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The History and Evolution of Aviation War Insurance: An Expert Interview with Glen Brighton

In this Issue:

*As our readers may know, one of the practice areas robert wray PLLC has focused on for many years is aviation finance. An important and interesting facet of aircraft financing transactions is insurance, in particular, war insurance. Over a drink at the historic Jefferson Hotel in Washington, DC, **Glen Brighton**, Executive Director of Aviation Advisory Services at Willis Towers Watson, discussed with **Geraldine Mataka**, the firm's managing member, the fascinating history of aviation war insurance and how the market's responses to significant events in the 20th and 21st centuries have shaped the current aviation insurance market.*

Geraldine Mataka (GRSM): Thanks again, Glen, for taking the time to sit down with us.

Glen Brighton (GB): Pleasure.

GRSM: Before we begin with specific questions about aviation war insurance, could you tell us a little bit about how you got started in this industry?

GB: Well, I guess the best answer to that is that no 17-year old ever dreams of going into the insurance market. You'll find very few who had a plan at 14 to actually at some point become an aviation insurance advisor. So, I sort of wandered into it just by mistake, really, like probably most of my colleagues. It's just one of those things where a friend of a friend…I was at college and I went out one night and was asked by this guy, "What are you doing for your career? What are you looking to achieve?" And I said, "I'm not really sure. I know that I need to get my exams done and once it's all finished, I'll be up and running, but I don't know what to do." And he said, "Well, why don't you come to an interview on Monday with my company?" I said, "What do you do?" He said, "I'm a Lloyds underwriter." And I said, "What's that?" He literally said, "Come Monday and I'll show you." So

(Continued on page 4)

Public and Private Insurers: What is the Optimum Relationship for Insureds?

***Malcolm Stephens** has a long and distinguished career in trade credit and political risk insurance. He is currently Group Chairman of International Financial Consulting.*

The relationship between private and public insurers has been a sensitive and changing area for as long as I have been involved with political risk insurance (PRI) and trade credit insurance (TCI). My involvement goes back as far as 1965 when I joined the UK export credit agency (ECA). Since then, I have witnessed the progression of the relationship from most standpoints, as a public insurer, private insurer, banker/customer, broker, President, and later Secretary General of the International Union of Credit and Investment Insurers (Berne Union) and, in recent years, as a consultant to private, public, government and IFI/multilateral clients.

In writing this article, I am assuming—perhaps bravely—that the common aim of all parties should be to maximize the market capacity available and, more importantly, to try to get the best possible deal for the insured party; in other words, the insured party should be the most important entity involved. More difficult is the issue of whether or not competition is necessary for these aims to be achieved and whether the present situation is anything like the optimum one.

Competition with private insurers is and always has been a sensitive issue for almost all public insurers. EDC of Canada is one of the very few public insurers who openly and actively compete with private insurers. Some public insurers, like those in the USA and the EU, are subject to specific restrictions or prohibitions on competing. Most public insurers

(Continued on page 6)

Trucking Under NAFTA: The Tortuous Path

***Mariano Gomezperalta**, a member of robert wray PLLC, represented the Government of Mexico and Mexico's trucking associations in various facets of the NAFTA cross-border trucking dispute. In this article, he comments on the twists and turns of one of the most entangled conflicts under NAFTA.*

The Retaliation Measure

It is five o'clock on February 23, 2009. Mexico's trade lawyers are outside the office of the Secretary of the Economy (Economía). They are waiting their turn to present a proposal to the Secretary for a retaliatory measure against the US in response to the US's cancellation of the NAFTA pilot program which allowed Mexican trucks to enter the US and deliver exports to their final destination. The retaliation measure will consist of an increase in the duties of 89 products exported by the US to Mexico. The team enters the Secretary's office. He reads the proposal and goes through the list of affected goods: Christmas trees, strawberries, soy sauce, batteries, pencils, almonds, potatoes, red wine, sunglasses, dog food, toilet paper, and dozens of other tariff items. He looks up and asks: "Is this the best we can do—impose tariffs on dog food and toilet paper?"

After several rounds of discussions, Economía's team is able to convince the Secretary of the logic behind the retaliation list. He makes only one change: batteries are out and coffee-makers are in. Economía verifies its trade figures to make sure the measure does not breach the proportionality rule under NAFTA. The Secretary submits the Decree for the President's review and approval. The President signs it and it becomes effective on March 18, 2009. The next day, a massive amount of US exporters and Mexican importing companies file injunctions in Mexican courts to freeze the effects of the retaliatory decree. Lobbyists in Washington and Mexico make every effort to get their products *off* the list. Meanwhile, hundreds of Mexican producers gather outside Economía's offices demanding additional products *on* the list. It is their opportunity to keep other US competing goods out of the Mexican market. Economía tries to hold the line.

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On a separate track, CANACAR, Mexico's powerful trucking association, prepares an investment claim against the US under NAFTA's investment chapter. They claim millions of dollars in damages and lost profits suffered by Mexican trucking companies that have been unable to enter the US market for almost 10 years. They also demand that Economía take a strong stance and prohibit all operation of US trucks in Mexico. The turmoil continues for several days.

The State-to-State Dispute

The origin of the dispute goes back to 1995 and relates to the US reservation under Annex I of NAFTA pursuant to which the US agreed to terminate the so-called "moratorium" and allow Mexican cargo trucks to have operating authority and enter the US. A few days before the expiration of the reservation, the Department of Transportation (DOT) announced that it would not process applications from Mexican carriers to operate in the US. The DOT stated that Mexican trucks posed a legitimate safety concern on US highways and referenced incidents in which Mexican trucks had been involved, including an accident allegedly attributed to 16-year-old Mexican driver Pedro Higuera who drove uninsured and with faulty brakes and bald tires.

