

Memorandum of Determinations

Expropriation Claim of Bank of America, as Trustee
India – Contract of Insurance No. F041

On March 22, 2002, Bank of America, N.A., in its capacity as trustee of the Bank of America Trust (the “Insured”), sent a notice of claim¹ under the expropriation coverage of OPIC Contract of Insurance No. F041 (as amended on September 26, 2000, the “Contract”).² The Contract covers a loan provided by the Insured to Dabhol Power Company (“DPC”), a special purpose entity established under Indian law to develop, construct, own, and operate a combined cycle power generating station and associated facilities, including a liquefied natural gas terminal, a regasification facility, a pipeline, port facilities, and an LNG tanker (collectively, the “Project”).

On June 7, 2002, the Insured filed an application for compensation (the “Initial Claim Application”)³ in support of its claim under the Contract (the “Claim”) and requested payment of US\$1,913,043.19 in respect of two unpaid installments of interest due September 17, 2001 and March 17, 2002, respectively, and US\$24,144,825.23 with respect to the outstanding principal amount on the Insured’s loan to DPC (the “Loan”). On July 24, 2002, at the Insured’s request, OPIC representatives met with representatives of the Insured to discuss the Claim Application. At that meeting, the Insured invited OPIC to provide its questions and requests for additional information in writing, which OPIC did under cover of a letter dated July 25, 2002. By letter dated November 21, 2002, the Insured submitted its response to OPIC’s requests (the “Response Letter”).⁴

OPIC subsequently met with Bank of America representatives identifying certain open questions with respect to the claim, matters with respect to which Bank of America undertook to provide supporting information. The Insured subsequently has provided additional supporting documentation, including a “Consolidated Claim Application” dated August 12, 2003⁵ (the “Consolidated Claim Application” and, together with the Initial Claim Application, the “Claim Application”) which, among other revisions, requested OPIC payment of an additional

¹ Attached as Exhibit A.

² Attached as Exhibit B.

³ Attached as Exhibit C.

⁴ Attached as Exhibit D.

⁵ Attached as Exhibit E.

\$1,447,511.78⁶ for the unpaid interest payments due on September 16, 2002, and March 17, 2003. OPIC notes that a further interest payment in the amount of \$607,739.74 came due on September 15, 2003, and was not paid.

OPIC has determined that the requirements of a claim for expropriation under Section 4.01 of the Contract have been met and that compensation should be paid in the amount, in each case as set forth in Schedule 1 hereto, of the defaulted interest payments scheduled through the date hereof, plus the full principal amount of the Loan which is due and in default as a consequence of its acceleration on March 21, 2002, plus interest on each such amount at the average daily federal funds rate as provided in Section 5.01 of the Contract, all as set forth in Schedule 1 attached hereto.

I. THE INSURANCE CONTRACT

The Contract was executed by OPIC on April 29, 1999, effective as of May 6, 1999, and was amended on September 26, 2000. Under the Contract, OPIC insured the Insured against losses in connection with the Loan as a result of, among other risks, “expropriation” as defined in Section 4.01 of the Contract.

II. FACTUAL SUMMARY

A. Overview

Enron Corp. (“Enron”), Bechtel Enterprises Holdings Inc. (“Bechtel”), and General Electric Capital Corporation (“GE” and, collectively with Enron and Bechtel, the “Sponsors”), each through one or more subsidiaries, made equity investments in DPC for the Project, one of the world’s largest power projects, located near the village of Dabhol in the State of Maharashtra, India. The Maharashtra State Electricity Board (“MSEB”), an enterprise owned by the State of Maharashtra, owns (indirectly through a subsidiary) an approximately 14.14% interest in DPC, diluted from the 30% interest received by MSEB from Enron in settlement of investment disputes that, as described below, arose between MSEB and DPC in 1995. MSEB was the sole purchaser of the power to be produced by DPC.

The Project was to be constructed in two phases. The first phase (“Phase I”) involved the construction of a 695 MW power plant (with an additional peaking capacity of 45 MW yielding a total capacity of 740 MW) as well as certain ancillary facilities. The power plant is capable of running on either naphtha or distillate. Financing for Phase I closed in March 1995 and was restructured in December 1996 following resolution of the disputes that arose between DPC and MSEB. Phase I of the Project began commercial operation on May 13, 1999.

⁶ The Insured subsequently reduced the calculated amount of the March 17, 2002, payment from \$719,757.24 to \$680,747.12, reducing the actual total for these two payments from \$1,408,501.66. Schedule 1 reflects the corrected amounts.

