considerations as the Agency may prescribe, including the effect on private foreign investment of the laws and policies of the Host Country regarding the treatment of, and the settlement of disputes with, private foreign investors." Although the subsequent Draft Articles of 1968 and 1972 referred to other tests to be prescribed by the Agency, they did not include any reference to the important example given in the 1966 Draft. Nor was it mentioned in subsequent discussions until a similar provision was suggested in the late stages of the discussion of the MIGA draft Convention as shown above.

14. See, Shihata, "Factors Influencing the Flow of Foreign Investment," 21 The International Lawyer ___ (1987).

15. Compare the requirements of MIGA's Draft Operational Regulations which go beyond this requirement as will be shown infra. Also compare the practice of national schemes of political risk insurance. For instance, the U.S. OPIC strictly requires a bilateral agreement with the host country as a precondition for cover and has entered into 108 such agreements. The agreements provide for OPIC's subrogation to the rights of the investor and for settlement of disputes between it and the host country ultimately through international arbitration; they do not include substantive standards regarding the treatment of the investment by the host country. Germany, France and the Netherlands rely on their bilateral investment treaties but allow their national agencies to issue guarantees for investments in countries with which they have no such treaties in exceptional cases in reliance on the domestic laws and the past record of the host country.

16. Proposal submitted by the German Executive Director to the Committee of the Whole on June 10, 1985, entitled "Legal Protection of Guaranteed Investments as Elements of the Draft Convention of MIGA" (unpublished). The German proposal was seconded by the French Alternate Executive Director.

17. For an explanation of the status of these efforts and the possible role of MIGA in enhancing them, see Voss, "MIGA and the Code of Conduct," The CTC Reporter, No. 22, at 51 (Autumn 1986).

18. See Sections 3.28 and 3.29 of the Draft Operational Regulations.

19. The text of Section 3.05 as originally prepared by the World Bank's Legal Department read:

 "In determining whether an Investment Project is economically sound, the Underwriting Authority shall assess the Investment Project's technical feasibility and its financial viability over the proposed period of guarantee. Such assessment shall have regard to all relevant economic factors, including external factors such as trade concessions or subsidies which might substantially affect the economic viability of the Investment Project."

 The U.S. delegation relied on the developmental character of the Agency to advocate the economic rate of return requirement.

20. Articles 22(b)(i) and 23(c) of the Convention.

21. Paragraph 24 of the Commentary.

22. See COW Records, Volume I, pp. 5-6, 9-17, 141-50 and Vol. II, pp. 369-78, 432-33. It should be noted that unlike the "Committee of the Whole of the World Bank's Executive Directors" which discussed the Convention, the "Preparatory Committee" consisted only of representatives of countries which signed the MIGA Convention and for this reason did not include "hardliners" on this issue.

23. It should be recalled that the German proposal submitted first during the discussion on the MIGA Convention and later in the Preparatory Committee was that in the absence of a bilateral investment treaty the Agency was to be satisfied that the standards maintained in the law and practice of the host country were comparable to the standards in bilateral treaties. This is consistent with the approach followed in the German national program.

24. See Iran-United States Claims Tribunal-Interlocutory Award in Case Concerning SEDCO, Inc. and National Iranian Oil Company and Iran, Award No. ITL 59-129-3, March 27, 1986, reprinted in 25 ILM 629 (1986). The Tribunal concluded that "the overwhelming practice and the prevailing legal opinion" before World War II supported the view that customary international law required compensation (for expropriated alien property), equivalent to the full value of the property taken and that this "traditional legal standpoint" has been challenged "only since those days." Id. at p. 632.

25. The "Calvo doctrine" advocated that the intervention of the states of foreign nationals in disputes resulting from the taking of property by their host states was a violation of the territorial jurisdiction of the latter states. See, Calvo, Manuel de Droit International Public et Privé 134-37 (1884). This position has been traditionally maintained by Latin American countries and is generally reflected in the U.N. Charter of Economic Rights and Duties of States referred to infra. The position that nationalization of foreign property is a matter of domestic jurisdiction was taken by the Soviet Union after the socialist nationalizations and in more recent U.N. debates. See, e.g., [The Soviet Association of International Law], Memorandum on the Question of Nationalization of Foreign Owned Property, in International Law Association, Report of the Fiftieth Conference, Annex B, pp. 148-52 (1962). See also the contention by the Soviet Union that each state has an "inalienable right to unobstructed...expropriation," in U.N. Doc. A/PV, 1193, p. 1131 (1962).

26. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 428 (1964).

27. Dolzer, "Expropriation and Nationalization," in 8 Encyclopedia of Public International Law 214, 216 (1985).

28. See H. Lauterpacht, "Some Observations on the Prohibition of Non Liquet and the Completeness of the Law," in Symbolae Verzijl 196 (1958); Fitzmaurice, "The Problem of Non Liquet," in Mélanges Offerts à Charles Rousseau: La Communauté Internationale 89 (1974).

29. In defense of this approach for broader purposes see Dolzer, "New Foundations of the Law of Expropriation of Alien Property," 75 AJIL 553, 556 and 577 (1981).

30. See, L. Oppenheim, International Law Vol 1, 352 (8th ed., H. Lauterpacht 1955).

31. The vast literature on this subject is well summarized in the 43 Annuaire de l'Institut de Droit International Vol 1, 42-125 (1950) (Session de Bath) and in the Comment and Reporters Notes of [The American Law Institute] Restatement of the Law. Foreign Relations Law of the United States (Revised). Tentative Draft No. 7, pp. 119-144. (April 10, 1986.) See also, Friedman, Expropriation in International Law (1953).

32. Cited in Moore, 4 Digest of International Law 5 (1906).

33. See Secretary Hull's letter of July 21, 1938 reprinted in Hackworth, 3 Digest of International Law 655-65 (1942). In his answer the Minister of Foreign Relations of Mexico took the position that international law required only that foreign nationals be treated no less favorably than were nationals, at least in the case of expropriations of general and impersonal character. Id. at 657-61.

34. See comments of the then U.S. State Department's Legal Adviser on the "draft Restatement of the Foreign Relations Law of the United States," in Robinson, "Expropriation in the Restatement (Revised)," 78 AJIL 176-

78 (1984); statement by the President of the United States on International Investment Policy, 83 Dep. State Bull. 38, 40 (1983) and statements by the German, French and UK governments mentioned in Dolzer, supra note 27, at 216.

35. See, e.g., a contrary view of the law in Williams, "International Law and the Property of Aliens," 9 Brit. Y. B. Int'l L. 1 (1928). See also the Mexican view at the time of the Hull letter explained in Garcia-Robles, La Question du Pétrole et le Droit International (1939).

36. For the doctrine and practice of Socialist countries see generally, Katzarov, The Theory of Nationalization 349 (1964); Seidl-Hohenveldern, Communist Theories on Confiscation and Expropriation: Critical Comments, 7 Am. J. Comp. L. 541 (1958); Carreau, Flory et Juillard, Droit International Economique 539 (1980); And see, e.g., for the views advanced by developing countries' publicists, Amerasinghe, The Quantum of Compensation for Nationalized Property in 3 The Valuation of Nationalized Property in International Law 91, 97 (R. Lillich ed. & contrib. 1975); Castaneda, La Charte des Droits et Devoirs Economiques des Etats, 20 Annuaire Français de Droit International 31 (1974); Aréchaga, State Responsibility for the Nationalization of Foreign-Owned Property, 11 N.Y.U.J. Int'l. L. & Pol. 179, 186-7 (1978), Salem, Le Développement de la Protection Conventionnelle des Investissements Etrangers 113 J. Dr. Int. 579, 620-22 (1986), and for the practice of developing countries, Rood, Compensation for Takeovers in Africa, 11 J. Int'l. L. & Econ. 521, 525 (1976).

37. [The American Law Institute], Restatement of the Law. Foreign Relations Law of the United States (second) Section 187 (1965).

38. Id. Tentative Draft No. 7 (Revised) Section 712 (April 10, 1986). The "Comment" on this Section of the 1986 draft Restatement permits deviation from the standard during war or similar exigency, Id., p. 123, and states that a taking might not be successfully challenged if it provided just compensation even if it did not meet the requirements of equal treatment and public purpose. Id. at 124.

39. Dolzer, supra note 29 at 565, 570. Professor Dolzer believes that "[n]either the Calvo doctrine nor the Hull rule represents existing customary law. Neither is tenable in principle, nor do they help explain prevailing practice. The practice lies somewhere between these rules." Id. at 572-73.

40. Id. p. 564, footnote 47a. See also Schachter, "Compensation for Expropriation," 78 AJIL 121 (1984). And see, Friedmann, "National Courts and the International Legal Order," 34 Geo. Wash. U. L. Rev. 443, 454 (1966) where he states that "[i]t is nothing short of absurd to pretend that the protestation of the rule of full, prompt and adequate compensation... in all circumstances is representative of contemporary international law."

41. The Hull rule is seen in abundant Western legal literature as lacking adequate support in state practice and cases. See, e.g., Schachter, supra, note 40 at 121-30 (1984); Dolzer, supra note 29 at 565, 2 W. Wengler, Völkerrecht 1008 n. 3 (1964), de Visscher, Theory and

Reality in International Law 203 (Corbett trans. of 3rd French ed. 1968); 5 Rousseau, Droit International Public 250 (1983), Bindschedler, "La Protection de la Propriété Privée en Droit International Public," 90 Recueil des Cours 173 (1956 II); I. Foighel, Nationalization - A Study in the Protection of Alien Property in International Law 115-26 (1957, reprinted 1982); Rubin, Private Foreign Investment: Legal and Economic Realities 11-23 (1956); Friedman, supra, note 31, etc.

42. Oppenheim, supra note 30, at 353.

43. Id. at 352.

44. G.A. Res. 1803, 17 U.N. GAOR Supp. (No. 17) at 15, U.N. Doc. A/5217(1962), reprinted in 57 AJIL 710 (1963). The use of the term "appropriate compensation" as distinct from the Hull formula was intentional. See details in K. Gess, Permanent Sovereignty over National Resources: An Analytical Review of the United Nations Declaration and its Genesis, 13 ICLQ 398 (1964).

45. G.A. Res. 3171, 28 U.N. GAOR Supp. (No. 30) at 52, U.N. Doc. A/9030 (1973), reprinted in 13 ILM 238 (1974).

46. G.A. Res. 3201, 28 U.N. GAOR Supp. (No. 1) at 3, U.N. Doc. A/9559(1974), reprinted in 13 ILM 715 (1974).

47. G.A. Res. 3281, 29 U.N. GAOR Supp. (No. 31) at 50, U.N. Doc. A/9631 (1974), reprinted in 14 ILM 251 (1975).

48. Id, Art. 2(2)(c).

49. See, e.g., Carreau, Flory et Juillard, id., note 36, at 558-559; Brower, Tepe Jr.: The Charter of Economic Rights and Duties of States: A Reflection or Rejection of International Law? 9 Int'l Law 295, 300-303 (1975); Virally: La Charte des Droits et Devoirs Economiques des Etats, 20 Annuaire Français de Droit International 58, 69 (1974); Feuer: Réflexions sur la Charte des Droits et Devoirs Economiques des Etats 79 RGDIP 273 (1975); Schwebel: The Legal Effect of Resolutions and Codes of Conduct of the United Nations (Forum Internationale No. 7, Apr. 1986); Higgins: The Taking of Property by the State, Recent Developments in International Law, 176 Recueil des Cours 259, 290-293 (1982).