Mexico could have opted to apply trade sanctions 30 days after the panel's decision, but [...] it opted for a negotiated solution.

Mexico moved to request the establishment of an international arbitration panel under NAFTA's state-to-state dispute resolution mechanism. Mexico argued that the US refusal to accept any application for operating authority coming from a Mexican trucking company conflicted with the US's obligations under NAFTA Chapter 12 (Trade in Services) and its commitments under Annex I. The US maintained that it was legal and appropriate for the US to delay the processing of Mexican applications for operating authority as the US and Mexico needed to work out an adequate safety enforcement framework to ensure that operating authority granted to Mexican trucking companies would not undermine US highway safety. The arbitration panel, led by a British arbitrator, ruled on February 6, 2001, against the US. Although it acknowledged that NAFTA parties may set the level of protection that they consider appropriate in pursuit of legitimate regulatory objectives, it determined that the DOT's blanket refusal to process applications for operating authority coming from Mexican nationals was inconsistent with the US's obligations under NAFTA. The executive branch sought to comply with the panel's findings but various legislative measures made it untainable. Pursuant to NAFTA Chapter 20, Mexico could have opted to apply trade sanctions 30 days after the panel's decision, but it

(Continued on page 3)

Trucking Under NAFTA: The Tortuous Path (*cont'd*)

decided not to do so ostensibly because the Mexican government believed at the time that a retaliatory measure would affect immigration initiatives and other matters that were on Mexico's agenda with the US. Mexico therefore opted for a negotiated solution.

The negotiations took several years. Six years after the panel's ruling, the US and Mexico agreed on a "pilot program" that would give access to up to 100 Mexican trucking companies. The pilot program was in operation for over one year and attracted only twelve companies but it served as an indication that the US would open the border to Mexican trucks once the program conditions were met. In March 2009, however, Congress prohibited DOT from spending funds on the pilot program for the fiscal year 2009. The program was immediately terminated and the border was again closed to Mexican trucks. Shortly thereafter, Economía announced its decision to impose the retaliatory tariffs over 89 products.

* * *

From a legal perspective, the retaliatory measure presented a number of interesting issues. NAFTA Article 2019 sets forth the rules for suspending trade benefits once a final arbitration award has been issued:

> *Article 2019: Non-Implementation-Suspension of Benefits*
>
> *1. If in its final report a panel has determined that a measure is inconsistent with the obligations of this Agreement or causes nullification or impairment in the sense of Annex 2004 and the Party complained against has not reached agreement with any complaining Party on a mutually satisfactory resolution pursuant to Article 2018(1) within 30 days of receiving the final report, such complaining Party may suspend the application to the Party complained against of benefits of equivalent effect until such time as they have reached agreement on a resolution of the dispute.*
>
> *2. In considering what benefits to suspend pursuant to paragraph 1:*
>
> *(a) a complaining Party should first seek to suspend benefits in the same sector or sectors as that affected by the measure or other matter that the panel has found to be inconsistent with the obligations of this Agreement or to have caused nullification or impairment in the sense of Annex 2004; and*
>
> *(b) a complaining Party that considers it is not practicable or effective to suspend benefits in the same sector or sectors may suspend benefits in other sectors.*
>
> *3. On the written request of any disputing Party delivered to the other Parties and its Section of the Secretariat, the Commission shall establish a panel to determine whether the level of benefits suspended by a Party pursuant to paragraph 1 is manifestly excessive.*

As required by Article 2019, Mexico was constrained to keep its measure within a reasonable range. NAFTA required the retaliation measure to be of "equivalent effect." This standard is relatively straightforward when dealing with regular exports of goods: if an arbitration panel confirms that (i) Country A is entitled to export tomatoes duty-free to Country B and (ii) Country B breached its trade obligation because it blocked exports from Country A, Country A would calculate its annual exports of tomatoes to Country B and adopt a trade measure of equivalent effect against Country B (e.g., impose a 200% tax on the importation of sugar to block sugar exports from Country B). How would Mexico calculate the value of "lost exports" when the measure at issue related to cross-border trucking services carrying 85% of Mexico's trade with the US? Would it be the annual value of the cargo (i.e., $150 billion), the lost profits of the actual Mexican trucking companies or some other value?

In addition, there was not a single case under NAFTA, WTO or any other forum in which a country had waited such a long time to suspend trade benefits to its counterparty. Typically, trade sanctions are adopted shortly after the affected country obtains a final ruling from an arbitration panel. Mexico had waited eight years. Did this mean Mexico was entitled to recover eight years of "lost exports" ($150 billion times 8 = $1.2 trillion)? The risk of "burning the toast," as Mexicans say, was very high. There was no record of any trade countermeasure of this magnitude. Although Mexico wanted to induce the US to open up the border to Mexican trucks, it had no intention of starting a trade war or even having a NAFTA Commission set an adverse precedent that Mexico's countermeasure had been manifestly excessive.

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Furthermore, due to Mexico's "tariff bindings" under WTO, it was not legally possible for Mexico to establish tariffs of 150% or 200% to completely block US exports of a few selected products. These bindings established Mexico's MFN (Most-Favored Nation) rate and functioned as a ceiling on customs tariff rates. If Mexico were to increase tariffs beyond its tariff bindings, it could be exposed to claims from the US under WTO. To avoid violating WTO provisions, the retaliation tariffs would need to be greater than zero but less than Mexico's MFN rates. For certain products, this meant Mexico

(Continued on page 11)

The History and Evolution of Aviation War Insurance: An Expert Interview with Glen Brighton (*cont'd*)

I went from college, literally as a 17-year old—right in the middle of college—and on a Monday I had an interview with the Lloyds company and I was offered the job and a week later I was walking around Lloyds of London, bemused by where I was and what I was looking at, and the whole thing was so new to me. Of course, I think at that point in time I was just happy to have a job and a chance and I guess that's exactly what it was: a chance for me to maybe at some point, you know, realize that the opportunity was there for me to have a career. It's easy for me to say this, but 30 years later, I'm still working in the market, doing aviation insurance, which I've been doing literally since 1986. So, 30 years. That goes to say, nobody goes into it thinking they're going to work in insurance…nobody does.