The second phase (“Phase II”) was designed to add two power blocks with an aggregate net capacity of 1,444 MW and to convert Phase I to use LNG as its fuel. Together, Phase I and Phase II would constitute a 2,184 MW LNG-fired power plant. The Loan was provided as part of the financing for Phase II, which closed in May 1999.

The Insured asserts in the Claim Application that, as a result of various actions taken by MSEB, the Government of the State of Maharashtra (“GOM”), the Maharashtra Electricity Regulatory Commission (“MERC”) and the Maharashtra Pollution Control Board (“MPCB” and, collectively with MSEB and the GOM, the “Maharashtra Governmental Authorities”), as well as the Indian judiciary and the federal government of India (the “GOI”), DPC defaulted on certain scheduled interest payments due under the Loan.⁷ On March 21, 2002, the outstanding principal amount of the Loan was automatically accelerated as a consequence of a bankruptcy Event of Default (the Bombay High Court’s appointment of a receiver for DPC) so that the full amount of the Loan, plus unpaid interest, is now due.

B. The Project Documents

DPC and MSEB are parties to a Power Purchase Agreement dated December 8, 1993 (as amended on February 2, 1995, July 26, 1996, and December 9, 1998, the “PPA”).⁸ Under the PPA, MSEB is responsible for making capacity and energy payments to DPC. If the PPA were to be terminated and the Dabhol Project transferred by DPC to MSEB in accordance with the terms of the PPA, then MSEB would be required to pay for the facilities by making a lump sum payment to DPC (the “Transfer Amount”).⁹ The PPA is governed by Indian Law and provides for arbitration in London pursuant to the UNCITRAL Arbitration Rules.

GOM issued a guaranty, dated February 10, 1994 (the “GOM Guaranty”), in favor of DPC, pursuant to which it guaranteed MSEB’s payment obligations under the PPA.¹⁰ The GOM Guaranty is governed by English law and, like the PPA, provides for international arbitration in London under UNCITRAL rules. The GOM and DPC also entered into a State Support Agreement dated June 24, 1994 (the “State Support Agreement”), which, upon settlement of the disputes that arose in 1995, was amended by a Supplemental State Support Agreement with DPC dated July 27, 1996 (together with the State Support Agreement, the “State Support Agreements”). In the State Support Agreements, the GOM promised, among other things, to promote and support the Dabhol Project, including using its power over other governmental entities to facilitate the permitting process. The State Support Agreements are

⁷ Consolidated Claim Application at 1.

⁸ Id. at 4.

⁹ See Section 17 and Schedule 11 of the PPA.

¹⁰ Consolidated Claim Application at 4-5.

governed by English law and provide for the arbitration of disputes in London pursuant to UNCITRAL rules and for waivers of sovereign immunity in connection with any proceedings brought against the GOM or its assets.

The GOI issued to DPC a counter-guaranty of the GOM Guaranty dated September 15, 1994 (the “GOI Guaranty” and, together with the GOM Guaranty, the “Guaranties”), pursuant to which it agreed to pay DPC “any sum of money validly due” under the PPA that had not been paid by MSEB or the GOM.¹¹ The GOI Guaranty is, however, subject to various exposure limits. (The GOM Guaranty, in contrast, covers all amounts that come due under the PPA.) The GOI Guaranty guarantees payment of the Transfer Amount upon termination of the PPA by DPC, but only in an amount equal to the lesser of (a) the amount of Phase I debt (currently at approximately \$203 million) and (b) US\$300 million. The GOI Guaranty is governed by Indian law but, like the PPA, the GOM Guaranty and the State Support Agreements, provides for UNCITRAL arbitration in London. The GOI Guaranty also provides for a waiver of sovereign immunity in connection with any enforcement proceedings brought against the GOI or its assets.

