Successful claimants in investor-state cases are being promised payment of their award even if the state won’t honour it, if they take advantage of a new insurance product that is attracting both praise and scepticism.

Last year, US insurance broker Arthur J Gallagher (AJG) announced that it was offering “arbitration proceedings award default insurance.” AJG promises to create a syndicate of four to five insurers willing to cover the damages, interest and legal fees owed by a state if it fails to pay an investor-state award within 60 days of it being issued. The insurers will then subrogate and seek to recoup the money by enforcing the award themselves. The cost of those enforcement proceedings will be borne by the syndicates alone, says AJG.

Early reactions to the product have been mixed. Nigel Blackaby, global co-head of international arbitration at Freshfields Bruckhaus Deringer in Washington, DC who is known for his work representing investors against Latin American states, praises it for cutting out the “back-end headache” of enforcement.

In contrast, Méliđa Hodgson, a partner at Foley Hoag in Washington, DC who regularly acts for states, says that the product raises several policy questions, including how an entity that is not able to bring a claim under a particular treaty can “step into a claimant’s shoes” to enforce an award, noting that “it’s not your usual subrogation.”

The cost of a five-year award default insurance policy will range from three to six per cent of the sum being insured – a premium that is analogous to the cost of enforcement, says AJG. The exact cost will be dependent on the insurer’s assessment of the state’s geopolitical situation at the time the policy is taken out. Where the case involves a state presenting a low risk of default, like Canada and the US, the premium may be nearer 3 per cent, while cases involving mid-level risk states such China, Liberia, Mexico and Ukraine will attract premiums closer to 6 per cent. Insurers are unlikely to offer the award insurance to those taking on high-risk states such as Argentina, Greece, Sudan, Venezuela, Yemen and Zimbabwe.
(although AJG says that this could change if the states’ geopolitical situations improve over time.)

The premium will remain the same throughout the term of the policy, regardless of changes in the state’s political climate, and payment of the premium may be made in three instalments to help claimants manage cash flow.

There is also the option of extending the term of the policy for an additional 12 months, though AJG says that the initial five-year policy is designed to reflect the average amount of time parties spend in arbitration.

Steve Jones, the London-based director of dispute resolution at AJG, tells GAR that investors have to grapple with three questions when entering arbitration with a state: “are we going to win; how much is it going to cost, and are we going to recover in the end?”

Award default insurance provides certainty and peace of mind regarding the third question in the event that the case is successful, he says.

According to Jones, award default insurance offers several advantages over political risk insurance – the major form of insurance available to investors in developing countries, who wish to protect themselves against risks including expropriation and default on an arbitration award.

Jones explains that parties have to decide whether to purchase political risk insurance even before making their investment. Award default insurance, on the other hand, can be bought if and when a dispute arises.

According to Blackaby, making an award default insurance claim under the policy appears to be simpler than making a political risk insurance claim.

A frequent problem with political risk insurance is that there is a “mismatch” between the type of award covered by the policy and actual award, he explains.

“Unless there has been a direct seizure of assets giving rise to a finding of expropriation, most investor-state tribunals rule that a state has breached the fair and equitable treatment standard of the relevant BIT,” he notes. Awards on this ground are not usually covered by political risk insurance policies, leading to a “fight with insurers who don’t want to pay up.”

In contrast, if a claim can be made where an award is final and the state has failed to pay, there will be no scope for debate over the meaning of expropriation and denial of payment on that basis.

Hodgson agrees that award default insurance presents, on the face of it, no downside for claimants, but notes that the same might not be true for states.

She tells GAR that she will be warning state clients that the product may encourage inflated claims as well as encouraging claimants to be less cooperative on the procedural aspects of the arbitration.

Another concern is how a potential alliance between an award default insurer and third-party funders could affect the transparency of an arbitration, she says.

“The more control [third-party funders and insurers] have over the management of a claimant’s case, the more control they have over the proceeding,” she says. The state is left wondering – who exactly is on the other side.