GRSM: So then you're the perfect person to talk about the history of aviation insurance [*laughter*], even though it goes farther back than 1986…

GB: It does! And to be honest with you, I actually take great pride in and have found out lots about the historical context of aviation insurance. I set out a couple of years ago actually to see if I could find out exactly about how it all started, who started it, and how we've gotten to be where we are today with some of the clauses—who wrote the clauses, in what point in time, what events triggered those clauses.

GRSM: So how did aviation war insurance come about? Was there a specific event that triggered it?

GB: Probably by the end of the First World War and the beginning of the 1920s, when aircraft became more complicated and we're starting to think more about the commercial reality of the aircraft, it's only that point, really, when the aviation insurance market was formed. There were most probably three or four underwriters in Lloyds that were interested and they were talking to the engineers who were developing the aircraft and eventually, I think that with the first few aircraft that were lost, people realized that it cost them a lot of money to develop and to build and it was about time to form a market. I can only imagine that it took most probably a few years before there were some major events that really affected underwriters to the degree that they thought we might actually have to start excluding certain elements of war coverage. And when I say "war" I don't clearly mean two countries fighting against each other; it's just "war and allied perils" and the allied perils are more likely to happen than anything else. It could be an act of terrorism or—well, there's quite a long definition of allied perils, but basically it's third-party impacts in a war event. So it developed from there, but it took a long time, I think, before we get to see aircraft used, for instance, in the way we saw them used on 9/11. And there were instances in the 1950s: there were plenty of little—sort of major—events, losses in areas of the world where things were not as obviously a war loss until you started looking into them. We found a great loss in the 1950s, where a guy put a bomb onboard an aircraft and then bought his mum an insurance policy at the airport. Unfortunately for him, his timing was off and the aircraft crashed over land and they were able to work out what happened. He was arrested, he admitted to the crime, and was convicted. So those sorts of things did start happening in the 1950s, but the war market didn't really start forming until the later 1960s and then it went spectacularly big.

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GRSM: And what precipitated the creation of AVN 48, which is the war hijacking and other perils exclusion clause?

GB: Well, AVN48 was actually born out of a couple of losses, really, but the one major loss was Dawson's Field, where there were a number of aircraft that were flown to Dawson's Field in Jordan and they were parked and it was the Palestine Liberation Organization (the PLO) who were asking for a number of their compatriots who had been jailed by the Israelis to be released or otherwise they were going to blow the aircraft up. And of course, what actually happened was…they blew the aircraft up when they weren't released. As you can imagine, up until that point, insurers had never seen anything like it and they suddenly realized that war risks and the potential damage that can result from an incident, an occurrence on that scale could wipe them out, could really do a lot of damage. So at that point they decided that it was then time for them to work on AVN48 and a new clause was born.

GRSM: You had mentioned allied perils and acts of terrorism. What else would you consider to fall into that category?

GB: Any kind of third-party damage—malicious damage is most probably the best way of describing it—to an aircraft. Another great example was about—I'm not sure how long ago it was, long enough ago in my career for me to remember—15, maybe 20 years ago? It was at FedEx, where one of their guys had been fired—he was in his 40s, if I remember—and he wanted revenge. He got on board one of the FedEx aircraft and literally he smuggled himself onboard and the aircraft took off. He had a hammer and he took the hammer into the cockpit and hit the co-pilot, hit the pilot, and he had decided that he was going to take control of the aircraft and fly into the headquarters of the company that had fired him. Fortunately, the two pilots actually fought back and, despite huge amounts of damage to

(Continued on page 5)

The History and Evolution of Aviation War Insurance: An Expert Interview with Glen Brighton (*cont'd*)

themselves, they managed to get control of both him and the aircraft and they landed safely and averted what would have been a potentially massive disaster. The pilots were actually brought to London and medals by Lloyds of London for averting a loss and obviously a massive, great claim. So they got a lovely shiny piece of silver on their mantelpiece whilst obviously insurers were most probably happy to have saved the $50 million. So it really is—when we say "allied perils," it's really all the events you could possibly think of that could do damage to the aircraft *maliciously.*

GRSM: So how does LSW555D, the aviation hull "war and allied perils" policy, fit into this picture?

GB: So once we had a war exclusion, there were a lot of people saying well, all of these things are actually excluded. How do we get comfortable if we finance or lease an aircraft to one of these airlines that's got all of these exclusions and one of these events happen and, well, we're uninsured. So what they did was they all came in together and matched—well, but of course the one thing that sits outside all of this and will most probably always sit outside all of this is the big nuclear bomb because you can't insure nuclear risks in most forms of insurance and certainly not in the aviation insurance world because the potential for damage by a nuclear weapon is so large. And, to be quite brutally honest with you, if we ever got to the point where a nuclear weapon was let off purposefully, then I'm not sure any of us would be worrying about aviation insurance at that point anyway. So it really did get to that point where they decided that, apart from writing back the nuclear coverage, they would provide the coverage for all of the other perils that had been excluded by the policy. So now, they dovetail.

So it really is—when we say "allied perils," it's really all the events you could possibly think of that could do damage to the aircraft maliciously.