50. See, e.g., The award in the SEDCO case, supra note 24, at 633-34.

51. Accord, Dolzer, supra note 29, at 562-65. But see Texas Overseas Petroleum Company v. Libyan Arab Republic (1977), 17 ILM 27-30 (1978); the separate opinion of Judge Brower in the SEDCO case, note 24 at pp. 643-45 and Clagett, "The Expropriation Issue Before the Iran - United States Claims Tribunal: Is 'Just Compensation' Required by International Law or Not?" 16 Law & Pol'y Int'l. Bus. 813 (1984).

52. This view was adopted by the U.S. Court of Appeals for the Second Circuit in Banco Nacional de Cuba v. Chase Manhattan Bank, 658 F2d 875, 892 (2d Cir. 1981). After declaring that the standard of "appropriate

compensation" would "come closest to reflecting what international law required," the Court added that an "appropriate compensation requirement would not exclude the possibility that in some cases full compensation would be appropriate."

53. See texts of these treaties referred to in note 5, supra.

54. Several sources estimate that these settlement agreements provided compensation in amounts varying between 80 percent and 20 percent of market value. See, e.g., Lillich, id. note 36 at 115-16. For settlements between foreign investors and host countries see a review of 154 such agreements in Sunshine, Terms of Compensation in Developing Countries' Nationalization Settlements, A Study for the UN Centre on Transnational Corporations, Feb. 9, 1981 (unpublished).

55. See Shihata, "The Treaty as A Custom Making Instrument," 22 Egyptian Rev. of Int'l. L. 51 (1966); Baxter, Treaties and Custom, 129 Recueil des Cours 25, 74 (1970I). See also the Vienna Convention on the Law of Treaties, adopted May 23, 1969, U.N. Conference on the Law of Treaties, Official Records, U.N. Doc. A/Conf. 39/27 (1971), at art. 38.

56. Kuwait v. The American Independent Oil Company (AMINOIL) (award of 24 March 1982) reprinted in 21 ILM 976 at para. 157.

57. Accord, SEDCO Award, supra note 24, at 633; Dolzer, supra note 29, at 566-8.

58. See an analysis of relevant provisions in Dolzer, ______________ (ICSID publication, forthcoming).

59. See, The Barcelona Traction Case (Belg. v. Spain), 1970 I.C.J. Rep. 3, 40 (judgment of Feb. 5) where the International Court of Justice described these agreements as "sui generis and provide no guide" as to general international practice. But see, Dolzer, supra note 27, at 218 where he argues that "it is more realistic to assume that the (lump sum and financial ad hoc) arrangements reached in practice reflect the parameters of an existing consensus."

60. For statements to this effect by the Investors' government see, e.g., Gantz, "The Marcona Settlement," 71 AJIL 474 (1977).

61. Vagts, "Foreign Investment Risk Reconsidered: The View from the 1980s," 2 ICSID Rev.-FILJ 1 (1987). On the more general issue of the status of international law on the rights and duties of states regarding foreign investment, the I.C.J. itself, in the Barcelona Traction Case, 1970 I.C.J. Rep. 3, 47, that "it may at first sight appear surprising that...no generally accepted rules in the matter have crystallized on the international plane."

62. Case Concerning the Factory at Chorzow (Ger. v. Pol.) (Merits), 1928 PCIJ, Ser. A, No. 17, at 3 (Sept. 13).

63. Id. at 47.

64. Id. at 46.

65. Id. at 47.

66. "If we look for 'traditional' law in the earlier cases, such as these collected by Ralston in his classic work (Ralston, The Law and Procedure of International Tribunals (rev. ed. 1926, supp. 1936), we cannot find a single decision expressing the 'prompt, adequate and effective' compensation formula." Schachter, "Compensation for Expropriation," 78 AJIL 121, 123 (1984). See also Mendelson, What Price Expropriation? 79 id. 414, 416 (1985), who, while agreeing that "none of the cases adopt the actual words of the Hull formula," emphasizes that several decisions before and after the Chorzow case require the payment of full compensation.

67. See, e.g., reference to "fair and equitable compensation" as a measure for the estimation of damages in Benvenuti & Bonfant v. People's Rep. of the Congo, Arbitral award of August 8, 1980, 21 ILM 740, 760 (1982) (Case decided ex aequo et bono) and in Libyan American Oil Co. (Liamco) v. The Government of the Libyan Arab Republic, Arbitral Award of April 12, 1977, 20 ILM 1, 86 (1981), ("...taking equity into consideration... with the classical formula of 'prior, adequate and effective compensation' remaining as a maximum and practical guide for such assessment"), and see reference to "appropriate compensation" and a "reasonably appraised value" in Kuwait v. The American Independent Oil Co. (Aminoil), Arbitral Award of March 24, 1982, 21 ILM 976, 1042 (1982) and to compensation "on equitable terms as quickly as possible" in The Goldenberg Case: Germany v. Roumania (1928), 2 United Nations Reports of International Arbitral Awards (RIAA) 903, and reference to "just compensation" in the Upton claim case (1903), 9 RIAA 234 and to a "fair sum" in the Southern Pacific Properties (SPP) v. The Arab Rep. of Egypt, Award of March 11, 1983, 22 ILM 752 (1983) set aside by a decision of the French Cour d'Appel of July 12, 1984 which was confirmed by another decision of the French Cour de Cassation of January 6, 1987.

68. Schachter, "Compensation Cases - Leading and Misleading," 79 AJIL 420, 421 (1985).

69. See, e.g., Mendelson, supra note 66; Schwarzenberger, Foreign Investments and International Law 4-5 (1969); Lord Shawcross, The Problems of Foreign Investment in International Law, 102 Recueil des Cours 336, 344-46 (1961-I); White, Nationalization of Foreign Property 162-79 (1961).

70. See in particular, American International Group, Inc. and American Life Insurance Co. v. Islamic Republic of Iran and Central Insurance of Iran, 23 ILM 1 (1984) and the SEDCO award referred to in note 24 supra. (Awards not signed by the Iranian arbitrator.)

71. See, however, INA Corporation v. Government of the Islamic Republic of Rian, Iran-U.S. Claims Tribunal Award No. 184-161-1, Separate Opinion of Judge Lagergren, Aug. 14, 1985 at 7. ("I am also inclined to the view that 'appropriate', 'equitable', 'fair' and 'just' are virtually interchangeable notions so far as standards of compensation are concerned. Nor is there any single method of valuation to be used in

all situations of compensation. Instead, there is a wide choice of well-established methods of valuation applicable and appropriate under different circumstances. Even the notions "full" and "adequate" compensation contain, inevitably and with the best of intentions, a margin of uncertainty and discretion.")

72. Dolzer, supra note 29, at 569.

73. Id. at 568 note 58 citing Article 11 of the Constitution of Belgium, the Preamble of the Constitution of France and the Fifth Amendment of the US Constitution which all call for "Just Compensation" as well as Article 14 of the Constitution of the Federal Republic of Germany which requires Parliament to find a "just balance of interests" of the owners and the public. See also Art. 42 of the Italian Constitution; Art. 33 of the Spanish Constitution; Ch. 2, Sec. 18 of the Swedish Constitution; etc.

74. For a comparative study see, e.g., Lowenfeld, ed., Expropriation in the Americas (1971).

75. See, e.g., 22 U.S.C. Sec. 2370(e)(1); id., Sec. 283r, 2850, 2909-8, 19 U.S.C. Sec. 2462(b)(4).

76. Banco Nacional de Cuba v. Chase Manhattan Bank, 658 F. 2d 875, 892-93 (2nd Cir. 1981).

77. United States v. Cors, 337 U.S. 332 (1948). See also United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950); United States v. Virginia Electric & Power Co., 365 U.S. 624, 633 (1961). In the last case, the U.S. Supreme Court explicitly stated that the fair market value was "not an absolute standard."

78. See examples in 8 Whiteman, Digest of International Law 1152-55 (1967) (Supreme Court of Japan); Journal Officiel de la République Française, 17 January 1982, p. 299 (French Conseil d'Etat).

79. Case of James v. Others, European Court of Human Rights, Series A, No. 98, p.36.

80. See Case of Lithgrow and Others, id., No. 102.

81. See U.N. Commission on Transnational Corporations (UCTC), Report on the Special Session (7-18 March and 9-21 May 1983, para. 54. E/1983/17/Rev. 1, E/C.10/1983/S/5/Rev. 1. (emphasis added) The same formulae are repeated in the last version of the Code of Conduct published by the Commission in September 1986, UCTC, Current Studies Series A, No. 4, p. 40 (September 1986).

82. Id. at p. 54 (1986).

83. Id.

84. 1 The Valuation of Nationalized Property in International Law, Foreword, p. viii (Lillich ed. 1972).

85. An element of flexibility may be introduced by authorizing MIGA before such agreement or arrangement is reached to cover the investment at hand only against the war risk (assuming that such a risk is assessed on its own merit to be eligible for MIGA's cover) as this particular risk does not seem to be affected by the standards issue. Such a pragmatic approach may help MIGA in establishing a working relationship with the country concerned which improves the chances of negotiating reforms in the country's investment conditions thus serving the overall objective of MIGA and enhancing the prospects of its activities in such a country.

Ch.5

CHAPTER FIVE

MIGA AND THE SETTLEMENT OF DISPUTES

Introduction

The Multilateral Investment Guarantee Agency (MIGA) may become involved in five types of dispute as a party thereto. Furthermore, it will have a clear interest in a sixth type, even though it will not be a party to a dispute of that type. In all, six types of dispute should therefore be discussed in this chapter:

(1) Disputes between the Agency and a member regarding the interpretation or application of the MIGA Convention.

(2) Disputes concerning claims of the Agency against the government of a host country where the Agency acts as subrogee of an investor whom the Agency has paid or agreed to pay compensation under a contract of guarantee.

(3) Disputes between the Agency and a member, other than those disputes already mentioned in (1) and (2) above, as well as disputes between the Agency and a state which has ceased to be a member.

(4) Disputes between the Agency and a holder of a guarantee or reinsurance policy issued by it.

(5) Disputes between the Agency and other third parties based on contractual or tort liability.

(6) Disputes between a holder of the Agency's guarantee and the government of the host country.

The first three types of dispute are regulated in some detail in the Convention (Articles 56-57 and Annex II). The fourth type is to be settled according to a specified method, the details of which are to be determined through the contract of guarantee (Article 58). Settlement of the fifth type of dispute depends on the nature of the other party and may be subject to the jurisdiction of local courts (Article 44). As for the sixth type, the Agency is called upon to facilitate the settlement of disputes of this type (Article 23(b)(i)) which otherwise fall outside the scope of the Convention.

I. Disputes Regarding the Interpretation and Application of the Convention

The Convention follows the tradition of the Bretton Woods international financial institutions where any "question of interpretation" of the provisions of the constituent instrument --not necessarily a "dispute"-- either between a member and the institution or among members of the institution, is to be submitted to the Board of Directors for its decision (Article 56(a)). The Agency would act on the basis of the Board's decision but any member may require that the question be referred to the Council of Governors which would have the final say on such appeals (Article 56(b)).

