

## *Client Alert*

# Will Recent Nationalisations in Bolivia Give Rise to Claims Under Political Risk Insurance Policies?

On 1 May 2006, the Bolivian government passed a law, Supreme Decree 28701, announcing that it was taking over the oil and gas resources in the country. This nationalisation policy sent shock waves throughout the oil and gas industry, especially foreign companies operating in Bolivia, including Repsol of Spain, B.P. of the United Kingdom, Total of France and Petrobras of Brazil. There is growing concern that the newly elected Bolivian President, Evo Morales, has fallen under the spell of the populist and controversial Venezuelan President, Hugo Chavez. The Venezuelan State has already confiscated oil fields operated by E.N.I. of Italy and Total. It is no coincidence that Hugo Chavez travelled to Bolivia just days after the new nationalisation decree was passed. The matter will not end here. Speaking at a May Day rally, the Vice President of Bolivia greeted the nationalisation by boldly declaring that “the government of the people, the government of the workers, has taken the most important decision of this century: this is the first nationalisation of the 21st Century.” There are signs already that the nationalist fever running through South America is spreading to other countries in the region that are not traditional allies of Venezuela and Bolivia. In the last few weeks, Ecuador has taken control of over US\$1 billion of assets owned by the US-based Occidental, the largest foreign investor in Ecuador.

The recent Bolivian nationalisation has seriously dented Brazil’s dominance in the region. Brazil’s Petrobras has assets worth US\$1.5 billion in Bolivia and it is ironic that the largest economy in the continent should have fallen prey to the nationalisation policy implemented by Bolivia, the poorest country in Latin America.

Investors in Bolivia are actively exploring how to recover their substantial losses. Initially, Evo Morales announced that there would be no compensation for nationalised assets. At the recent Latin American summit in Vienna on 11 May 2006, Brazil reacted angrily to this announcement and Morales eventually agreed to consider claims for compensation later this year.

In the meantime, investors affected need urgently to consider whether to notify claims under available Political Risk insurance policies. Before considering the cover afforded by these policies and how they may respond to claims arising from the Bolivian nationalisation, it is necessary to review the applicable Bolivian legislation.

The starting point is Law No. 3058 passed on 17 May 2005. Article 5 of this law provided that property in all oil and gas resources then in production vested in the State of Bolivia. All oil and gas companies operating in Bolivia were given 180 days from the date of this law to enter into new contracts with the state energy company, YPFB. Pursuant to these new contracts, YPFB assumed responsibility for the commercialisation and production of oil and gas reserves.

This law was the precursor to the nationalising statute of 1 May 2006. Supreme Decree 28701 recites that the 180-day period prescribed in Article 5 of Law No. 3058 has expired and that “as a measure of national sovereignty, and following the mandate from the Bolivian people expressed in the Referendum held on 18 July 2004 ..., all oil and gas resources in the country are hereby

nationalised.” Significantly, Article 1 of the Decree declares that “the State acquires ownership, possession and total and absolute control of these resources.” Article 3 provides that the only companies that can continue operating in the country are those that comply immediately with the terms of the nationalisation Decree. These companies are given a further 180 days to enter into new contracts with YPFB, failing which they will not be able to continue operating in the country. During this transitional period, oil and gas fields that produce more than 100 million cubic feet per day will have to pay 82% of their production value to the State, leaving them with a mere 18% to cover the cost of operations and investment. Two important fields operated by Petrobras are immediately affected. Even if others are not affected by this onerous provision, they will have to enter into new contracts surrendering control to the Bolivian State within the allotted time and attempt to secure a negotiated solution to their claim for compensation. Otherwise, at the end of the 180-day period they will have to cease operating in the country.

Can the companies affected by the nationalisation recover their losses other than by securing compensation from the Bolivian State? Political Risk insurance is designed to protect foreign investors from losses arising from expropriation, selective discrimination, currency inconvertibility and political violence. Policy wordings available in the commercial market vary. Some wordings require “total expropriation” suggesting that partial loss of title or “creeping” expropriation (that is, indirect acts of expropriation that do not immediately result in loss of ownership or control) is not sufficient. Other wordings provide cover for losses caused directly by an “Expropriatory Act.” This is defined in one wording as “an act or series of acts occurring within the policy period not limited to expropriation but including also confiscation, nationalisation, requisition and sequestration by law, order or administrative action of the government of the Host Country.” Additionally, some Political Risk wordings insist on the deprivation of the investor’s ability to control or operate the project concerned which results in a default by the investor on a payment due to its lenders.