GRSM: Historically we have seen the aviation market responding soon after a major event, for example, during the First Gulf War, when Iraqi forces invaded Kuwait and Kuwait Airways had 15 aircraft on the ground and a large amount of spares and equipment at Kuwait International Airport. How did this event shape the market's view of policy limits?

GB: There was a big debate about the level of coverage—a big debate that went through the courts and took about 10 years—about whether the event was one occurrence or a number of occurrences, because a number of the aircraft that were at the airport were taken by the Iraqi forces, flown back to Baghdad, painted green, and called Iraqi Airways. And, as you could imagine, the Kuwaitis were not keen on that and they made claims on their insurance policies and they were soon told well, actually there's a limitation on the amount of coverage. You know, insurers are not out there to provide unlimited funds in any claim, really—there are limits on *every* policy. The Kuwaitis argued that every time they took one of these aircraft it was a separate event. Insurers eventually won out and the full aggregate policy limit was paid. That was a defining moment for most in the market because they did realize at that point the potential loss of millions of dollars' worth of aircraft can happen in one incident and if that was to happen too many times, it would most probably bring down the market. So hull war aggregates after that time were reduced significantly to minimal amounts. In a historical context, it has taken a number of years for that to then grow back into a position where insurers are happy to provide not unlimited numbers, but billions of dollars' worth of coverage. If you bring that up to today, then we had in 2014—in July, in Libya—the same kind of event happen, where you had a number of aircraft that were bombed on the runway and insurers are sitting there saying well, we can't stop this so there's a policy aggregate limit that will apply. And that's exactly what happened.

That was a defining moment for most in the market because they did realize at that point the potential loss of millions of dollars' worth of aircraft can happen in one incident and if that was to happen too many times, it would most probably bring down the market.

GRSM: We're heading to a discussion of what is perhaps one of the most important events in aviation history or history in general for that matter. I'm sure the market responded in a number of ways after 9/11, but what was the most significant response?

GB: The initial response was to stop, because we didn't understand at that point what was happening next. I remember us being in quite a few smoky rooms with colleagues discussing how we were going to get the markets to continue providing coverage. Because at that point, the whole world had changed, including a massive market who saw what they thought were aircraft one day turn into missiles the next day. Aircraft used as weapons. This was the first time this really had happened in any meaningful way. So I think that we had to persuade insurers not to give notices of cancellation across the board. If they had done that—and the war policy provides for seven days' notice of cancellation—we would have most probably seen the world's airline fleet grounded. I think that, to its credit, the market understood that. And I don't know what the political ramifications

(Continued on page 9)

Public and Private Insurers: What is the Optimum Relationship for Insureds? (*cont'd*)

would probably go along some general (but, in practice, often pretty meaningless) objective of "cooperation" with private insurers.

This is, however, much more than a matter of semantics. One of the most important but frequently overlooked characteristics of both PRI and TCI is that they are insurance facilities and so insurers need both spread of risk and some stability and continuity of premium income. Reflecting this, it is very hard for any public insurer to operate on even a marginally profitable or even break-even basis if all it is allowed to do is to underwrite business that is not acceptable to any other insurer—in other words, to be quite literally an "insurer of last resort."

Apart from all else, public insurers need to be in the market on a permanent and continuing basis in order to keep in place the infrastructure of skills, experience, and expertise essential to giving their customers acceptable service levels. Put more crudely, public insurers need to be either in or out of the market. They cannot veer from one to the other or suddenly spring back into fully effective life like some latter day Sleeping Beauty.

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This whole area is one which abounds with myths.

For example:

1. "*It is only 'bad' risks for which there is a market capacity problem*." This is simply not true and, even for very good risks, there may be aggregation or concentration problems which can prevent insurers and even reinsurers from taking on very large cases or a number of such cases.
2. "*Only public insurers can provide the services and facilities that small companies need*." This is, at best, dubious especially in the area of TCI with its heavy reliance on huge quantities of status and other relevant information being manipulated by expensive IT systems. I would argue that, in many ways, only large private insurers can provide the minimum administration, maximum streamlining, quickest and clearest answer facilities that smaller companies need. It is, of course, true that only public insurers and their governments will knowingly provide below-cost facilities and subsidized premium rates, although who in anything other than the short run benefits from this is a good question.
3. "*Public insurers traditionally underwrite only political risks*." Most public insurers began life as short term (ST) TCI underwriters, moved into medium and long term (MLT) areas, and then project financings and PRI. And for many years very few private insurers have offered commercial risk only products and facilities. Few people would now accept the view that private insurers are unwilling/unable to provide insurance on large or long term political risks on a stable and continuing basis or that public insurers' premium rates are always higher (or lower for that matter) than those of private insurers. Both private and public insurers can now offer experience and expertise and broadly comparable wordings.
4. "*It is always preferable for the public insurer to be the lead insurer and for private insurers to 'follow' when both are involved in the same case*." In practice, this is best looked at case by case to reflect not only the relative exposures, but also the comparative experience and expertise. It has, in my view and experience, never been the case that all of the best and most relevant expertise, information, and experience reside in the public sector and the passage of time has enhanced this view. This area is, of course, complicated by the position of the Multilateral Investment Guarantee Agency (MIGA), which can provide access to the "IFI Umbrella" to private insurers who follow it on a case. Arguably, this is a factor which distorts competition not only between MIGA and private insurers but also between MIGA and public insurers who do not enjoy any kind of "preferred creditor" status.

It is, of course, very dangerous and misleading to try to generalize not only about public insurers, but also about classes or categories of insurance. Public insurers differ greatly between countries not only in the level and range of facilities they can offer, but also in terms of the requirements and restrictions placed on them by their governments and, in the case of EU member states, by the Commission on Member States. Public insurers also differ greatly in status. Some are government departments (e.g., the UK), some are government owned corporations or companies (e.g., Canada), whilst some are private companies who operate part of their activities on "Government Account" (e.g., Germany).