In connection with the financing of Phase II, DPC entered into an Escrow Agreement with MSEB and Canara Bank, dated as of September 19, 1998 (as amended and restated as of March 27, 1999, the “Escrow Agreement”), pursuant to which MSEB agreed to establish certain arrangements, including escrow accounts, for the collection of receivables from MSEB’s electricity sales to provide security for the payment and performance of MSEB’s obligations under the PPA. The Escrow Agreement, though governed by Indian law, provides for disputes to be arbitrated in London pursuant to UNCITRAL rules.¹²

On July 17, 1999, Canara Bank, a GOI-owned bank, issued a letter of credit for up to \$1.36 billion rupees (the “Canara Bank LC”) in favor of DPC, who then assigned the Canara Bank LC to the onshore trustee as collateral. The letter of credit could be drawn in the event MSEB failed to make timely payment of amounts due under the PPA. The offshore lenders had required issuance of the Canara Bank LC as a condition to financing the project.¹³

C. Actions by Indian Governmental Authorities

1. *Actions of MSEB, the GOM and the GOI.*

MSEB has rescinded the PPA twice, first in 1995 and then again in 2000. The first rescission occurred in August 1995, when the GOM declared its intent to cancel the PPA

¹¹ Consolidated Claim Application at 5.

¹² Id. at 15-16.

¹³ Id. at 16.

shortly after construction on Phase I began.¹⁴ MSEB then both formally rescinded the PPA and directed DPC to stop construction of the Project. DPC promptly initiated arbitration proceedings against the GOM in London. Although the GOM filed suit in the Bombay High Court seeking to block the London arbitration from proceeding, the arbitral panel persisted and issued an interim award with respect to DPC's complaint.

By the end of November 1995, the parties had resolved the dispute. The resolution involved an amendment to the PPA, conclusion of the Supplemental State Support Agreement, and Enron's transfer to MSEB of a 30% equity interest in DPC (subject to subsequent dilution to its current 14.14% interest). Shortly thereafter, MSEB dropped its suit in the Bombay High Court, and DPC withdrew the arbitration complaint. Construction on the Dabhol Project resumed in 1996. Phase I was completed and entered into commercial service on May 25, 1999.¹⁵

After roughly eighteen months of successful operations, problems re-emerged. MSEB failed to make the October 2000 capacity payment to DPC and partially defaulted on four capacity payments between October 2000 and January 2001 by a total amount of approximately US\$49 million.¹⁶

In October 2000, the GOM formed an Energy Review Committee (the "Godbole Committee") to review the power situation in the State of Maharashtra generally and "[t]o suggest the broad future course of action for reforms in the energy sector in the State."¹⁷ It was also asked specifically to review the PPA and "to suggest appropriate measures to facilitate purchase of the power produced by the DPC by other agencies/parties (including [the GOI] or their agencies)." In a subsequent supplement to the terms of reference, the GOM also asked the Godbole Committee:

- “1. To examine the situate of present availability and actual supply of electricity within Maharashtra. Also to estimate State's requirement of power for next 10 years and suggest measures to meet the requirement of power.
2. To review the tariff presently charged by Maharashtra State Electricity Board to various categories of consumers, the per unit cost for generation

¹⁴ Consolidated Claim Application at 6.

¹⁵ Id. at 8.

¹⁶ Initial Claim Application at 6.

¹⁷ Report of the Energy Review Committee (the "Godbole Committee Report"), Annex 2a, at 124.

of electricity from various sources, total realisation from billing, electricity distribution efficiency and to examine its impact on MSEB. Also to suggest measures to improve financial position of MSEB.

3. Evaluate and review Dabhol Power Project, review any and all of its clearances, tariff, and all aspects in the context of the relevant laws and notifications as may be applicable at any specific time.
4. Suggest appropriate measures to ensure that the interests of the State, Maharashtra State Electricity Board and electricity consumers of the State of Maharashtra are properly and adequately considered, evaluated and safeguarded.
5. Negotiate with Dabhol Power Company on behalf of State Government and Maharashtra State Electricity Board for lowering the tariff, capital cost and all other aspects of the Dabhol Power Project.”¹⁸

The Godbole Committee’s final report concluded that the MSEB was financially incapable of meeting its payment obligation under the PPA¹⁹ and proposed another renegotiation of the project and financing documents, seeking, among other things, a restructuring of the tariff (de-linking it from the dollar/rupee exchange rate), separating the LNG facility and selling LNG on the spot market, canceling the planned escrow arrangements,²⁰ an increase in the term of the

¹⁸ Godbole Committee Report, Annex 2b, at 126-127.

¹⁹ Id. at 90.

²⁰ With respect to the revenue collection escrow account, the Godbole Committee recommended:

The Escrow Agreement with DPC, as currently structured, requires fresh regions to be added when there is a shortfall in revenue requirements. This will soon give rise to a situation where virtually all of MSEB's revenues will be required to be escrowed to meet DPC's payments, leaving little for wages and fuel, let alone additional power purchase. As discussed in Chapter 6, the escrow arrangement is not even in the interest of DPC, since it would retard reform of distribution, which is critical to raise revenue collection. However, as long as escrows remain, privatization will not be possible. The Committee therefore recommends that, as part of the negotiation, the current Escrow Agreement with DPB be cancelled. The security of future payments to DPC under the restructured tariff (and the security of payments to other IPPs) will be based on increased cash flows from a reformed distribution system, which the Committee will address in Part II of the Report.