The key question is whether the steps taken by the Bolivian government satisfy the definition of expropriation in the applicable wording. Under article 7 of Decree No. 28701, the Bolivian State will acquire a controlling 51% stake in the main companies concerned—Chaco (part-owned by BP), Andina (controlled by Repsol of Spain), Transredes (controlled by Royal Dutch Shell) and Petrobras Bolivia. However, acquiring a controlling stake in a company does not amount to full nationalisation. The rationale is that the Bolivian State does not have the finance, technology or know-how to fully exploit these resources and must therefore limit its participation to a 51% stake. The new contracts currently being negotiated do provide the Bolivian State with 82% of all revenue, but there is a reasonable argument that the proposed changes do not amount to expropriation or confiscation such as to trigger coverage under a Political Risk insurance policy.

The debate will focus on whether the measures taken by the Bolivian government are tantamount to expropriation. Morales’s view is that they are not. Speaking to a Committee of the European Parliament on 15 May 2006, he said: “I want people to understand that we are not expropriating or expelling anybody.... I understand that [the foreign investors] have to recover their investment and that they are entitled to profit. However, they cannot own the oil and gas reserves nor can they control them. The Bolivian State will control the wells and headquarters and [the foreign investors] will be partners but not owners of our natural resources.”

The issue of what amounts to expropriation has been reviewed in a number of arbitrations before the International Centre for the Settlement of Investment Disputes (“ICSID”). ICSID was created by the 1965 Washington Convention and operates under the auspices of the World Bank.

In *Tecmed v. Mexico* (2003), it was alleged by Tecmed that the Mexican authorities had expropriated its investment by refusing to renew a licence to operate a hazardous waste landfill site in Mexico. The Tribunal had to construe the terms of the applicable bilateral investment treaty between Mexico and Spain. It considered the meaning of the terms “indirect expropriation” and “tantamount to expropriation.” The Tribunal held that expropriation includes “a number of situations defined as de facto expropriation, where ... actions or laws transfer assets to third parties different from the expropriating state or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government.” Thus, a single act of expropriation by the state is not required: it is enough if the measures adopted by the State are permanent and irreversible and if the effect of these measures is that the assets and rights of the investor are affected in such a way that they cannot be exploited. Whilst direct expropriation is readily apparent, it is harder to identify interference with an investor’s rights. It is a question of fact in each case whether the effect of the state action is such that the investor’s rights can no longer be exploited. In the earlier case of *Metalclad v. Mexico* (2000), the Tribunal had also attached great weight to the effect of the government measures on the rights of the foreign investor. The Tribunal held that the measures were tantamount to expropriation because they “effectively and unlawfully” prevented the investor’s operation of the project. However, the case demonstrates that arbitration awards on the meaning of “expropriation” are not immune from challenge. Mexico appealed to the Supreme Court of British Columbia and the Court held that it did not have jurisdiction to interfere with the Tribunal’s interpretation though it did not adopt all of its reasoning.

Whilst these decisions show that arbitration tribunals and courts have adopted liberal interpretations of the term “expropriation,” foreign investors affected by recent developments in Bolivia will first have to turn to their individual policy wordings to see how the term is defined. Only then will the aggrieved foreign investor be able to determine whether to notify a claim under the policy. The insured investor is generally required by the policy wording to notify his insurers of any circumstance likely to give rise to a claim within a short period, normally 30 days. Typically, policies will then require the act or acts of expropriation to subsist for a defined “waiting period” which can be as long as 180 days before payment is made. This gives the parties a window in which to settle with the government or obtain compensation from other sources.

Foreign investors would be well advised to notify circumstances that may give rise to subsequent claims even if they are currently in negotiations with the Bolivian government for compensation under the terms of a bilateral investment treaty or some other form of investor protection legislation. In fact, it may be more advantageous for the foreign investor to pursue a claim under a Political Risk insurance policy and allow the insurers to recover subsequently under any applicable investment treaty by way of subrogation.

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8 June 2006

**For Additional Information**

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