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However, all public insurers, whatever their size or status, face the challenge of how best to work with private insurers in order to meet the legitimate needs and requirements of their customers. Of

(Continued on page 7)

Public and Private Insurers: What is the Optimum Relationship for Insureds? (*cont'd*)

course, the objectives of public insurers are more complicated than simply reacting to customer needs and wishes. Emphasis also has to be given to financial results and the restrictions and requirements placed on them by their governments. As suggested earlier, some spread of risk and some minimum levels of premium income are vital if regular losses and deficits are to be avoided. So the (inevitable) efforts of public insurers to achieve some spread of risk and some certainty and continuity of premium income often hinge on public insurers looking at business that would probably be acceptable to some private insurers. Put another way, there will always be some areas of potential competition.

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In the past, competition between private and public insurers was probably thought of as a phenomenon of ST TCI business. However, this was never really the case and is far from the case in today's market where private insurers are increasingly able and willing to underwrite the full range of PRI risks and, importantly, are happy to take long maturity cases.

As noted earlier, it is misleading to treat public insurers as a homogenous group. In practice, they differ greatly not only in size and status but also in the range and nature of the facilities they offer. But it is equally misleading to treat private insurers as a group of broadly similar entities. They also differ greatly, ranging from huge, primarily ST TCI insurers (e.g., Atradius, Euler Hermes, and Coface, offering not only insurance facilities in a large and growing number of countries, but also a range of associated activities and products such as the provision of status information on buyers and debt collection) to relatively small scale underwriting of particular PRI risks by underwriters in Lloyds syndicates.

Until the 1990s, one difference between private and public insurers was in relation to reinsurance. Public insurers did not normally reinsure (at the end of the day, the risks were, in effect, taken by their governments) and some of the largest reinsurers were in any case unhappy with political risks. Today, many public insurers are interested in and involved with co-insurance and outward reinsurance, even as many governments look to reduce their involvement in TCI and PRI and their exposure to contingent risk.

All public insurers are subject to varying kinds of oversight from their governments. They are also subject to two main multilateral agreements. First, under the terms of the WTO, governments and their ECAs/public insurers are required at least to operate on a break-even basis over time and to avoid the provision of subsidies for premium rates, etc. In practice, this has never proved to be a particularly onerous requirement and few countries seem to wish to be the one to throw the first stone in terms of initiating action against another country for breach of this requirement. Second, there is an OECD agreement (the OECD Arrangement formerly known, colloquially, as the Gentleman's Agreement) in relation to the terms which may be supported by public insurers/governments in respect of MLT business. This has become an increasingly wide-ranging and detailed agreement. Originally it applied only to length of credit and profile of repayments, quickly took in minimum interest rates, and now sets out minimum premium rates for both political and commercial risks. It also embraces project financings. This has been pretty effective not only in controlling and eliminating "competitive subsidies" on interest rates and trying to rationalize and standardize premium rates, but also in providing a forum for regular meetings between OECD governments and public insurers on technical matters relating to MLT business. Interestingly, the OECD Arrangement does not, in general terms, apply to PRI facilities issued by public insurers.

Today, many public insurers are interested in and involved with co-insurance and outward reinsurance, even as many governments look to reduce their involvement in TCI and PRI and their exposure to contingent risk.

More controversial and wide ranging restrictions on public insurers—or, more precisely, on their governments—are applied by the EU Commission on Member States via the Provisions on Marketable and Non-Marketable Risks. Put simply, these restrictions relate essentially to ST business. The Commission (which arguably is not at its best when dealing with real life commercial matters) purports to divide risks/cases into two categories: first, marketable risks, supposedly representing risks that the private market is able and willing to insure with no significant gaps and, second, non-marketable risks, which private insurers/reinsurers are regarded as unable or unwilling to underwrite on any scale and so where market gaps exist. The categories are supposed to be kept under close review so as to take account of changes in the market. Public insurers are only able to operate in the second area (i.e., in the area of non-marketable risks). Thus EU public insurers are prohibited from underwriting marketable risks.

In the real world, the categories are artificial and usually bear little relationship to day-to-day private market activities. In practice, and for the reasons mentioned earlier in relation to spread of risk and

(Continued on page 8)

Public and Private Insurers: What is the Optimum Relationship for Insureds? (*cont'd*)

minimum premium income, some governments/public insurers are not slow to press for categories of business to be categorized as "non-marketable." The result is that EU public insurers regularly underwrite business that could be done by private insurers, so getting a wider spread of risk and higher premium income. It is very important to note that these restrictions and categories do not apply to public insurers outside the EU.

In practice...some governments/public insurers are not slow to press for categories of business to be categorized as "non-marketable."

In general, the Commission looks to the OECD Arrangement to apply control on the MLT activities of public insurers in member states and, misleadingly, says in the preamble to the Communication that "MLT export credit business is largely non-marketable at the present time." However, even though the marketable and non-marketable categories are EU concepts and apply only to ST business, they seem to have taken on a life of their own and conclusions seem to be drawn more widely in the market that, if a country is categorized as non-marketable for ST business, it must be the case that it is in the same category for all other business, especially MLT and even PRI business. Clearly this can have implications for public insurers and judgements on competition.

This last point is interesting in the sense that perhaps the leading specialist PRI broker told me that, in a very recent review of their substantial book, virtually the whole of the cases both by number and by value were in respect of business in countries categorized by the Commission as non-marketable. Interestingly, little or none of the business is written in conjunction with or under the umbrella of an ECA or MIGA. (One potentially fascinating consequence of the recent Brexit vote in the UK is that when the UK leaves the EU, the UK's public insurer (UK Export Finance, formerly ECGD) will no longer be subject to any EU restrictions on marketable risks.)