Reference of questions of interpretation of the agreement establishing an international institution to the governing bodies of that institution, rather than to an international judicial or arbitral body, was first adopted in the Articles of Agreement of both the International Monetary Fund and the World Bank.1/ It has since been consistently followed in the conventions of most international financial institutions. The purpose of course is to ensure that such questions will be settled through a process internal to the institution which involves its policy-making organs, rather than through an

independent judicial process concerned only or mainly with the legal aspects of the matter. While this approach gives the Board of Directors considerable latitude in interpreting the Convention and in adapting its provisions to the changing conditions in which the Agency will operate, it does not endow it with an absolute power in this respect.2/ The Board's power of interpretation clearly involves a much wider discretion than that of a judicial authority. It cannot, nevertheless, be so wide as to ignore the explicit language of the interpreted text (unless such language leads in a certain situation to manifestly absurd results). Nor can it run counter to other provisions of the Convention or undermine the overall objective of the Agency. In other words, although the interpretation given by the Board could, and, given the long span of time over which the Agency will operate, should include such elements of ingenuity and creativity as may be required for the successful pursuit of the Agency's objective, it should not amount in fact to an amendment of the Convention. This latter process is entrusted to the Council of Governors acting by a very strict majority or, in the case of certain provisions, unanimously, as provided in Article 59 of the Convention.3/ Amending the Convention under the guise of interpreting it would evidently constitute an excessive exercise of the power of interpretation and therefore an abuse which cannot be authorized under the Convention. Similar provisions on the interpretation of the Articles of Agreement of the World Bank have been understood in this manner by the Bank's successive General Counsel.

Implied in the power of interpretation under Article 56 of the Convention is the power of the Board to determine whether a certain issue may be settled through interpretation or rather requires a filling of a gap in the Convention, either by amendment of the Convention or through the exercise by

the Board of other powers (such as its power to settle questions of application of the Convention (Article 56) or to do what is "necessary or desirable" to enable the Agency to function efficiently).4/ This preliminary compétence de la compétence is indeed inherent in the exercise of the power of interpretation and of the judicial function in general.5/

Theoretically, one may distinguish between, on the one hand, interpretation in the strict sense, i.e. clarifying the meaning of a given text, and, on the other hand, providing a solution for matters where the text is silent or has become devoid of any meaning and, therefore, incapable of interpretation. In judicial practice, the distinction between the filling of lacunae or legislative gaps and interpretation proper is not always maintained, however. Both are indeed part of the judicial function under which, following the principle that there cannot be a non liquet, a tribunal is prohibited from denying justice on the basis that the law is silent on the issue or that its provisions have become devoid of meaning. At any rate, Article 56 of the Convention entrusts the Board with the solution not only of any question of interpretation, but also of any question of application of the provisions of the Convention. The application of legal provisions no doubt involves both the understanding of the meaning of the text and the filling of such gaps as may not have been anticipated at the time of drafting the text. The possibility of the filling of gaps through the Board's power of deciding on questions of application of the Convention and its general incidental powers referred to above should enable the Agency to develop solutions to new problems without having to amend the Convention through the rigid requirements of Articles 59 and 60.

II. Disputes Resulting from Subrogation

Pursuant to Article 18(a) of the Convention, upon payment by the Agency of compensation to a holder of a guarantee or even its agreement to pay such compensation, the Agency becomes subrogated to "such rights or claims related to the guaranteed investment as the holder of a guarantee may have had against the host country and other obligors." The terms and conditions of this statutory subrogation are left to be determined in the contract of guarantee and have been dealt with in detail in the Agency's draft Operational Regulations.6/

Not every payment by the Agency would entail subrogation to a specific claim against the host government, however. As shown earlier, certain losses, resulting from a covered loss, may not entail an obligation on the host government to compensate the investor (e.g., losses associated with the war risk). Even when subrogation is established as a matter of right, the Agency may, as a business decision, not press its claim against the host country. According to the draft Operational Regulations, the President of the Agency should therefore decide in each case whether to seek recovery of payments from the host government. The Agency is also mandated to "make every effort" to reach a negotiated settlement before attempting any other method of conflict resolution.7/ Although, to ensure a speedy settlement, the Convention (Annex II, Article 2) deems negotiations to be exhausted if the parties fail to reach agreement within 120 days from the date of the request of either party to enter into negotiation, the draft Operational Regulations (the Regulations) (Section 4.22) provide that the Agency may thereafter "extend the negotiations over a reasonable period if it appears to the Agency that this would facilitate a settlement." Even if another method of conflict resolution is pursued later on, the Agency should be prepared throughout to resume negotiation.8/

Disputes between the Agency, acting as subrogee of a compensated investor, and the host government (or any of its agencies), which could not be solved through negotiation, would have to be solved through an independent mechanism. Whether this mechanism should be only the local courts of the host country and such other methods as may have been originally available to the investor concerned or, given the nature of the Agency as international organization, should be international arbitration, was one of the most controversial issues during the preparation of the MIGA Convention.

1. Drafting History

The March 8, 1985 draft Convention submitted to the World Bank's Executive Directors' Committee of the Whole provided in its Article 63 (the predecessor of present Article 57) that "any dispute between the Agency and a member ... concerning an investment guaranteed or reinsured by the Agency" --not only disputes involving the Agency as subrogee-- would be settled according to procedures detailed in an Annex to the Convention.

The Annex stipulated that it "shall be an integral part of this Convention and shall not be open to any reservation." It provided, however, that disputes within the scope of Article 63 would be settled in accordance with the procedures set out in it "unless the Agency, with the approval of the Board by special majority, and a member have agreed otherwise." The Annex itself envisaged settlement through negotiation and, should this prove to be impossible, through international conciliation if agreed by the parties and otherwise by international arbitration.9/ In the June 10-14, 1985 meetings of the Committee of the Whole, this text was strongly opposed by two groups, one asking for automatic and compulsory arbitration, and the other insisting on the adjudication of disputes before the national courts of the host

country and under their domestic law. At the end of these meetings, I attempted, as the Committee's Chairman, to forge a compromise by suggesting that upon the request of the host country, the Agency, when acting as subrogee of a compensated investor, should exhaust the local remedies which were available to the investor before resorting to international arbitration, and that an attempt at conciliation could be required as a precondition for international arbitration. I also suggested that the text of the Convention itself, and not only the Annex, could explicitly provide that the Agency and the host member might agree on alternative methods of conflict resolution. As a result, the "package" submitted to the Committee of the Whole on July 1, 1985 for discussion in its second round of meetings (July 18-19, 1985) included the following revised text of draft Article 63:

> "Without prejudice to the provisions of Article 62 and Article 1 of the Annex to this Convention, any dispute between the Agency and any member or any agency thereof concerning an investment guaranteed or reinsured pursuant to this Convention shall be settled in accordance with the procedure set out in the Annex to this Convention, except that in the cases where the Agency shall be subrogated to claims of a holder of a guarantee based on an investment contract between such holder and the host government, such government may require the Agency, before resorting to the procedure for settlement provided for in Article 4 of the Annex, to exhaust the remedies which were available to such holder under such investment contract to the extent that they shall be available to the Agency. This provision shall apply to any dispute between the Agency and a country (or agency thereof) which has ceased to be a member of the Agency whether or not the dispute concerns a guaranteed investment."10/

Likewise, Article 1(a) of the Annex was changed to read as follows:

> "All disputes within the scope of Article 63 of this Convention shall be settled in accordance with the procedures set out in this Annex, unless the member concerned requests the Agency to exhaust local remedies before resort to the arbitration procedure provided under Article 4, or enters with the Agency into an agreement on alternative methods of settlement. Such agreement shall be subject to the approval of the Board by special majority."11/

Following discussion of the above texts in the July 18-19, 1985 meetings, an alternative text proposed by the chair, after consultation with several participants, distinguished in two separate paragraphs disputes concerning claims of the Agency acting as subrogee of an investor from its other disputes with members (other than those relating to the interpretation and application of the Convention). Where the Agency acts as subrogee, this alternative text took a more conservative attitude than that underlying the original compromise proposal which was not acceptable to many participants. The new text had no reference to the exhaustion of remedies originally available to the investor, and it limited the possibility of departure from the procedures detailed in the Annex by an agreement to be reached between the Agency and the member "prior to the undertaking by the Agency of operations in the territories of the member concerned." It further provided that the Annex would still serve "as the basis for such an agreement." What became "Alternative 2" for Article 63 thus read as follows:

> "(a) Without prejudice to the provisions of Article 62 and of Section (b) of this Article, any dispute between the Agency and a member or an agency thereof and any dispute between the Agency and a country (or agency thereof) which has ceased to be a member, shall be settled in accordance with the procedure set out in the Annex to this Convention.
>
> "(b) Disputes concerning claims of the Agency acting as subrogee of an investor shall be settled in accordance with the procedure set out in the Annex to this Convention, except that the Agency and the member concerned may agree on an alternative method or methods for the settlement of such disputes. The Annex shall serve as the basis for such an agreement which shall, in each case, be approved by the Board, by special majority, prior to the undertaking by the Agency of operations in the territories of the member concerned."12/

Article 1(a) of the Annex was consequently revised under this alternative to read:

> "All disputes within the scope of Article 63 of this Convention shall be settled in accordance with the procedures set out in this Annex, except in the cases where the Agency has entered into an agreement with a member pursuant to Article 63."13/

Debate on the new alternative text yielded agreement in substance on its content except that the Annex would serve, under the agreed text, as "a basis" rather than "the basis" for the agreement which may be reached between the Agency and a member on alternative mechanisms for dispute settlement. The change, suggested by one participant, was welcomed by the Chairman as a drafting improvement as any alternative agreement "by definition, would be different from the Annex."14/ Two Executive Directors maintained their reservations, however, one on the basis that resort to local courts should be the course to follow unless the parties agree to pursue the procedures detailed in the Annex and the other, to allow for working with his objecting colleague on a unanimously agreed solution. The text survived discussions in further meetings, where it was renumbered, but continued to be the subject of a reservation of one Executive Director.15/

2. Rationale

The near unanimous acceptance of the text of Article 57 and Annex II of the Convention, and its acceptance even by Executive Directors representing Latin American countries known for their strong position on the jurisdiction of local courts under the Calvo doctrine,16/ was based on the following arguments:

(i) A dispute between MIGA and the host country of a guaranteed investment is a conflict between two international persons, both subjects of international law, unlike the typical case of a dispute between a

foreign investor and the host government to which both the traditional objection to international arbitration and the Calvo doctrine apply. Submission to international arbitration of disputes concerning financial transactions between an international financial institution and a member state is generally accepted in international practice and reflected in the loan agreements of the World Bank and similar institutions including the Inter-American Development Bank. The only existing multilateral investment insurance agency, the Inter-Arab Investment Guarantee Corporation, also follows the same practice in accordance with its convention which provides for the settlement of disputes with its members through international conciliation followed by arbitration.17/

(ii) As the private investor will not be a party to the arbitration proceedings between MIGA and the host government, the envisaged arbitration by no means contravenes the several inter-American instruments which refuse to give foreign private corporations direct access to international tribunals. Already no less than 28 executive agreements concluded by the US with Latin American and Caribbean countries recognize the subrogation of the US Overseas Private Investment Corporation (OPIC) to the rights of indemnified US investors and the right of the US Government to resort to international arbitration for settlement of questions of public international law "arising out of any project or activity for which coverage has been issued."

(iii) International arbitration as a method of settlement of MIGA's disputes with host countries is provided for only as the ultimate route to be followed in the unlikely event that a dispute cannot be resolved through negotiation. In the experience of other

international financial institutions, the latter mechanism (negotiation) has proved so far to be adequate for the settlement of all disputes and no resort to arbitration has taken place in spite of its availability. At any rate, settlement through conciliation is also available by mutual consent of the parties before resort to arbitration.

