Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues
No. 223 April 9, 2018
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Investment arbitration liability insurance: a possible solution for concerns of a regulatory chill?[*]

by
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Regulatory chill, one of the key tensions between international investment agreements (IIAs) and democratic governance, could be dealt with by creating liability insurance for governments. Regulatory chill occurs when governments refrain from adopting certain measures out of fear that these would trigger costly arbitration disputes with affected foreign investors. Importantly, since IIAs often contain standards of treatment that create uncertainties about how an arbitration panel would interpret and apply them, governments might even refrain from measures that would have been found to be consistent with their obligations if challenged in arbitration. Though clarifying these standards could, theoretically, mitigate such concerns, efforts to do so have had limited success and could reduce the protection provided to investors.

Liability insurance for investor-state dispute settlements (ISDS) could protect governments' policy space while maintaining the protection granted to foreign investors by IIAs. By offering governments partial indemnification for their losses in arbitration, the risk of liability would be alleviated.

Governments already use liability insurance in other contexts. As government immunity from tort liability has diminished, local governments across the US have begun purchasing liability insurance. This has allowed them to avoid devastating consequences if found liable for significant damages. Insurance is acquired from private carriers or by joining municipal risk pools, commonly sponsored and administered by non-profit organizations, which enable several municipalities to join together and pay premiums in return for liability coverage.

Important examples of such insurance are errors and omissions (E&O) policies that provide coverage for any act of neglect or breach of duty. They may cover claims that arise from decisions made by elected or appointed officials that allegedly cause loss of revenue or property rights, including planning and zoning issues.[1] Similar claims may constitute breaches of IIA obligations to provide foreign investors fair and equitable treatment and to refrain from indirect expropriation. ISDS liability insurance could provide a sort of E&O insurance to participating governments in the event of certain ISDS claims.

While insurance could mitigate concerns of a regulatory chill, concern with moral hazard may limit its practicality. An insurer would worry that insured governments might not act as carefully toward foreign investors as they would in absence of insurance. In theory, the insurance could exclude deliberate violations of IIAs. However, ascertaining intent is likely to be impossible, and efforts to do so might undermine its purpose of enhancing predictability. Therefore, the insurer would use objective criteria to determine what types of measures should be covered by the policy. For example, insurance could be limited to measures that promote clearly defined public interests such as public health. In addition, experience from E&O policies shows that there may be other ways of addressing moral hazard concerns. First, insurance policies could have coverage limits and large deductibles, thus exposing governments to a certain risk. Additionally, premiums could be determined in relation to the level of care countries adopt by considering losses in arbitration and could be linked to the characteristics of each country's IIAs. These safeguards would reduce concerns of moral hazard, though still limit the possible consequences of each arbitration claim.

As E&O policies, such insurance could be provided either by private carriers or by a risk pool established by multiple governments. Theoretically, a risk pool could provide cheaper insurance since it does not seek to make a profit. Although a competitive insurance market might lower costs by pricing risk more effectively, an ISDS liability insurance market may not be large enough to ensure competition.

A risk pool could operate similarly to regional disaster risk insurance programs, such as the Caribbean Catastrophe Risk Insurance Facility (CCRIF). The CCRIF allows participating countries to pool their specific catastrophe risks into one diversified portfolio. Aside from an initial funding from donors, it is based on premiums that are calculated according to each country's risk profile that assesses the probability of a catastrophe, based on its characteristics and historical events. Though the CCRIF is not subject to moral hazard as an ISDS insurance pool, its general structure could be similar: the ongoing activity could be funded by premiums that are based on each country's ISDS experience, IIAs and desired coverage.

Clearly, such a plan demands the participation of several countries. Though large countries may prefer self-insurance, others may be inclined to participate, especially once experiencing regulatory chill, even if an actual arbitration claim was not filed. Nevertheless, if insurance rates were high and equal for all countries, a country that does not foresee a probable risk of arbitration might not be inclined to purchase such insurance. The above guidelines would likely increase the number of countries that might find such insurance attractive. It would allow them to strive for more regulatory space and mitigation of risks of regulatory chill caused by IIAs, while still promoting investment and protecting their investors abroad.

Often, the choice between policy space and foreign investor protection through IIAs is described as a zero-sum game. Introducing insurance into this game may achieve the impossible: assuring policy space while not reducing the protection granted to investors.

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[1] See, Christopher Serkin, "Insuring taking claims," *Northwestern University Law Review*, vol. 111 (2016), pp. 75-137.

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