More widely, public insurers might argue that they have to operate under constraints and influences that do not apply to private insurers. Some restrictions are international like the OECD Arrangement and, for EU member states, the Commission's requirements on marketable risks. Some public insurers might say that they are "forced" by their governments to do business that does not conform with their normal underwriting standards but are still required to meet the cost of claims/losses. However, private insurers also operate under constraints, albeit different ones. As a general rule, public insurers are not subject to the (often onerous) rules and requirements that the insurance regulators or national supervisors in their countries apply to private insurers.

Looking to the future and trying to draw some conclusions from the foregoing, I cannot escape the view that some public insurers have never come to terms with the fact that they no longer have monopoly products and that, nowadays, their customers often have a real choice between buying insurance from a public or a private insurer. Put in starker terms, some public insurers have still to come to terms with the reality of competition. This must, and does, impact cooperation and collaboration between private and public insurers. One potentially important manifestation of this is the continuing and disappointing unwillingness of (some) public insurers to allow private insurers to join the important Medium and Long Term Committee of the Berne Union. This must surely have some adverse impact on full cooperation and does nothing to help increase the overall MLT capacity of the market.

All of this gives rise to the question of what would be the ideal or optimum kind of relationship between public and private insurers. To some extent, of course, the answer depends on the position of the person asking the question. Would, for example, both private and public insurers give more or less the same answer? Would public insurers really want to see a larger and more vibrant private sector with greater and greater capacity? Would private insurers really want to see public insurers retreat to a contingent or truly "insurer of last resort" status, operating only when there were clearly defined and established "market gaps," i.e., public insurers would really only issue facilities when all other options had demonstrably failed?

Against this background, it is perhaps best to try to work from the standpoint of the insured party or buyer of insurance. In other words, what kind of relationship between private and public insurers would be best for their actual or potential customers?

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I imagine that most customers would like to see the maximum market capacity and appetite for risk, including for more difficult and challenging cases and countries. They would also prefer low(er) premium rates, high(er) percentages of cover/indemnity, and few(er) exclusions. No doubt they would also like clearer, less ambiguous wordings. I think they would also like facilities that provide

(Continued on page 9)

Public and Private Insurers: What is the Optimum Relationship for Insureds? (*cont'd*)

the easiest and least conditional access to finance at the cheapest rates/lowest costs. For banks looking to buy insurance, I assume they would like facilities that give them most in terms of meeting the requirements of Basel III (i.e., coming closest to being unconditional guarantees). No doubt the more experienced insureds would look for a sensitive and positive attitude towards potential loss, claims payments, and recoveries/loss minimization.

More difficult, perhaps, is to assess whether insureds are likely to achieve better results in all or most of these areas from competition between public and private insurers or whether, in anything but the short run, collaboration and cooperation between insurers will be likely to be more effective.

In a perfect world, I guess that insureds would like to begin in situations where insurers, private and public, were actively competing for the business but where, once the insured had made the choice of insurer, all insurers would work together with full collaboration and cooperation. But, in the real world, is this practical and achievable?

One trend that should, perhaps, be a cause for concern is where public insurers attempt to "corner the market," seeking to obtain advance commitments from private insurers and reinsurers, so "soaking up" pretty much all available capacity in the market. This means that insureds and their brokers have, in effect, no choice of insurer and any potential competition has effectively been eliminated. To the extent that this has been happening, I think it is a very undesirable trend and is not in the interests of insureds or potential insureds. In effect, it is a suppression of competition and, however it is dressed up, it is not in any sense an optimum position. This would of course be true if it were to be private insurers taking the lead in cases.

Relations between private and public insurers may well not be a new topic. It is one which has a long and sometimes checkered history. But it remains an area of real practical importance and one that would benefit from greater and more open scrutiny.

It is not realistic and—other than in the very short run—in anyone's interests to expect public insurers always to withdraw if a private insurer is willing to underwrite a case. Not least from a customer point of view, I believe some competition is desirable and competition would be reduced, probably significantly, if public insurers were to adhere strictly to an "insurer of last resort" role. It is still the case that the market needs the capacity that public insurers have and this is true across the whole risk spectrum and not just in the "bad risk" area.

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This much is pretty common ground for all parties. Beyond this, I doubt there is much consensus. What, for example, do public insurers bring to the market apart from capacity? Should public insurers be, in effect, freed from restraints on competition with private insurers? Can there ever be fair competition between public and private insurers? Essentially, the question is, "What in current conditions is the best role for public insurers?"

Perhaps these questions are the subject of active discussion. If not, then they certainly should be. ■

The History and Evolution of Aviation War Insurance: An Expert Interview with Glen Brighton (*cont'd*)

would have been if they had done that. On top of what was going on in the world, I think when you consider what the aviation insurance market provided in the next few weeks and months and eventually years, it was a great service to the world. Because if they had, and financiers would have said there's no coverage, I think banks would have most probably grounded aircraft because they wouldn't have been prepared to take the risk. So the insurance market rallied around, came up with solutions, they provided a limited amount of coverage—and it was very limited, but it was a start—and then we had governments who stepped in, in most places in the world, to provide some additional coverage that meant that the people who owned the aircraft, financed the aircraft, would be comfortable. And that's how it all panned out. The United States' whole position was, you know, that this was an act against the state, it wasn't an act against the airlines that were involved and they wanted to keep the world running, so they provided assistance and up until only two years ago had provided the coverage. At the time, it was difficult because there were lots of conversations that had to be had and I think we had to get people comfortable with the future and potential risks that were going on and there were certain markets that stepped up and to be quite honest with you, there were some very big decisions made by groups that had never been in the aviation market before to get involved in aviation war insurance and war liability insurance who then went on to make a huge amount of profit out of the whole industry. But then in those early days, we all

(Continued on page 10)

The History and Evolution of Aviation War Insurance: An Expert Interview with Glen Brighton (*cont'd*)

thought they were taking a huge risk. We didn't think that 9/11 was just a one-off event; we didn't know if it was going to be happening on a weekly basis. So they came in and they offered their capacity and they provided the coverage and they were very, very well paid for doing it and eventually…they made a great profit on it and eventually got out of it. Mr. Buffet is a very, very clever man, I will tell you that.