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project debt, and enhanced financial support from the GOM and the GOI.²¹ The Godbole Committee Report was at least as harsh in its judgments on MSEB as it was on DPC. For instance, “[t]he Committee would like to state strongly that none of the solutions espoused for IPPs in general and DPC in particular is tenable without reform of MSEB.”²²

On January 25, 2001, DPC demanded payment under the GOM Guaranty for amounts that, in its view, were due from MSEB under the PPA but remained unpaid.²³ The GOM compensated DPC for the payments from October and November 2000, but did not pay the amounts owed for December 2000 and January 2001.²⁴

On February 28, 2001, MSEB charged that DPC had misdeclared the amount of available capacity for one hour on January 28, 2001. MSEB later alleged that on at least two additional occasions there had been capacity shortfalls consequent to a cold start of the Dabhol Project (a situation in which the plant is shut down for over twelve hours). MSEB alleged that these shortfalls amounted to a breach of the PPA and justified its rescission of the contract.

On March 7, 2001, DPC called the GOI Guaranty, demanding payment from the GOI for the invoices outstanding under the PPA.²⁵ The GOI refused to make the requested payments, stating that the GOM had informed the GOI that in the circumstances “the invocation of the [GOI Guaranty] may be rejected by the [GOI].”²⁶ The GOI noted that the GOI Guaranty was not unconditional and that “there has been no determination by any court or tribunal that the sum of money payable to DPC by MSEB under the [PPA] is validly due.”²⁷ The GOI further stated that “it would appear that the condition precedent to the invocation of the [GOI Guaranty] has not been fulfilled and consequently [the GOI] is not obligated to pay any sum under the [GOI

(Cont'd from preceding page)

Godbole Committee Report at 90.

²¹ Id. at 83-92.

²² Id. at 93.

²³ Initial Claim Application at 7.

²⁴ Id.

²⁵ Id.

²⁶ GOI letter to DPC dated March 31, 2001, para. 5 (Exhibit 9 to the Consolidated Claim Application).

²⁷ GOI letter to DPC dated March 31, 2001, para. 5 (Exhibit 9 to the Consolidated Claim Application).

Guaranty] as demanded by DPC.”²⁸ DPC’s subsequent demands on the Guaranties also were not honored.

MSEB paid the February 2001 and March 2001 invoices “under protest,” but DPC accepted the payments. MSEB made the April 2001 payment with an attached statement that it was made subject to resolution of the pending disputes. DPC, objecting to that condition, returned the payment. DPC subsequently sought reissuance of the proffered April payment, but MSEB refused.

On April 7, 2001, DPC issued to MSEB a Notice of “Political” Force Majeure pursuant to Section 16.3 of the PPA, citing (a) payment defaults (including MSEB’s failure to pay amounts due under the PPA, the GOM’s failure to honor the GOM Guaranty, and the GOI’s failure to honor the GOI Guaranty), (b) the GOM’s failure to honor its obligations under the State Support Agreements, (c) MSEB’s failure to comply with certain obligations under the PPA, including constructing transmission infrastructure, providing payment security, and facilitating plant operation, and (d) MSEB’s failure to absorb Phase I power at a load factor of 90%.²⁹

In April DPC served arbitration notices against each of MSEB (on April 12, 2001, pursuant to the arbitration provisions of the PPA), the GOM (on April 10 and 11, 2001, under the GOM Guaranty and the State Support Agreements), and the GOI (on April 4, 2001 under the GOI Guaranty). MSEB responded on or about May 8, 2001, notifying DPC of its appointment of an arbitrator.³⁰

In a May 23, 2001, letter to DPC, MSEB declared its rescission of the PPA, alleging misrepresentations and assorted other wrongful actions by DPC.³¹ On May 25, 2001, MSEB petitioned the Maharashtra Electricity Regulatory Commission (“MERC”) to declare that the PPA was validly rescinded by MSEB, to enjoin DPC from international arbitration against MSEB, to prevent DPC from exercising remedies under the Escrow Agreement, and to set, by regulatory decree, the price for power produced by the Dabhol Project. On May 29, 2001,

²⁸ GOI letter to DPC dated March 31, 2001, para. 5 (Exhibit 9 to the Consolidated Claim Application).