(iv) The host country and the Agency have the option, under Article 57(b), to agree on alternative methods of settlement of disputes. Through the exercise of this option, the two parties may enter into an agreement thereby adjusting the dispute settlement mechanism to the peculiar legal and political situation of such country. Similar arrangements were reached in agreements between host countries and the US OPIC.18/

3. Operational Issues

(i) Conciliation and Arbitration

Annex II of the Convention sets out the procedures to be followed in the settlement of disputes between the Agency and a member under Article 57. Once negotiations are exhausted to no avail, because after 120 days from the date of the request to enter into them, or after any extension period granted by the Agency under its Regulations, the dispute remained unsettled, either party will have the option to initiate arbitration proceedings. Such proceedings will not be initiated, however, if the parties reach agreement to resort first to conciliation. Although the latter procedure is not compulsory, the Agency is called upon, under its proposed Regulations, to respond favorably to any request by the host government to institute conciliation proceedings. If the agreement to resort to conciliation fails to

mention the name of the conciliator, such agreement would automatically terminate if the conciliator is not appointed within 90 days thereafter either by the parties' mutual consent or, upon their joint request, by the Secretary-General of the International Centre for Settlement of Investment Disputes (ICSID) or the President of the International Court of Justice (Article 3(b) of Annex II). Unless otherwise agreed by the parties, the conciliator maintains a great freedom of decision over the procedure. He shall be "guided" by ICSID's Conciliation Rules, but is under no obligation to follow them. He has 180 days to issue his report unless the parties agree to extend this period. The report will not include any decisions but merely recommend actions or proposals for the settlement of controversial issues which, though not binding on the parties, will receive "their most serious consideration" (Article 3(d)). Each party is then given 60 days from the date of the receipt of the report to express to the other party its views on it in writing. The conciliation procedure will not be terminated, and, therefore, resort to arbitration cannot be initiated except in the situations specified in the Annex (Article 3(g)), i.e., (i) if the conciliator fails to submit his report within the required period, (ii) if, 60 days after both parties have received the report, they fail to accept it, (iii) if, within the same time limit, the parties fail to agree otherwise on a settlement of all controversial issues, or (iv) if either party fails to express any views on the report in the specified 60-day period.

In case, after the "exhaustion of negotiations," the Agency and the member have not agreed to resort to conciliation or, in spite of their agreement to do so, have not succeeded in having a conciliator appointed within 90 days of such agreement or, in spite of their initiation of a conciliation proceeding, one of the four situations mentioned in

Article 3(g) of the Annex and described above takes place, either party will be free to initiate arbitration proceedings. The Annex specifies in some detail certain procedural and substantive aspects of these proceedings. More detailed arbitration procedures are left to be determined by the Tribunal which "shall be guided" by the ICSID Arbitration Rules unless the parties agree otherwise. Since ICSID's Rules assume that the dispute falls under the ICSID Convention, their application should take into consideration that this assumption does not hold in this instance. For example, chapters I (Establishment of the Tribunal) and VII (Interpretation, Revision and Annulment of the Award) of the ICSID Arbitration Rules will not be applicable.19/ If the jurisdiction of the tribunal to handle the case is disputed, the tribunal will have the power to decide on this preliminary issue unless the objection is based on the assertion by the respondent party that the matter falls within the jurisdiction of the Agency's Board or Council (questions of interpretation or application of the Convention) or within the jurisdiction of another judicial or arbitral body designated in an agreement reached between the Agency and a member under Article 57(b) of the Convention. In either of these two cases, the tribunal, after first ascertaining that the objection is not frivolous, will stay the proceeding, refer the jurisdictional issue to the body alleged to have competence over it and will abide by its decision in this regard (Article 4(f) of the Annex). The tribunal is authorized to determine the applicable rules of arbitration beyond those specified in the Convention, and, as a public international law tribunal, will not be subject in this respect to the law of the situs of arbitration or to the supervision of any local court.

The substantive law applicable by the tribunal is defined in Article 4(g) of the Annex in a manner which helped the drafters reach a

consensus but left some doubts as to its proper application. In the original March 8, 1985 draft, the tribunal was to apply (i) the provisions of the Convention, (ii) any relevant agreement between the parties, (iii) the Agency's by-laws and regulations, and (iv) "the general principles of international law." It could also decide a dispute ex aequo et bono if the two parties so agree but "without prejudice to the provisions of the Convention." In the discussion of that draft by the World Bank's Executive Directors, there was considerable argument on the extent to which the Agency could agree to a ruling ex aequo et bono20/ but no problem was raised as to the application of the first three sources enumerated above. Objections were raised, however, regarding the application and the meaning of the general principles of international law in this respect, and some participants insisted on the reference instead to the domestic law of the host country.21/ The problem was finally solved by analogy with the ICSID Convention which provides, in its Article 42(1), that in the absence of agreement by the parties on the applicable rules "the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable."22/ The final text of Article 4(g) of the Annex to the MIGA Convention thus listed as sources of the applicable law "the Convention," "any relevant agreement between the parties" and "the Agency's by-laws and regulations" before mentioning also "the applicable rules of international law, the domestic law of the member concerned as well as the applicable provisions of the investment contract, if any." While the provisions of the investment contract will apply to the extent that the Agency may have claims or duties under them in its capacity as subrogee or assignee of the investor, the issue is more problematic as to the manner in which "applicable rules of

international law" and "the domestic law of the member concerned" may be applied. Under the somewhat different language of Article 42(1) of the ICSID Convention different interpretations have emerged. Some have found that "the tribunal may apply both national and international law" and, specifically, "may apply international law (i) when national law calls for its application, (ii) where the subject matter is directly regulated by international law, and (iii) where national law or action taken thereunder violates international law."23/ Others have argued that international law will not merely complement applicable national law but will apply in all cases.24/ It might also be argued that both the text of Article 42(1) of the ICSID Convention, and its drafting history, call for priority to be given to the application of domestic law of the member concerned and that international law would play only a complementary role.25/ A balanced interpretation of that text was recently given by the ICSID Ad Hoc Committee which annulled the award in the Klockner v. Cameroon case. After emphasizing that reference to international law in the text of the ICSID Convention is limited to "such principles of international law as may be applicable," this Committee concluded that:

> "This gives these principles ... a dual role, that is, complementary (in the case of a "lacuna" in the law of the State), or corrective, should the State's law not conform on all points to the principles of international law. In both cases, the arbitrators may have recourse to the 'principles of international law' only after having inquired into and established the content of the law of the State party to the dispute ... and after having applied the relevant rules of the State's law."26/

It should be noted, however, that the text of Article 4(g) of Annex II to the MIGA Convention is different in its language and more so in its drafting history from that of Article 42(1) of the ICSID Convention. After

the original text of the former article (in the March 8, 1985 draft) was opposed by several participants in the June 1985 discussions, the Chairman submitted, in his July 1985 package of "Solutions for Remaining Issues," a new text which provided for the application, with other enumerated sources, of "the applicable rules of international law and, subject to the foregoing, the laws of the member concerned."27/ The underlined words were later dropped from the text upon the request of several participants with the Chairman's explanation that:

> "Once reference was made to 'applicable rules of international law and of the domestic law' it would be up to the Tribunal to decide which would prevail in case of conflict. It could be assumed that it would give preference to international law."28/

As agreed during the discussions29/ the Commentary on the Convention also makes it clear that "[i]n case of a conflict between rules of international law and rules unilaterally issued by either of the parties to the dispute, international tribunals apply rules of international law."30/

The controversy which preceded the agreement on the text of Article 4(g) of Annex II reflects a general disagreement between Western countries on the one hand and some developing and socialist countries on the other, and among international law scholars, on the applicability of international law to the underlying dispute between a foreign investor and the host government. Such disagreement is related to a broader difference of views over the substance of international law rules in this area. In particular, as seen in the preceding chapter, disagreements persist on whether there exists a universal rule which requires the payment of prompt, adequate and effective compensation in case of a taking by the host government of the property of a foreign investor.31/ Significantly, some partici-

pants in the discussion of the MIGA Convention insisted on mentioning in the text of said Article 4(g) "prompt, adequate and effective compensation for expropriated property" as a specific example of the applicable principles of international law.32/ They were persuaded to change their position, however, after other participants strongly objected to such an addition and after repeated interventions by the chairman to the effect that, in an arbitration between two subjects of international law, substantive rules of such law identified as such by the arbitral tribunal would be expected to prevail over conflicting domestic legislation. The fact that MIGA's substantive rights as subrogee cannot exceed those of the compensated investor could complicate matters if such rights were to be seen only in the light of domestic law, regardless of its consistency with international law standards. Clearly, the Convention was not the appropriate document for the settlement of the controversy over what standards, if any, international law establishes in this purpose.33/ The consensus reached on the text of Article 4(g) of Annex II was based, however, on the assurance that principles of international law, whatever their content on this matter may be, would normally prevail over conflicting rules of the law of the host country in an arbitration proceeding between the Agency and that country.

Other Methods

As mentioned earlier, Article 57(b) of the MIGA Convention authorizes, as an alternative to the procedures set out in Annex II, settlement of the claims of the Agency acting as subrogee of an investor in accordance with "an agreement to be entered into between the Agency and the member concerned on an alternative method or methods for the settlement of such disputes." The Article requires in this case that "Annex II of the Convention shall

serve as a basis for such an agreement which shall, in each case, be approved by the Board by special majority prior to the undertaking by the Agency of operations in the territories of the member concerned."

The above text calls for some clarification:

First, the requirement that Annex II of the Convention "shall serve as a basis" for the agreement on alternative methods would be completely paradoxical if it were to mean that such agreement should only provide for the same methods mentioned in the Annex. Rather, as I had the chance to explain in the Committee of the Whole which approved that text,34/ it can only mean that in negotiating such a bilateral agreement, the Agency and the member concerned should take Annex II as the starting point of their discussions, with a view to minimizing the points of departure from it. The Commentary on the Convention confirms this view by giving examples of other methods to be agreed upon by the parties, taking Annex II "as a basis":

> "To the extent that such arrangements are satisfactory to the Agency, the agreement could, for example, provide that the Agency first seek remedies available to it under the domestic laws of the host country and seek recourse to arbitration only if it has not obtained relief under such remedies within a specified period of time. ... The agreement may also provide for alternative methods to arbitration such as seeking an advisory opinion from the International Court of Justice."35/

Second, the agreement reached between the Agency and a member under Article 57(b) will be subject to the general requirement of Article 23(b)(ii) that any agreement between the Agency and a prospective host country "will assure that the Agency, with respect to investment guaranteed by it, has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or state in an agreement relating to investment." Thus, as explicitly mentioned in the Commentary on the Convention,36/ a member which has accepted resort to

arbitration as the method for the settlement of claims of a national investment guarantee agency acting as subrogee of an investor, or of the state of the investor, should not object to the extension of the same treatment to the Agency.

Third, the requirement that agreement on alternative methods of the settlement of disputes be reached "prior to the undertaking by the Agency of operations in the territories of the member concerned," should not be literally read as a requirement that such agreement must be reached before any operation is undertaken by the Agency in the territories of that member. It should not in other words prohibit the Agency from entering into such an agreement after it has undertaken in the country concerned certain guarantee operations to which Annex II would be applicable. The Convention's requirement is simply meant to ensure that the method of the settlement of potential disputes should be clearly established before any particular operation is undertaken. If a member has a problem as to the applicability of the methods mentioned in Annex II to disputes arising under an operation of the Agency, it should raise the matter and such operation will not be undertaken before this issue is settled. The member will either accept the application of the Annex or will reach agreement with the Agency on an alternative method or methods. Such an agreement could thus take place after the Agency had already made one or more guarantee operations for investments in the territory of that member to which absent agreement on an alternative method, only the annex would be applicable.