GRSM: There was a relatively quiet period from an aviation war insurance perspective after 9/11, that is until 2014, when in March of that year, Malaysian Airlines Flight 370 disappeared mid-flight. Can you describe for us what the claims process was like for that particular aircraft?

GB: Well, it was very dynamic, when I think about it. The aircraft was lost—I'm pretty sure it was lost on either a Thursday or Friday night and I know that because I was actually in Singapore. I was on an airplane at the same time as Malaysian Airlines Flight 370 went missing. I went from Singapore back to London at pretty much the same time of night as Malaysian Airlines was taking off and flying to its doom. I got home that morning and remember the taxi driver telling me that there's been news of an aircraft going missing and then, like always, I contact my colleagues and have a little chat, work out it's Malaysian Airlines, which is a Willis client, and then we have to work out what we're going to do. Our initial reaction was let's start collecting a claim. So we go to the market—the hull all risks market—and we say, "Well, the airplane has gone missing, it's been missing for more than 48 hours"—there was a "missing 48 hours" clause in the policy, so once it's gone missing for more than 48 hours, its declared a total loss, so that had been triggered. And once that process had started, we were going out to the markets which insured the aircraft and we told them what the agreed value of the loss was and we started collecting the claim. And that process went on for the next six days. Then we got to the next Saturday morning, when we all woke up and put the news on and there was the Prime Minister of Malaysia telling everybody that actually, events weren't what we thought they were and that there was an investigation looking at the pilot and some of the things that he had done and he was raising suspicion that this wasn't a mechanical failure, that maybe this was an outside influence, a war loss potentially. So on the Monday morning, we have to go back to all the insurers who had provided us with the funds to pay the claim and say, "Well actually, we think that this is a debatable loss now and we're not sure which policy should respond." So we then go to the hull war market and we say to them, "Well actually, guys, this is now potentially a war loss so we're going to invoke the 50/50 clause." The 50/50 clause is all about insurers cooperating with each other and paying a loss knowing that of the two policies out there—hull all risk policy and the hull war risk policy—that one of those policies would respond and once the information and the aircraft could be found and we'd worked out exactly what had happened to the aircraft that one set of underwriters would reimburse the other set and in the meantime, the financiers have been paid within the specified agreed time that's most probably in the financial lease agreement, so the financiers would be happy, the airline would be happy, and of course the insurers would wait until the aircraft is found. But now, what we've actually found, coming up on two and a half years later, there's still no real evidence of what's happened to the aircraft. I mean, I know that they've found some pieces and I'm sure that experts have looked at that and I'm reading some stories that they're thinking that there is some kind of damage that they're going to be able to tell what's going on, but that's not absolutely agreed and my understanding is that there's now going to be, at some point, a conversation between the two sets of insurers to work out what they're going to do next. So it's an interesting time to see the 50/50 clause worked, as far as financiers are concerned, but does it provide everything that most probably insurers want out of it? Because one of them has paid half of a loss that they didn't have to, and so trying to work out the next part of the scenario is actually quite difficult.

So they came in and they offered their capacity and they provided the coverage and they were very, very well paid for doing it and eventually…they made a great profit on it and eventually got out of it. Mr. Buffet is a very, very clever man, I will tell you that.

GRSM: How long did it take for the claim payment to be made?

GB: I reckon it was, from start to finish, about four weeks.

GRSM: That's pretty good, isn't it?

GB: It's pretty good, considering the loss. But you've got to remember we work in a market that's actually very, very good and active at paying claims. They know what their responsibilities are and they know that it means a lot to get this done as quickly as possible, so they're very happy to work from that basis. This is not a bunch of insurers who are not looking to pay claims. They are very responsive and have always been responsive and it would probably be very difficult to find anybody out there that would talk badly about the aviation insurance market when it comes to paying claims.

So it's an interesting time to see the 50/50 clause worked, as far as financiers are concerned, but does it provide everything that most probably insurers want out of it?

GRSM: There were a couple of other events in 2014. One you mentioned: the attack on the Tripoli International Airport in July and then

(Continued on page 11)

The History and Evolution of Aviation War Insurance: An Expert Interview with Glen Brighton (*cont'd*)

there was also the shooting down of Malaysian Airlines Flight 17 over Ukrainian airspace. How did these events in 2014 affect pricing?

GB: Well, I guess we were all sitting there—the brokers—talking about this in the meeting room, thinking this may have a huge impact on pricing, but in reality, the market is driven by capacity and the more capacity, the harder it is for the market to react. The problem is when you've got so much over capacity, if you're an insurer and you want to put the price up in the hundreds of percentage points, there's always going to be another market that didn't write the risk, that doesn't think the risk is as bad as you might now, and the loyalty of maybe the airlines is there to the markets that've always supported them as long as they don't get too much of a swing in price issues. So the reality is the market reacted in a rather strange…it was nearly like it had never happened. I mean, that sounds strange, but the reality was: can you think of it as a one-off event? Can you go back to Malaysian Airlines and say, "Actually, guys, we're going to really punish you. Not only did you have a loss in aircraft with your crew and your passengers and what that's going to do to your business, but actually the double whammy is that we're going to charge you three times as much next year," for an event that, really, none of us actually thought was their fault—they were just in the wrong place at the wrong time. I think that the market was most probably fair with Malaysian Airlines. I'm sure that there was an increase in premium, but it wasn't dramatic enough—the event—to turn the market.