²⁹ See the Notice of Political Force Majeure, issued by DPC to MSEB, dated April 7, 2001 (Exhibit 14 to the Consolidated Claim Application).

³⁰ Letter from MSEB to DPC, dated May 8, 2001 (in OPIC files).

³¹ Letter from MSEB to DPC, dated May 23, 2001 (Exhibit 16 to the Consolidated Claim Application).

MSEB informed DPC that it would permanently cease to purchase power from the Dabhol Project.³²

On September 10, 2001, the onshore collateral trustee (the “Onshore Trustee”) presented documents to Canara Bank to draw on the Canara Bank LC. Canara Bank declined to pay and asked the trustee to return the next day. On that next day, however, MSEB applied to the Bombay High Court for, and received, an injunction against payment, nominally for 10 days. That injunction remains, however, in place.³³

2. *MERC Actions*

MERC issued an interim order on May 29, 2001 (the “MERC Order”) declaring that, as a preliminary matter, it had jurisdiction to adjudicate the dispute between MSEB and DPC. It granted MSEB’s petition that it enjoin DPC from proceeding in any manner with, or participating in, the arbitration that DPC had initiated against MSEB. The MERC Order also enjoined DPC from taking any action to recover funds owed by MSEB through the Escrow Agreement. The MERC Order is, however, silent with respect to DPC’s rights to pursue arbitrations against the GOM and the GOI under the GOI Guarantees.³⁴

MERC determined, after reviewing the Electricity Regulatory Commissions Act of 1998 (“ERCA”), that “the provisions relating to arbitration in the PPA are inconsistent with §22(2)(n) of [ERCA]. Therefore, the relevant PPA provisions cannot have any force whatsoever.”³⁵ MERC also ruled that “[t]he only Indian law governing the subject of disputes and differences between the electricity utilities in existence today, when these disputes have actually arisen, is [ERCA].... Therefore ... MERC has sole and exclusive jurisdiction to adjudicate upon the disputes and differences between the MSEB and the DPC.”³⁶

Relying on the MERC Order, Canara Bank refused to reactivate the collection arrangements agreed under the Escrow Agreement.³⁷

³² Consolidated Claim Application at 12 and 15-16.

³³ *Id.* at 16-17.

³⁴ MERC Order, para. 15, at 11. (Exhibit 22 to the Consolidated Claims Application) See also Consolidated Claim Application at 16.

³⁵ *Id.*, para. 6, at 5.

³⁶ *Id.*, para. 7, at 5.

³⁷ Consolidated Claim Application at 15-16.

3. *MPCB Actions*

According to the Insured, DPC filed a timely application to MPCB in January 2001 for a renewal of MPCB's "consent to operate" Phase I.³⁸ MPCB failed to provide its consent and informed DPC that its application had been referred to the Consent Appraisal Board. As of the date of the Consolidated Claim Application, no decision had been made and the original consent had expired.³⁹

In connection with the development of Phase II, DPC notified MPCB on November 24, 2000 of its intent to test and commission the first block of turbines for Phase II.⁴⁰ On March 9, 2001, MPCB informed DPC that it was prohibited from testing and commissioning Phase II.⁴¹ The following month MPCB consented to DPC's testing and commissioning of Phase II, subject to certain conditions. DPC never agreed to these additional conditions, which MPCB has apparently never rescinded.

4. *Indian Judicial Actions*

On June 6, 2001, DPC sued MERC and the GOM in the Bombay High Court ("BHC") seeking to reverse the MERC Order.⁴² The BHC denied the request on June 26, 2001, finding that the MERC had authority itself to determine its jurisdiction. DPC appealed to the Supreme Court of India, which on August 6, 2001, reversed the BHC's decision, finding that it was up to the BHC to review and determine whether MERC had properly asserted its jurisdiction. On March 1, 2002, the Supreme Court remanded the case to the BHC to resolve that question for itself. Pending resolution of the matter, however, the Supreme Court continued the effectiveness of the MERC Order. Consolidated Claim Application at 17. On March 5, 2002, the BHC ruled orally that MERC has exclusive jurisdiction over the disputes with MSEB and that "DPC would have to resolve all disputes there."⁴³ As of the date of the Claim Application, the BHC had not issued a written decision. In April 2003, with a written decision still not issued, DPC applied to the Indian Supreme Court asking that it hear DPC's appeal notwithstanding the lack of a written decision, which the Supreme Court agreed to do. Shortly thereafter, on May 2, 2003, the BHC issued its written decision confirming the position adverse to DPC that it had

³⁸ Consolidated Claim Application at 9.