III. Other Disputes with Members and Disputes with States which have Ceased to be Members

Article 57(a) of the Convention explicitly provides that disputes between the Agency and a member state which do not fall under Article 56

(concerning interpretation and application of the Convention) or Article 57(b) (concerning claims of the Agency as subrogee to the claims of an investor) "shall be settled in accordance with the procedure set out in Annex II to this Convention," i.e., through negotiation, conciliation or arbitration as described above. No alternative method is envisaged in this respect under an agreement to be bilaterally concluded between the Agency and the member concerned. As the parties to the dispute in such cases are both international persons and the potential claims of the Agency would not be based on or derived from the rights of an individual investor, settlement through international arbitration would be the normal course if negotiations fail. This aspect of the MIGA Convention was not controversial and the occasion for disputes between the Agency and a member other than those envisaged under Article 56 and Article 57(b) may rarely arise in any case.

All disputes between the Agency and a state which has ceased to be a member will also be settled according to the procedure set out in Annex II. This applies to disputes concerning the interpretation or application of the Convention which, if left in this case also to the governing bodies of the Agency, would make the Agency a judge of its own case with a third party. Resort to arbitration for the settlement of such disputes is a standard mechanism under the Articles of Agreement of the World Bank and similar institutions.

The option provided in Article 57(b) for settlement of disputes through alternative methods bilaterally agreed upon does not apply to disputes between the Agency and a former member when the Agency's claims are based on subrogation to an investor's rights against that country. Since, as already explained, the agreement on such alternative methods can only be concluded before the Agency issues its guarantee of the investment concerned, no such

agreement can be made with a state which is no longer a member. However, if an agreement of this type had been concluded with a state while it was still a member, the cessation of membership would have no effect on that agreement which could still be invoked for the settlement of disputes concerning the investments to which it applied.

IV. Disputes Arising Under a Guarantee (or Reinsurance) Contract

Article 58 of the Convention provides that:

> "Any dispute arising under a contract of guarantee or reinsurance between the parties thereto shall be submitted to arbitration for final determination in accordance with such rules as shall be provided for or referred to in the contract of guarantee or reinsurance."

While this provision establishes arbitration as the method of settlement of this type of dispute, it leaves it to the contract between the Agency and the holder of its guarantee or reinsurance to either provide for or refer to the rules to be applied to such arbitration. The proposed Operational Regulations provide some details on how the matter should be handled in such contracts.

Arbitration Proceedings

According to Section 2.16 of the draft Regulations, the "standard contract of guarantee" will refer to the ICSID Institution and Arbitration Rules except that the Secretary-General of the Permanent Court of Arbitration (PCA) would, instead of the Chairman of ICSID's Administrative Council, be the appointing authority of the arbitrator or arbitrators not otherwise appointed pursuant to the Rules. This particular exception is well justified as the Chairman of ICSID's Council, being also the Chairman of MIGA's

Board of Directors, should not be involved in the administration of the arbitration proceedings. In addition, the draft Regulations do not limit the Secretary-General of the PCA in his choice of members of a specific arbitral tribunal to the names on ICSID's Panel of Arbitrators. They are also careful to state that the application of ICSID Rules would only be referred to in the standard contract and not necessarily in every contract of guarantee. An actual contract would naturally refer to the rules agreed upon between the Agency and the other contracting party which may not accept the application of ICSID Rules without further amendments, or at all. The proposed Regulations also provide for the possibility of including in the contract such modifications of the ICSID Rules "as may be required." They do not mention, however, the possibility of agreeing on another set of rules, such as ad hoc rules to be provided in the contract, or other established rules of arbitration like the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) or of the International Chamber of Commerce (ICC). Such a possibility was envisaged, however, at the time of drafting the Convention and is mentioned in the Commentary.37/

ICSID Rules were suggested in the draft Regulations because of the familiarity of the World Bank staff with these self-contained rules which allow for the initiation and completion of the arbitral process independently of any national law and without need for the formulation or intervention of any other rules. However, ICSID Rules are the rules of an international arbitration system, not subject to judicial supervision by national courts.38/ Such independence cannot be maintained for arbitration proceedings which fall outside the scope of a treaty such as the ICSID Convention, even when conducted under the ICSID Rules.39/ Awards rendered pursuant to such proceedings are obviously not ICSID awards and thus cannot

benefit from the provisions of the ICSID Convention (Articles 53 and 54) regarding the finality and recognition of such awards. It may be argued, however that, given the international character of the Agency and of its guarantee contracts, there is a case for the independence of arbitration under such contracts at least up to the time of the rendering of an award.40/ This argument may be further substantiated by the fact that arbitration in this case is not an option left to the discretion of the parties. It is required under Article 58 of the Convention, which, as applied by the authorized organ of MIGA, requires the application of ICSID Rules. The disputes in question may also involve either private investors or public entities41/ and this difference in the identity of the investor should have no bearing on the nature of the applicable procedural rules. The view that an arbitration must necessarily be subject to a specific system of domestic law, may readily be advanced in the sphere of private arbitrations.42/ It should not apply, however, under this argument in the context of MIGA's contracts of guarantee or reinsurance, where at least one of the parties will be a subject of public international law and where the arbitral settlement of such disputes is required by an international convention and prescribed and regulated by rules adopted pursuant to it.43/

In practice, the independence of the proceedings should present no difficulties in the countries which recognize party autonomy in the choice of applicable rules including the freedom of the parties to opt out of the application of local procedural law.44/ However, as courts in other countries may, if the issue came before them, feel bound to apply rules of their domestic law which conflict with the ICSID Rules made applicable by the parties' agreement,45/ the above mentioned argument notwithstanding, and as arbitrators sitting in such countries might feel the same,46/ the Agency

is best advised to specify the situs of arbitration in the guarantee contract so that it may take place only in a country which definitely recognizes party autonomy under the so-called "denationalized" arbitration.47/ Reference in the contracts of guarantee to ICSID Rules cannot, however, by itself eliminate the supervisory role of national courts over the awards to be issued. In spite of the attraction of the argument elaborated above, such courts are expected to apply the principle codified in the UNCITRAL Rules which provide that where the Rules conflict with a provision of the [domestic] law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail.48/

Anticipating that ICSID Rules cannot be fully applied in an arbitration proceeding between MIGA and a holder of its guarantee, Section 2.16 of the draft Regulations envisages that the application of the ICSID Arbitration Rules would be subject to modifications. In fact, ICSID does have a set of Arbitration Rules specifically designed to apply to arbitration proceedings which do not relate to investment disputes and which are not based on the ICSID Convention. These are ICSID's Additional Facility Arbitration Rules.49/ Such Rules may thus readily present themselves as the most appropriate "modified ICSID Rules" for the purposes of MIGA's contracts. The application of these Rules, which is subject to the mandatory provisions of the domestic law applicable to the arbitration,50/ will only be subject to a few exceptions. References to ICSID's Chairman of the Administrative Council or to its Secretary-General should be read as reference to the PCA's Secretary-General, and the applicable law would be that required by MIGA's Regulations and contract not that provided for in Article 55 of the Additional Facility Rules. With such adaptations, the Arbitration (Additional Facility) Rules of ICSID could be referred to in MIGA's Standard

Contract of guarantee as the applicable contractual rules of arbitration.51/ Should the Secretary-General of the Permanent Court of Arbitration decline to assume the roles attributed to ICSID's Chairman and Secretary General under the Additional Facility Rules, the same Rules could still be integrated in the Standard Contract after adapting them to apply to an ad hoc, rather than administered arbitration.

Applicable Law

The draft Regulations (Section 2.17) also provide, in the context of the arbitration of disputes between the Agency and a holder of its guarantee, for the applicable substantive law. According to this Section, the tribunal "shall apply the contract of guarantee, the Convention and, to the extent that issues in dispute are not covered by the contract or the Convention, general principles of law". To be applied, this provision has, of course, to be reflected in the contract of guarantee. Assuming this to be the case, a number of questions need further clarification:

First, can the parties, through their agreement that the contract, the Convention and general principles of law constitute the "applicable law", exclude the application of national law, such as the substantive law of the investor's home country, including its mandatory rules? It is clear that the intention of the parties would be to subject their relationship to a special legal regime and to exclude the application of domestic laws where little or no nexus exists with the subject matter of the dispute.52/

In fact, the mere reference in other contexts, to the "general principles" as the subsidiary source of law applicable to disputes arising under a given contract has been seen by some writers as an expression of the specific intent "to avoid the application of any particular municipal law."53/

Other writers have further suggested that such a reference should be deemed to imply submission of the relationship to international law,54/ a position which was also taken in at least one arbitral award.55/ Some writers56/ and arbitrators57/ have also expressed the view that the "general principles" constitute an independent source of law distinguishable from international law. While these views differ as to whether the "general principles" clause has the effect of "internationalizing" the relationship or merely "delocalizing" it, they do agree on the exclusion, as a result, of the application of any specific domestic law, to the contractual relationship concerned.

Such exclusion is not uncommon in transnational contracts concluded by international persons.58/ It has been provided for in the General Conditions Applicable to the World Bank loan agreements including those made with private borrowers.59/ It is also implied in the 1979 Resolution of the Institut de Droit International concerning the law applicable to agreements between a state and a foreign private person.60/ The issue of whether the contract of guarantee could in certain cases be made subject to a specific domestic law (e.g., the law of the investor's country) was raised during the discussion of Section 2.17 of the draft Regulations in the Preparatory Committee which recommended them. It was agreed, however, that the Agency's contract of guarantee should not in any case be regarded as a domestic law contract. This is a transnational contract. One party to it (the Agency) is an international person which enters into the contract in pursuit of an international public purpose. The provision on applicable law in the contract will merely reflect the provision of the Agency's Regulations which are adopted by the organ of the Agency authorized to apply and interpret the Convention. The contract is to be concluded only after approval by the host country of the operation61/ and could result in a direct relationship,

through subrogation, between two international persons, the Agency and the host country.62/ In fact, the guarantee contract may be concluded ab initio between two international persons when the other party to the contract is itself a state or another international person acting as the investor.63/ In all cases, there is no "significant relationship" or "real connection" between this contract and any given domestic law.64/ On the contrary, the contract's most significant relationship is rooted in a network of international interests and is much closer to the sphere of international law.

It should be recalled in this respect, however, that international financial institutions which deal normally with private investors, such as the International Finance Corporation, have not attempted to insulate their dealings with their borrowers, creditors or partners from the sphere of domestic law. Their agreements with private parties either leave open the matter of applicable law and jurisdiction over settlement of disputes or state that there will be recourse to the courts of a given country with the assumption that such courts would apply their domestic law.65/ There is of course a difference between these institutions and MIGA as far as this issue is concerned. Under the Articles of Agreement of such institutions there is no requirement to settle disputes with private parties through arbitration, as is stipulated in Article 58 of the MIGA Convention. Where arbitration is agreed upon as the method of settlement (as e.g. in the context of the loan agreements concluded by the World Bank and regional development banks with their respective borrowers, including private borrowers) it has been provided not only that such arbitration would be independent from the law of the situs, but also that the relationship would not be subject to any domestic law.66/

<u>Second</u>, what would happen in case of an alleged conflict between the provisions of the MIGA Convention and those of the contract of guarantee, given the requirement that the arbitral tribunal should apply both? Section 2.02 of the draft Regulations provides that:

> "Contracts of guarantee shall be presumed to be consistent with the Convention and these regulations. Contracts of guarantee shall provide that such presumption shall not be challenged by either party thereto."