GRSM: Do you see the pricing now holding steady? I guess it's part of a bigger question about what you see for the foreseeable future.

GB: I actually think the whole market has been expecting prices to stabilize at some point. I do think this may well be the year—and we're in the fourth quarter of 2016, so most of the market is now beginning to renew their policies—I think that we're managing expectations with maybe not big reductions, but maybe not…there's no increases. I think it'll be stable, is how we can see it.

GRSM: Based on this interview and the number of years that we've worked with you, we know, and our readers may be able to glean from this interview, that you're very passionate about your job. So our last question to you is what do you consider the most enjoyable part of your job?

GB: That's a good question! I guess I get to see so many different things at so many different times from so many different places. I get to work on transactions from all over the world and the reaction on a transaction in India can be very different from the one that I might get on a transaction in Western Europe. I have fun answering the questions and explaining to people about the cultural differences of what we do—and it really is a cultural difference overall. And you never know what you're going to go into and how people are going to react. I guess that's the part that I really enjoy the most, explaining to people that I've done a deal in that part of the world and it's very different from another part of the world. I enjoy that bit.

GRSM: Great. Thank you so much, Glen. ■

Trucking Under NAFTA: The Tortuous Path (*cont'd*)

would not be able to impose tariffs beyond 10% or 15%. If Mexico was not able to shut down exports of certain US goods completely, then the target retaliation figure would have to be achieved through small tariff increases over a larger number of products. This posed several problems. First, the effect on trade would be even more substantial as more products would be involved in the retaliation. It was one thing to affect three or four products but a very different thing to affect 80, 90, or 100. Second, Mexico would have to find products that were not used for the production of other goods in Mexico as this would result in a loss of competitive advantage to Mexican exporters of final goods, i.e., a shot in the foot. Third, the products on the list would have to be "inflationary-neutral" to avoid pressures on the price of basic goods consumed in Mexico such as milk, eggs, beans, rice, and corn, among others. Fourth, Mexico had to be careful not to select products that were already part of distorted markets or subject to other trade disputes (e.g., fructose, beef, steel, tuna, chicken, etc.). Finally, the selected products also had to be important for the US as otherwise, the retaliation measure would not have the desired effect of motivating the US to bring its DOT policies in compliance with NAFTA. In a fully integrated North American market with NAFTA operating in Canada, the US, and Mexico for almost 15 years, finding 100 products (out of thousands of tariff items) meeting these conditions presented a real challenge. Toilet paper, dog food, Christmas trees, and the like were not only Mexico's preferred choices; they were its only choices.

Toilet paper, dog food, Christmas trees, and the like were not only Mexico's preferred choices; they were its only choices.

The Investment Arbitration Claim

In the midst of the retaliation process, Mexico's national trucking association, CANACAR, realized that if Mexico were to use some form of "lost profits" approach when calculating its countermeasure and an arbitration panel had already established that the US

(Continued on page 12)

Trucking Under NAFTA: The Tortuous Path (*cont'd*)

measures on cross-border trucking services were inconsistent with NAFTA, then CANACAR might be able connect these points and submit an investor-state claim against the US under NAFTA's Chapter 11, which, if successful, could result in a substantial monetary award in favor of CANACAR.

CANACAR initiated its investment claim against the US under NAFTA Chapter 11 on April 2, 2009. As with the retaliation measure, this investment claim posed a series of novel issues. CANACAR represented the interests of almost 4,000 individual investors/claimants. This was not the typical investment arbitration case between one investor and the respondent state. It was a multi-party, mass claim type of action that was unprecedented under NAFTA and had rarely occurred under other investment treaties. Was NAFTA designed to support this type of arbitration? Was it logistically possible to administrate a dispute with 4,000 claimants?

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CANACAR's claim also presented interesting jurisdictional issues. As a starting point, would Mexican trucking companies qualify as "investors" within the definition of Article 1139 of NAFTA? Some considered that NAFTA has a territorial basis and that investments by Mexican nationals in Mexican trucks that were not operating in the US could not possibly qualify as international "investors" for purposes of NAFTA. A deeper and more careful analysis could suggest otherwise. Although there were variations among the numerous claimants, Mexican trucking companies owned assets that had been acquired with the expectation that they would be used to obtain economic benefit in the US. These properties included the actual trucks (which had been made NAFTA-compliant over many years with the expectation of providing long-haul, point to point, trucking services to the US) as well as equipment, holding yards and patios, office spaces, etc. and rights to business income. These were "wealth-producing" elements that could make CANACAR's assets fall within NAFTA's definition of "investment."

Despite the legal challenges and logistical issues, CANACAR decided to proceed. The US responded that it would defend the claim vigorously.

CANACAR's claim was also initially tagged as unviable since it was considered that disputes relating to trade in goods and services were outside the jurisdiction of Chapter 11 that was supposed to be solely for investment disputes. There were a few arbitration precedents, however, that indicated the contrary. Despite the legal challenges and logistical issues, CANACAR decided to proceed. The US responded that it would defend the claim vigorously.

To this day, neither the state-to-state dispute nor CANACAR's investment claim have so far been fully and finally resolved. A former owner of a cross-border trucking company (who is both a US and a Mexican citizen) declared to the press that the trucking case was "testing whether NAFTA's rules could resolve any type of dispute despite its size, duration or complexity." The answer to this remains to be seen. ■

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