³⁹ *Id.* at 9.

⁴⁰ *Id.* at 8.

⁴¹ Letter from MPCB to DPC, dated April 4, 2001 (Exhibit 11 of the Claim Application).

⁴² Consolidated Claim Application at 14.

⁴³ *Id.*

taken orally.⁴⁴ A procedural hearing has since been held at the Indian Supreme Court where, as of the date of this Memorandum of Determinations, the matter remains pending.

On September 11, 2001, MSEB applied to the Bombay High Court for an injunction against payment of the Canara Bank LC, which the BHC immediately granted.⁴⁵ On September 17, 2001, DPC asked the Indian Supreme Court to lift that injunction. On September 21, the Court declined to do so. The Insured asserts that this injunction remains in place.⁴⁶

Each of the Bombay High Court and the Indian Supreme Court, in continuing the injunction issued by MERC, blocked DPC's pursuit of its arbitration rights set out in the PPA. The Bombay High Court's subsequent injunction against DPC pursuing arbitration against the GOM under the GOM Guaranty and the Delhi High Court's June 18, 2003, injunction against DPC pursuing arbitration against the GOI under the GOI Guaranty have similarly blocked DPC's pursuit of its arbitration rights under those contracts.⁴⁷

III. DETERMINATIONS UNDER THE CONTRACT

As a condition to receiving compensation for a loss covered by Section 4.01 of the Contract, the Insured must demonstrate that an expropriation, as described in Section 4.01, has occurred and is not subject to the exclusions set forth in Section 4.02 (as amended by Section 10.05). OPIC has determined that the Insured has made the required demonstration and consequently is entitled to compensation under the Contract.

A. Requirements for Expropriation Under the Contract

The Contract requires OPIC to pay compensation for expropriation if, in relevant part, expropriatory acts attributable to a foreign governing authority in de facto control of the part of the country in which the Project is located violate international law and are a substantial factor in causing a default on a scheduled payment on the Loan, subject to the exclusions

⁴⁴ Consolidated Claim Application at 14.

⁴⁵ Id. at 16-17.

⁴⁶ Id. at 18.

⁴⁷ See id. at 15.

provided in Section 4.02 (as amended by Section 10.05).⁴⁸ OPIC has determined that the facts presented in the Claim satisfy these requirements.

Section 4.01 requires the expropriatory acts to be “attributable to a foreign governing authority which is in de facto control of the part of the country in which the project is located.” There is no question that the alleged expropriatory acts discussed below -- acts of MSEB, MERC, MPCB, the GOM, the GOI, and certain Indian courts -- are actions of governmental authorities in control in their respective areas of competency at the Project’s location. The issues requiring more consideration are whether the relevant acts are (i) expropriatory, (ii) violative of international law, (iii) a substantial factor in the scheduled payment defaults, and (iv) not excluded from the scope of the Contract’s coverage.

1. *Alleged Expropriatory Acts*

a. Violations of the State Support Agreements

The Claim Application proposes certain alleged breaches by the GOM of the State Support Agreements as actions contributing to a creeping expropriation of the Dabhol Project.⁴⁹

The State Support Agreements generally obligate the GOM to exercise its powers to facilitate the permitting process for the Dabhol Project. The Insured argues that the GOM breached this obligation through its failure to prevent certain actions and inactions by MPCB that were adverse to the Project. The Insured also argues that the GOM breached the State Support Agreements by establishing the Godbole Committee and by instructing that body to examine the permits and clearances required under the PPA in order to determine whether any fault or defect in such clearances could supply the GOM with justifications for revoking the PPA.⁵⁰

i. MPCB Actions

The actions of MPCB for which the Insured would hold the GOM responsible include: (i) MPCB’s failure to renew DPC’s “consent to operate Phase I” before it expired, (ii) MPCB’s delay in responding to DPC’s notice regarding the testing and commissioning of Phase II, (iii) MSEB’s interim decision to prohibit such testing and commissioning, and (iv) its subsequent decision to impose conditions upon the testing and commissioning of Phase II that were not part of the original terms.

⁴⁸ Section 4.01 of the Contract also requires that the acts at issue continue for at least 90 days. OPIC concurs with the Insured that this requirement has been satisfied with respect to the relevant acts.