While this provision should minimize the possibilities for considering this issue, an arbitral tribunal may itself find an inconsistency between the two instruments, the above presumption notwithstanding. In such a case, it is my view that priority should be given by the tribunal to the provisions of the contract. The Agency should not use its own constituent instrument as an excuse for the violation of its contractual obligations with a third party. A similar conclusion is reached in the 1986 Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations which codifies the principle that an international agency may not invoke its own rules, including the provisions of its constituent instrument, as justification for its failure to perform a treaty to which it is a party.<u>67</u>/

<u>Third</u>, what are the "general principles of law" which the arbitral tribunal is called upon to apply in the absence of a governing clause in the contract or the Convention? Naturally, the tribunal would have in such instances to undertake the task of ascertaining the substance of such general principles, using comparative law analysis.<u>68</u>/ While this will not be confined to the laws regulating investment guarantees, applicable principles will normally be deduced from the rules pertaining to this particular business<u>69</u>/ which may be ascertained through an analysis of

relevant domestic law, the practice of national agencies, the Inter-Arab Investment Guarantee Corporation and private insurers as well as such arbitral and judicial decisions as may be available. The disparity of principles applicable to investment guarantee contracts under different jurisdictions, and the dearth of judicial and arbitral precedents in the area of political risk insurance may make this task particularly difficult. In practice, the application of "general principles of law" would give the tribunals the opportunity to exercise judicial discretion when such principles are not readily discernible. The required latitude in this respect is, in fact, not uncommon in the application of general principles of law whenever these are recognized as a subsidiary source of applicable law. As already mentioned, some recent international arbitral awards have applied general principles of law in the absence of an explicit reference to them in the relevant legal documents and at times despite explicit reference to other sources, such as a given domestic law, in such documents.

The need for the arbitral tribunal to resort to general principles of law is not likely to arise at any rate except in rare circumstances. The details provided in the Convention, the Regulations, and the contract of guarantee should normally include the basis according to which controversial issues may be settled. In the unlikely event that practice proves this not to be the case and the application of general principles of law prove to be particularly difficult in this regard, the Agency can always amend its Regulations to provide for the application of a particular domestic legal system instead.

V. Disputes between the Agency and Third Parties other than Those Already Mentioned

Article 44 of the Convention provides that:

"Actions other than those within the scope of Articles 57 and 58 may be brought against the Agency only in a court of competent jurisdiction in the territories of a member in which the Agency has an office or has appointed an agent for the purpose of accepting service or notice of process. No such action against the Agency shall be brought (i) by members or persons acting for or deriving claims from members or (ii) in respect of personnel matters. The property and assets of the Agency shall, wherever located and by whomsoever hold, be immune from all forms of seizure, attachment or execution before the delivery of the final judgment or award against the Agency."

Following the example of the Articles of Agreement of the World Bank and other international financial institutions,70/ this article does not endow the Agency with immunity from legal process before domestic courts. Such immunity is otherwise a characteristic feature of other international organizations, so much so that many authors71/ considered it a rule of customary international law.72/ In the case of the World Bank (and the institutions which followed its pattern), immunity was discarded in order to facilitate borrowing by the Bank from the market, as it was thought that prospective investors in its securities might otherwise be discouraged.73/ Indeed, the constituent agreements of the African, Asian and Caribbean Development Banks expressly limit those institutions' amenability to suit to cases where this would be necessary to protect the investors involved.74/ However, the provision allowing suits against the Bank is general in its terms and extends the Bank's amenability to suit to any cause of action with the exclusion only of suits brought by Bank members, or on their behalf, or based on claims derived from members. In the case of the Bank, no attempt has been made so far to restrict the application of such provision to suits brought by creditors who loan money to the Bank or benefit from its guarantees. Such attempt might find some support, however, in the drafting history of the text and would bring it closer to the relevant provisions of the Articles of the African, Asian and Caribbean Development Banks (which

were drafted restrictively to avoid the broad implications of the Bank's Articles). It could also be based on the argument that, as an international organization, the Bank has a general immunity under international custom and provisions which derogate from such immunity should be interpreted strictly. Regardless of the merits of this argument (which was refuted by a U.S. court in the context of a similar provision in the Agreement Establishing the Inter-American Development Bank),75/ it cannot be made with respect to Article 44 of the MIGA Convention. The Agency's disputes with the investors benefitting from its guarantee are not in fact governed by this Article and, as already seen, are to be settled through arbitration, as provided in Article 58 of the Convention. Article 44 covers, therefore, such legal actions as may be brought against the Agency, which are not based on the contracts of guarantee or reinsurance. Such actions would presumably be brought by creditors other than guaranteed investors, on the basis of contractual or tort liability.

Article 44 explicitly excludes from its scope of application not only the disputes which fall under Article 58, but also those which fall under Article 57 (disputes with members regarding interpretation or application of the Convention) and, for the same reason, actions by persons acting for or deriving claims from members. In addition, the Article codifies a general rule regarding the immunity of international organizations, including those with a general amenability to suit, from legal process before domestic courts in respect of suits brought by their personnel. This principle has been recently upheld by US courts in cases brought against the World Bank.76/ Although the latter has not otherwise claimed that its amenability to suit should be applied strictly, it has consistently taken the position, in suits brought against it by its employees, that national courts have no

jurisdiction over such disputes. It should be noted, in this respect, that in 1980 the Bank established an Administrative Tribunal to consider such disputes. The Agency is expected to enter into an agreement with the World Bank under which the jurisdiction of this Tribunal would be extended to disputes between the Agency and its staff.77/

The amenability of the Agency to suits brought by its creditors before domestic courts does not, of course, preclude it from agreeing with such creditors on other methods of settlement such as arbitration. In fact, the Agency might find it more practical to include an arbitration clause in its contracts with third parties to avoid appearance before different domestic courts.

VI. Disputes Between a Holder of the Agency's Guarantee and a Host Government

Disputes which arise between an investor enjoying the guarantee of the Agency and the government of his host country are to be resolved in the manner provided for in the agreement between these two parties. In the absence of agreement on this matter, these disputes would presumably be settled according to the domestic law of the host country, subject to such safeguards as may be established by treaty or customary international law. The general method for the settlement of such disputes is adjudication before domestic courts. These would normally be the courts of the host country concerned. However, courts of other countries may also have jurisdiction under their respective national laws (e.g., because a certain asset of the host country, which the investor seeks to seize, is in the territory of another country). The investment contract may require the investor to settle disputes with the host government only through recourse to the local

courts of that country under the so-called Calvo Clause.78/ It may also refer such disputes to the domestic courts of a certain foreign jurisdiction, like the courts of London or New York, as is common in international banking transactions and international bond issues.79/ Frequently, however, investment contracts stipulate that disputes between the investor and the host government would be settled by arbitration. The same method is often referred to in bilateral investment treaties80/ or in the investment laws of host countries.81/ While they may allow only domestic arbitration in the host country or under a certain foreign jurisdiction, such clauses increasingly refer to international arbitration, under an institutional arbitration system, which, in the case of investment treaties, is typically that of ICSID. They may also simply refer to a set of international arbitration rules such as that of UNCITRAL. In spite of the frequent reference to international arbitration in important investment contracts, the complexities and cost of such arbitration have limited the cases of actual resort to it. In fact, an international arbitration clause often works as a deterrent against the behavior which leads to actual recourse to arbitration, or as an incentive to reach an amicable settlement.

Whatever the method of settlement of disputes between an insured investor and his host government, it is obvious that the Agency is not a party to that dispute. It has, however, a clear interest in the outcome of such dispute. In fact, its self-interest requires that events which lead to losses resulting in claims by investors against it be minimized. For these reasons, the Agency must play a role in the avoidance of disputes between insured investors and their host governments. When such disputes become inevitable, the Agency should be equally interested in their amicable settlement.

The Agency's Contribution to Avoidance of Investment Disputes

The Agency's interest in avoiding conflicts with its developing member countries is self-evident. Such interest should lead it to work for the avoidance of disputes between these countries and the investors covered by its guarantee. After all, it is these disputes which eventually give rise to investors' claims against the Agency.

The seeds of an investment conflict are often to be found in the terms and conditions of such an investment. If the terms of the investment turn out to be unfair to either party or if they lack the flexibility to be smoothly adjusted to changing circumstances, a party, especially a host government, might later feel tempted to remedy the arrangement by unilateral action. Also, if a project runs into financial or technical difficulties, a host government might interfere in order to protect its interests or those of its nationals. In addition, the absence of applicable standards or the application of ambiguous rules often lead to the initiation or aggravation of investment disputes. MIGA will therefore carefully screen every investment project to make sure it is economically sound, will contribute to the development of the host country and is consistent with its laws and development objectives.82/ It will deny coverage when it finds deficiencies in the investment arrangement. It is furthermore encouraged to enter into agreements with member countries on the standards applicable to the investments guaranteed by it and is in fact prohibited from initiating guarantee operations in a country if it is not satisfied as to the availability of fair and equitable treatment and legal protection for the investment.83/ A final safeguard against conflicts with respect to guaranteed investments is the MIGA Convention's requirement regarding host government approval for both the issuance of MIGA's guarantee and the risks designated for cover.84/

The Agency's Role in the Amicable Settlement of Disputes

The Agency is mandated, under Article 23(b) of its Convention, to facilitate the amicable settlement of investment disputes whether or not they are related to investments guaranteed by it. This general role befits MIGA's mission as an instrument for the building up of confidence between the foreign investors and host countries. Prolonged investment disputes have historically had a very negative impact on the investment climate. The sooner such disputes are resolved, the better the effects on the general investment conditions in the country concerned, all the more so if the settlement is amicable.

The Agency will also serve its best self-interest when it persuades host governments and investors covered by its guarantee to settle their differences amicably. It can always offer its good offices to enable the parties to reach agreement. Eventually, the Agency's accumulated experience, and the broad information available to it through its varied activities should enable it to better assess and moderate the conflicting claims of the two parties. Its objectivity and the interest of both parties in maintaining a good and continued working relationship with it should also add credibility to its advice and increase the likelihood of the success of its mediating efforts.