⁴⁹ See Consolidated Claim Application at 9-12 and 27-29.

⁵⁰ Consolidated Claim Application at 10-11.

These actions could constitute a breach of the State Support Agreements by the GOM if the GOM failed to support DPC's application with MPCB or to "take all steps within its power" to see that all clearances are granted, subject to legal requirements. The Insured has offered no evidence of, and OPIC is not aware of any such steps, much less "all [such] steps," being taken by the GOM to support DPC's application to MPCB. On the other hand, nothing in the State Support Agreements constitutes a waiver by the GOM of its governmental responsibilities. It is clear now that there were serious environmental issues associated with implementation of the Dabhol Project, such as leaks of naphtha that have fouled drinking water in neighboring areas.⁵¹ No reasonable reading of the State Support Agreements could cause the project lenders to conclude that such issues would or should be ignored by the MPCB or, for that matter, the GOM.

Further, it is not clear what, if any, practical consequence these actions had for the Project. Phase I was authorized to continue operating pending reissuance of the environmental permits. The Insured does not allege that Phase II construction was suspended for lack of MPCB clearance. The MPCB might have blocked the operation of Phase I and the completion of Phase II, but it did not. Although the Phase I permit was not reissued, the plant was specifically permitted to continue operating. By the time the interim consent expired, operations had ceased for other reasons.

It should be noted, however, that actions need not be illegal, or constitute breaches of the State Support Agreements or any other contracts, in order to contribute to a creeping expropriation. To the extent that any of these actions weakened the Project, they may have contributed to the susceptibility of the Project to succumb to other actions taken by governmental authorities that did violate international law. Thus, whether or not the State Support Agreements were breached, it is plausible that the multi-pronged attack on the Project from various GOM authorities either aggregated to a creeping expropriation or at least made DPC vulnerable to other actions -- such as the taking of its arbitration rights -- that were more clearly wrongful.

ii. Establishment of the Godbole Committee

The Claim Application does not explain how the GOM's establishment of the Godbole Committee violated the GOM's obligations under State Support Agreements to support the issuances of permits and clearances. Further, the Claim Application, mischaracterizes the

⁵¹ See letter from Bechtel affiliate Energy Enterprises (Mauritius) Company to Dabhol Power Company dated March 25, 2002 (in OPIC files), referencing the pollution of drinking water in the village of Brambanwadi and the related report by ThermoRetec Consulting Corporation dated January and February, 2001, which dates immediately precede the dates of the actions by MPCB of which the Insured complains.

Godbole Committee's terms of reference that it cites.⁵² At the time the Godbole Committee was established, a degree of crisis in the Maharashtra power sector was becoming apparent. Indeed, the first charge to the Committee was to review the state of that sector and to make appropriate recommendations. It was also charged by the GOM specifically to review certain issues posed by the Dabhol Project. Such issues could hardly be ignored, however, given the potentially huge role of the Dabhol Project in the state's power sector. Nothing in the State Support Agreements absolves the GOM from its governmental responsibility, or prevents it from undertaking to meet its responsibility, to be alert to critical issues affecting the public welfare. Further, OPIC finds nothing expropriatory in the issuance of non-binding recommendations by an advisory committee. The committee's recommendations do not have force of law and could only have had effect upon implementing action of the GOM. Perhaps the actions recommended, if actually taken by MSEB or the GOM, would have buttressed the case for expropriation. The Insured does not allege, however, that any such action was taken, nor is OPIC aware of any such action having occurred. Finally, the Godbole Committee report did not recommend unilateral abrogation of the PPA but rather bilateral negotiation of terms that would not become effective without DPC's consent. It appears that DPC would have been willing to participate in good faith in such negotiations were they to occur.⁵³

While creeping expropriation may comprise a myriad of slight cuts, none of which alone rises to the level of an expropriation, each element that supports a finding of creeping expropriation must, at least, occur and, in fact, contribute to that result, not just threaten or have an unrealized potential to so contribute. It is not clear that either MPCB or the Godbole Committee contributed materially to the collapse of the Project, whether or not any of their actions evidenced breaches by the GOM of the State Support Agreements.⁵⁴

⁵² The Consolidated Claim Application asserts (at 11) that "the terms of reference for the Godbole Committee were amended to focus its review entirely on DPC, evidencing that the principal purpose of the Committee was to find a way to avoid its [sic] contractual obligations in connection with the Dabhol Project." By resolution on March 9, 2001, the GOM supplemented the committee's terms of reference to add five additional points, of which only two focused on DPC. The other three concerned the power situation in the state generally.