Another way in which MIGA may induce host governments and investors to arrive at amicable settlements is the alleviation of the financial burden of such settlements on the governments. For example, MIGA might accept the local currency of the host country on a temporary basis and pay the investor out of its own funds in freely usable currency. MIGA might then, under an agreement with the host country, sell the local currency to other international institutions, to companies importing goods from the host country or

to the host government itself over a period of time and recover its position accordingly.85/ MIGA might also finance the settlement by paying the investor in cash and accepting debt instruments from the government as recoupment. As a variant of this approach, MIGA could persuade the investor to accept installments rather than insisting on a cash payment by backing the government's commitments with its guarantee. Finally, where the views of the investor and the host government with respect to an adequate compensation for a covered loss cannot be completely reconciled, MIGA might in exceptional cases pay all or part of the difference and in this way facilitate a settlement. In view of its developmental mandate and institutional interests, MIGA can be expected to use its potential for the facilitation of amicable settlements at least as actively as some of the national agencies, especially the U.S. Overseas Private Investment Corporation (OPIC), have successfully done.86/

Conclusion

The MIGA Convention clearly indicates the method of settlement of every type of dispute to which the Agency may become a party. Disputes with members over the interpretation or application of the Convention's provisions will be settled by the Agency's Board subject to possible appeal by the member concerned to the Agency's Council of Governors. Other disputes between the Agency and its members and all its disputes with a state which has ceased to be a member will be settled according to the procedures detailed in Annex II of the Convention which envisages negotiations, possibly conciliation and, failing a solution of the dispute, compulsory arbitration. Disputes between the Agency and a holder of its guarantee or a beneficiary of its reinsurance will be settled by arbitration which is

suggested to be conducted in accordance with modified ICSID Arbitration Rules unless the parties agree otherwise. When the Agency is subrogated to an investor and becomes as a result party to disputes with the host country, such disputes will be settled according to the procedures mentioned in Annex II of the Convention unless an alternative method has been agreed upon beforehand between the Agency and that country. Creditors other than members of the Agency, guaranteed investors and claimants deriving their claims from members may still sue the Agency before domestic courts which have jurisdiction pursuant to their respective laws or by virtue of explicit provisions in an agreement with the Agency. Such agreements may of course specify other methods such as arbitration.

In addition to the various types of disputes to which the Agency may become a party, disputes between holders of the Agency's guarantee and their host countries are of such importance to the Agency that the Convention directs it to play a role in their avoidance and resolution. Furthermore, the Agency, in pursuance of its general mandate to improve investment conditions, is called upon to assist in the amicable settlement of investment disputes, even when they are unrelated to any specific guarantee issued by it.

NOTES TO CHAPTER FIVE

1. See Broches, International Legal Aspects of the Operations of the World Bank, 98 Recueil des Cours 297, 312-3 (1959), where he states that this innovation "may have been influenced by the uncertainty which existed in 1944 as to the position of the Permanent Court of International Justice" but agrees that the main consideration was that the development of these new institutions "could best be furthered by leaving their interpretation to the membership, as represented by the high technical and policy-making officials serving as Executive Directors and Governors." Id. at 313.

2. Accord, Broches, id.

3. While interpretation can be made by a simple majority of the votes cast in the Board, Article 59(a) requires a vote of three-fifths of the governors exercising four-fifths of the total voting power for the amendment of the Convention. Amendments modifying the right of a member to withdraw or the limitation on its liability require the affirmative vote of all members, while any amendment modifying the loss-sharing arrangement under sponsored investments which involves an increase in a member's liability requires the approval of the governor of each such member. Amendment of Schedules A (Membership and Subscription) and B (Election of Directors) requires approval by the special majority of not less than two-thirds of the total voting power representing at least 55 percent of subscribed capital. Pursuant to Article 60, any amendment should be first recommended by the Board of Directors (by the simple majority of the votes cast).

4. Cf. Article 2(c) of the Convention.

5. For a treatment of this preliminary power in international arbitration and adjudication, see I. Shihata, The Power of the International Court to Determine its Own Jurisdiction - Compétence de la Compétence (1965).

6. See chapter 4, Sections III and IV of the draft Operational Regulations dated September 19, 1986 (prepared by the Staff of the World Bank for submission to MIGA Preparatory Committee), at ch. 4. ss. III and IV. See also Chapter Four supra at _______.

7. Article 2 of Annex II of the Convention and Draft Operational Regulations, supra note 6 at ss. 4.20 and 4.22. According to Section 4.20 of these Regulations "settlements involving a write-off of more than $1 million shall require the approval of the Board."

8. Draft Operational Regulations, supra note 6, at sec. 4.24.

9. See text of Article 3 of the Annex to the March 8, 1985 draft Convention in Appendix _____, infra. The earlier proposal, submitted to the Bank's Executive Directors in May 1984 in the "Main Features of a Proposed Multilateral Investment Guarantee Agency" paper, envisaged

conciliation as a necessary intermediate procedure between negotiation and arbitration. See Chapter Two, supra at ________.

10. I.B.R.D., 3 Meetings of the Committee of the Whole of the Executive Directors of the International Bank for Reconstruction and Development, held June 10-14, July 18-19, August 6-7 and September 5, 1985, at 313 (1985) (hereinafter referred to as COW Records). The qualification in the above quoted text of the available remedies was meant to exclude remedies which might be available to an investor but not to an international agency subrogated to his rights, such as resort to ICSID arbitration.

11. Id. at 320.

12. 4 COW Records, supra note 10 at 357.

13. Id.

14. 2 COW Records, supra note 10 at 369.

15. Id. This reservation was the only one reflected in the report of the Executive Directors to the Board of Governors on the text of the Convention.

16. For details of this doctrine and the arguments in favor of the solution adopted in the Convention, see Shihata, Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA, 1 ICSID Review - Foreign Investment Law Journal 1, 1-3 and 19-25 (1986).

17. See Article 35(1) and Annex to the Convention Establishing the Inter-Arab Investment Guarantee Corporation. See also Shihata, Arab Investment Guarantee Corporation - A Regional Investment Insurance Project, 6 J. World Trade L. 185 (1972).

18. Differing in detail, some of these agreements provide for the prior exhaustion of local remedies and confine international arbitration to "questions of public international law." Under Article 23(b)(ii) of the MIGA Convention, the Agency should be able to receive through its bilateral agreements a treatment "at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency."

19. These matters are regulated differently in Annex II to the MIGA Convention. Compare Article 4(a), (b), (c) and (h) of this Annex with ICSID Institution Rules and Arbitration Rules (Rules 2-5 and Rules 50-55) reprinted in ICSID, ICSID Basic Documents 57-60, 66-8, 85-89, Doc. ICSID/15 (Jan. 1985). Under Article 4(h) of the Annex, the award "shall not be subject to appeal, annulment or revision."

20. Some participants requested that the Agency should not agree to authorize a ruling on this basis except by decision of its Board acting by special majority. See, 1 COW Records, supra note 10, at 213-6.

21. See id. at 211, 269-271.

22. See text in ICSID Basic Documents, supra note 19, at 11, 22. The Preliminary Draft of the [ICSID] Convention originally included a provision to the effect that, in the absence of agreement on applicable law or on the tribunal's power to decide ex aequo et bono "the Tribunal shall decide the dispute submitted to it in accordance with such rules of law, whether national or international, as it shall determine to be applicable." Questions related to the Tribunal's application of international law and objections to its freedom to determine the applicable domestic law led eventually to agreement on the present text. See Broches, The Convention on the Settlement of Investment Disputes between States and Nationals of Other States: Applicable Law and Default Procedure, Liber Amicorum for Martin Domke 12, 13-17 (1967).

23. Broches, supra note 22 at 17. See also Lew, Applicable Law in International Commercial Arbitration 349 (1978).

24. See Lauterpacht, "The World Bank Convention on the Settlement of International Investment Disputes" in Recueil d'Etudes de Droit International en Hommage À Paul Guggenheim 642, 660-1 (1968).

25. See supra note 22. See also, e.g., ICSID, 2 Convention on the Settlement of Investment Disputes between States and Nationals of Other States - Documents Concerning the Origin and the Formulation of the Convention 800-804 (1968).

26. Klöckner v. Cameroon, Decision of the Ad Hoc Committee, published in an English translation in 1 ICSID Rev. - Foreign Investment Law Journal 89, 112 (1986). See also El-Kosheri and Riad, The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process, 1 ICSID Review - Foreign Investment Law Journal 257 (1986).

27. 3 COW Records, supra note 10, at 321 (Emphasis added).

28. Id., Vol II, p. 319, para. 151.

29. Id. at 321, para. 160.

30. See Commentary, para. 78.

31. See Chapter Six, supra, pp ____

32. See, COW Records, Vol. I pp. 212, 218-220, Vol. II, p. 319.

33. See details in Chapter Six, supra.

34. See, COW Records, Vol. II, pp. 311, 312, 316.

35. See Commentary, para. 76(c). Invoking the advisory jurisdiction of the ICJ has its limitations, however, and may not be a realistic alternative for this purpose.

36. Ibid.

37. See Commentary, para. 77.

38. See Article 26 of the ICSID Convention. See also, Delaume, "ICSID Arbitration and the Courts", 77 AJIL 784 (1983).

39. An example is found in clauses stipulated in a number of loan documents concerning borrowings made on the Euro-market by Brazilian public entities, with the guarantee of Brazil. These clauses incorporate by reference provisions of the ICSID Convention and provide that the Secretary-General will act as designating authority. The full text of this type of clauses appears in Delaume, "ICSID Arbitration: Practical Considerations", 1 J. Int. Arb. 101 (1984), at p. 121, note 72. It should be noted that the typical clause provides that:

> "The decision of [the] arbitral tribunal shall be final to the fullest extent permitted by law and a court judgment may be entered thereon."

which shows clearly that the parties are conscious of the fact that an award rendered in a dispute between them would not benefit from the unique treatment of ICSID awards and that its finality and recognition would be governed by domestic law.

40. Cf. the similar argument presented with respect to the Iran-United States Claims Tribunal in Lake and Dana, "Judicial Review of Awards of the Iran-United States Claims Tribunal: Are the Tribunal's Awards Dutch?" 16 L. and Pol'y in Int'l Bus. 755 (1984). The question here is basically whether the arbitration rules agreed upon by the parties in a contract removed from domestic law can be considered as contractually "internationalized."

41. See Article 13(a)(ii) of the Convention.

42. See, e.g., Mann, "Lex Facit Arbitrum," in International Commercial Arbitration, Liber Amicorum for Martin Domke 157 (P. Sanders ed. 1967).

43. See, e.g., A.J. van den Berg, The New York Convention of 1958 at 33-34 (1981) who suggests that while the legal status of "denationalized arbitrations" is uncertain, international conventions can provide a sufficient legal basis for such arbitrations. Cf. Mann supra note 42, who restricts his argument that every arbitration is necessarily subject to the law of a given State to arbitrations between private parties.

44. Such is the case in France, Germany, Greece, and possibly in the United States. See Delaume, "International Arbitration under French Law: The Decree of May 12, 1981", 37 Arb. J. 38 (Mar. 1982); Fouchard, "L'Arbitrage International en France après le Décret du 12 mai 1981", Journal du Dr. Int. 1982, 374; Glossner, "Federal Republic of Germany", 4 Y.B. Com. Arb. 60 (1979); Foustoucos,

"Greece", 5 Y.B. Com. Arb. 57 (1980); Feldman, "An Made Award in New York Can Be a Foreign Arbitral Award", 39 Arb. J. 14 (Mar. 1984).

45. Examples of such conflicting rules may be found in domestic law provisions regarding the nationality, religion, sex or profession of eligible arbitrators which may conflict with ICSID Arbitration Rules 2, 3 and 4; provisions related to objections to arbitration for other than the jurisdictional issue mentioned in ICSID Rule 41; and provisions conflicting with ICSID Rule 45 which authorizes the tribunal to take note of a discontinuance of the proceedings due to the failure of the parties to act.

46. Cf., e.g., Alsing Trading Company Ltd. and Svenska Tändsticks Aktiebolaget v. The Greek State, Award of December 22, 1954, 23 Int. L. Rep. 633 (1956); Sapphire International Petroleums Ltd. v. National Iranian Oil Company, Award of March 15, 1963, 35 Int. L. Rep. 136 (1967); B.P. v. Libyan Arab Republic, Award of October 10, 1973, 53 Int. L. Rep. 297 (1979); Kuwait v. The American Independent Oil Company (AMINOIL), 21 ILM 976 (1982). But see, Saudi Arabia v. Arabian American Oil Company (ARAMCO), Award of August 23, 1958, 27 Int. L. Rep. 117 (1963); Texaco Overseas Petroleum Company, California Asiatic Oil Company v. The Government of the Libyan Arab Republic, Award of January 19, 1977, Journal du Dr. Int. 1977, 350, 17 ILM 3 (1978). See generally, Delaume, Transnational Contracts, Chapter XIV, para. 14.04 (Oct. 1986).

47. To avoid the impression that the choice of such a country implies a choice of its arbitration laws, as inferred in Société Fougerolle S.A. c. Ministère de la Défense de la République Arabe Syrienne, Cour de Justice de Genève, 4 Bulletin de l'Association Suisse de l'Arbitrage 91-92 (1986), the contract should add after the designated seat "or any other place agreed by the parties." This was done in the US-Iran Claims Settlement Declaration, reprinted in 20 ILM 230 (1981) (Article VI, para 1) and was mentioned by Lake and Dana, supra note 40 at 776 as an argument against the jurisdiction of Dutch Courts over arbitral awards of the Iran-US arbitration tribunals seated at the Hague.

48. UNCITRAL Arbitration Rules, Article 1, para. 2. The Commentary on these Rules notes, however, that the conflict between them and mandatory provisions of national law would arise only in "rare and exceptional circumstances" and that "where an arbitration under the UNCITRAL Rules is of an international character, provisions in the Rules, although in conflict with national public policy for domestic arbitration, may nevertheless be upheld, when the more restrictive standard of international public policy is applied." See text in 2 Y.B. Com. Arb. 172, 179-180 (1977).

49. The "Additional Facility" was established by ICSID's Administrative Council on September 27, 1978 to administer at the request of the Parties certain proceedings between states and nationals of other states which do not fall within the scope of ICSID's arbitration. Conciliation, arbitration and fact finding procedures under this Facility are administered by the ICSID Secretariat and access to them is subject to the approval of ICSID's Secretary-General. See ICSID,

Additional Facility for the Administration of Conciliation, Arbitration and Fact Finding Proceedings (1979).

50. See Article 1 of the Arbitration (Additional Facility) Rules, id at 35, which reiterates the same language of Article 1, Para.2 of the UNCITRAL Rules, note 48 supra.

51. As these Rules would then apply as the rules mutually accepted by the parties and would not require administration by ICSID's Secretariat, the approval of ICSID's Secretary-General would not be required. Rather, the Secretary-General of PCA should consent to performing the duties prescribed under these Rules for ICSID's Chairman of the Administrative Council or for ICSID's Secretary-General.

52. Compare Shihata, Arab Investment Guarantee Corporation - A Regional Investment Insurance Project, 6 J. World Trade L. 185, 201 (1972) (for a similar provision) and Shihata, Kuwait Fund for Arab Economic Development in Rubin, Ed., Foreign Development Lending - Legal Aspects 121, 140-142 (1971) (for the loan agreements between the Kuwait Fund and foreign governments).

53. See Seyersted, Applicable Law and Competent Courts in Relations Between Intergovernmental Organizations and Private Parties, 122 Hague Academy, Recueil des Cours 427, 495 (1967).

54. See, e.g., Mann, "The Proper Law of Contracts Concluded by International Persons" (reprinted from the B.Y.B.I.L. 1959, 34), in Mann, Studies in International Law (1973), 211, at pp. 224 and 232; Friedmann, The Changing Structure of International Law 176 (1964).

55. Award of January 19, 1977, Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic, 17 ILM 3 (1978), 53 Int. L. Rep. 389 (1979), hereinafter referred to as the TOPCO award, at para. 42. This award has been criticized on the ground that the arbitrator's holding was not justified by the language of the choice of law clause agreed by the parties. See, e.g., Weil, "Principes Généraux du Droit et Contrats d'Etat," in Le Droit des Relations Economiques Internationales, Etudes Offertes à Berthold Goldman (1982), at p. 408; Delaume, Transnational Contracts, Chapter XIV, para. 14.05, p. 33 (May 1985). On several occasions the Iran-US Claims Tribunal, relying on the broad language of the Algiers Accords establishing it, applied "general principles of law" in spite of express contract clauses designating a domestic law as applicable. See, e.g., DIC of Delaware, Inc. v. Tehran Redevelopment Corporation, Award 176-255-3 (April 26, 1985); CMI International, Inc. v. Ministry of Roads and Transportation, Award 99-245-2 (December 27, 1983).

56. See, e.g., Lord McNair, "The General Principles of Law Recognized by Civilized Nations," 33 B.Y.B.I.L. 1 (1957), at p. 19; Seyersted, op. cit. note 53 supra, at p. 527, who states that "general principles of law can also be an independent system of law, which replaces even mandatory municipal law (emphasis in the original text), and at p. 609; Weil, op. cit. note 55 supra, pp. 404 et seq.

57. Award of October 10, 1973 and August 1, 1974, BP Exploration Company (Libya) Limited v. Government of the Libyan Arab Republic, 55 Int. L. Rep. 297 (1979), hereinafter referred to as the BP award, at pp. 349-350; Award of April 12, 1977, Libyan American Oil Company (LIAMCO) v. The Government of the Libyan Arab Republic, 20 ILM 1 (1981), hereinafter referred to as the LIAMCO award, at p. 72 of the award.

58. See Delaume, Transnational Contracts, Ch. I and Ch. XIV (1986); Weil, op. cit. note 55 supra; Lalive, Contrats entre Etats ou Entreprises Etatiques et Personnes Privées. Développements Récents, 181 Hague Academy, Recueil des Cours 9 (1983). More recent transnational contracts tend to subject disputes arising under them to the law of the host country. See Delaume, id.

59. See, Sections 10.01 and 10.04 of the World Bank's General Conditions Applicable to Loan and Guarantee Agreements. It should be noted that loan agreements between the Bank and a private person are always coupled with a guarantee agreement between the Bank and the government of that person. This coupling has been cited as the reason for insulating the agreement with the private borrower from domestic law. See Broches, op. cit., note 1 at 370-371 (1959); Lavalle, La Banque Mondiale et ses Filiales: Aspects Juridiques et Fonctionnement 234-235 (1972). The language on excluding the application of domestic law seems to have been used in this context as a substitute for stating that the agreements were governed by public international law.

60. Article 2 of the above cited Resolution reads:

> "Les parties peuvent notamment choisir comme loi du contrat, soit un ou plusieurs droits internes ou des principes communs à ceux-ci, soit les principes généraux du droit, soit les principes appliqués dans les rapports économiques internationaux, soit le droit international, soit une combinaison de ces sources de droit."

See 58 Annuaire de l'Institut de Droit International, Part 2, at 192 (Athens Session, 1979).

61. See, Article 15 of the MIGA Convention.

62. See, Article 18 of the MIGA Convention.

63. For eligibility of such an investor, see Convention, Article 13(a)(ii) and Chapter III, supra.

64. The most significant relationship between a contractual transaction and a particular legal system seems to provide the most relevant test for the choice of applicable law according to the modern trend in comparative legal literature on this subject. This trend has already found its expression in international conventions and in the above mentioned 1979 Resolution of the Institut de Droit International which provides (Article 1) that: "Les contrats entre un Etat et une personne privée étrangère sont soumis aux règles de droit choisies par les parties ou, à défaut d'un tel choix, aux règles de droit avec

lesquelles le contrat comporte le rattachement le plus étroit." See, generally, Delaume, op. cit., note 58 Ch. III, pp. 2-3; Lalive, op. cit. note 58 at 52; Weil, op. cit. note 55 at 409; Mann, op. cit. note 54 at 224-32.

65. See generally Seyersted, op. cit., note 53, supra.

66. See, note 48 supra. The practice of regional development banks is mostly consistent with this trend. See, e.g., Rubin, ed., supra note 52, at 63.

67. See Article 2(j) and Articles 27 and 46 of the above-mentioned Convention in A/CONF. 129/15, 20 March 1986, reprinted in 25 ILM 543, 547, 561, 570.

68. See, e.g., Weil, op. cit. note 55 at 387; Delaume, "State Contracts and Transnational Arbitration", 75 AJIL 784 (1981); R. von Mehren and P. Kourides, "International Arbitrations between States and Foreign Private Parties: The Libyan Nationalization Cases", 75 AJIL 476 (1981).

69. See Seyersted, op. cit. note 53, at 539 and 608.

70. See, e.g., the Articles of Agreement of IBRD, Article VII, Section 3; of IFC, Article VI, Section 3; of IDA, Article VIII, Section 3; and Agreement Establishing the Inter-American Development Bank, Article XI, Section 3. See also, G. Delaume, Transnational Contracts, Ch. XI, para. 11.03 and Ch. XII, para. 12.06 (May 1985).

71. See, e.g., Lalive "L'Immunité de Juridiction des Etats et des Organisations Internationales", 84 Recueil des Cours 205, 388 (1953). But cf., Dominice "L'Immunité de Juridiction et d'Exécution des Organisations Internationales," 187 Recueil des Cours 145, 174-177 (1985).

72. See, however, the decision of the Supreme Court of Italy in FAO contro I.N.P.D.A.I., Sentenza 18 Oct. 1982 n. 5399, Corte di Cassazione, 19 Rivista di Diritto Internazionale Privato e Processuale 151, 158 (1983) upholding the decision of the Tribunale di Roma, 24 Jan. 1981 18 id 95 (1982) which limited FAO's immunity from legal process to sovereign like acts and refused to extend it to commercial acts (actione gestiones) under the distinction applicable to the sovereign immunity of states as now applied by national courts and adopted in modern legislation in several countries.

73. See Broches, op. cit. note 1, at 309.

74. See Agreement Establishing the African Development Bank, at art. 50(1); Agreement Establishing the Asian Development Bank, at art. 52(1); Agreement Establishing the Caribbean Development Bank, at art. 49(1). See also J. Syz, International Development Bank 57-8 (1974).

75. See Lutcher S.A. Celulose e Papel v. Inter-American Development Bank, 382 F.2d 454 (1967). See also Syz, supra note 74 at 58.

76. See, Mendaro v. The World Bank, 717 F.2d 610 (C.A.D.C., 1983) affirming C.A. 80-1204 (D.D.C., September 16, 1982).

77. Article XV of the Statute of the World Bank's Administrative Tribunal envisages such extension of the Tribunal's jurisdiction.

78. See generally, Shea, The Calvo Doctrine (1955). See also Shihata, note 16 supra, at 1-2.

79. See Delaume, "ICSID and the Transnational Financial Community", 1 ICSID Rev. - FILJ 237 (1986).

80. See examples in ICSID, Investment Treaties (1983-, looseleaf service).

81. See examples in ICSID, Investment Laws of the World (1973-, looseleaf service).

82. See, Article 12(d) of the MIGA Convention and Chapter Six, supra at _____.

83. Id.

84. See, Article 15 of the MIGA Convention and Chapter Three, supra at _____.

85. See, Article 18(c) of the MIGA Convention and paragraph 27 of the Commentary.

86. According to unpublished figures obtained from OPIC in 1985, that Corporation has settled claims in the total amount of $96 million by paying compensation in cash to the investor while accepting installments from the host govenment; and claims totalling some $292 million, by persuading investors to accept host government commitments backed by OPIC guarantees or by a combination of cash payment and guarantees.

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