⁵³ The Godbole Committee Report states: "During discussions held, DPC has indicated that nothing was sacred and it was willing to reexamine all project issues, but with the relevant parties, viz, MSEB, GOI and GOM together at a common forum." Godbole Committee Report at 87.

⁵⁴ The Insured makes the argument (see the Consolidated Claim Application at 10) that the delay of Phase II testing delayed the "Entry into Commercial Service" (as defined in the PPA), which in turn delayed the triggering of an obligation by MSEB to make higher capacity payments to DPC. While this could suggest a motive for MSEB somehow directly,

(Cont'd on following page)

b. Repudiation of the PPA

The Insured argues that MSEB's rescission of the PPA was expropriatory and, notwithstanding the "ancillary commercial effect"⁵⁵ thereof, these actions were taken in a governmental capacity and consequently are not subject to Section 4.02(b)'s exclusion of government action as a purchaser from, or guarantor of obligations to, DPC.

Section 4.02(b) of the Contract, as amended by Section 10.05, expressly excludes from coverage any expropriatory action taken by a foreign governing authority "in its capacity or through its powers" as, among other things, a purchaser from DPC or as a guarantor of any payment obligation to DPC, absent satisfaction of certain additional requirements that all parties agree have not been met. It may be that, as the Insured argues, MSEB's motivation in defaulting in payments and in rescinding the PPA was governmental rather than commercial. The exclusion under Section 4.02(b) does not, however, depend on the motivation behind the MSEB's action. Rather, the exclusion is of actions taken by governmental actors through certain specifically cited relationships with the Project. The Insured's interpretation would have the phrase "in its capacity" read to mean, "motivated by." Thus, MSEB, if motivated by governmental rather than commercial objectives, is said by the Insured to be acting in its "capacity" as government, rather than in its "capacity" as a commercial actor.

This reading is wrong for at least two reasons. First, it is wrong on its face. The obligations on which MSEB defaulted arose under its unique capacity as party to the PPA. Others may have contributed to the occurrence of those defaults, but only MSEB, which carried the obligations, could default. Likewise, only MSEB as party to the PPA could purport to rescind the contract. Regardless of the motivation, those actions could only be taken by MSEB in its capacity as party with DPC to the PPA. Second, even if doubt existed as to whether "capacity" might mean "motivation," the operative language states "in its capacity or through its powers." It is clearly that the power to default and the power to rescind lay uniquely with MSEB as party to the PPA. Expropriatory actions taken through the powers bestowed by that relationship, or by any of the relationships to the Project specified in Section 4.02(b), are excluded from the Contract's coverage. There can be no doubt that MSEB's rescission of the PPA was taken in its "capacity or through its powers" as a purchaser from DPC. Consequently, such action is subject to the exclusion to OPIC's expropriation coverage provided for in

(Cont'd from preceding page)

or indirectly through the GOM, to cause MPCB to delay its issuance of permits, no evidence of MSEB's or the GOM's having done so was provided to OPIC. The allegation is rather that the GOM failed to prevent MPCB from delaying issuance of these permits. In any event, given the review of other governmental actions, it is not necessary for OPIC to resolve whether or not MPCB or, with respect to MPCB, the GOM acted improperly.

⁵⁵ Consolidated Claim Application at 30.

Section 4.02(b) and, therefore, cannot form the basis of a claim for expropriation under the Contract, absent the Insured's satisfaction of the additional specific conditions provided in Section 4.02(b).⁵⁶

The Claim Application alleges that political pressure from the GOM is the real reason for MSEB's payment defaults under the PPA and the GOM's payment defaults under the GOM Guaranty and MSEB's rescission of the PPA.⁵⁷ The Insured cites as evidence statements by the GOM's Financing and Planning Chief Minister indicating that these payment defaults were not driven by the GOM's finances but rather were strategic decisions taken to determine whether to renegotiate or to "scrap" the PPA.⁵⁸

It is not clear, however, that this statement demonstrates that MSEB's actions were not essentially commercial. Indeed, the Minister's statement could be entirely consistent with GOM concurrence with a rational economic decision by MSEB to attempt to force, within the confines of Indian contract law, avoidance of a tariff that MSEB could not afford to pay.⁵⁹ The failure of demand for power in Maharashtra to meet the aggressive projections made at the time the PPA was signed and the subsequent failure of MSEB to improve its record in collecting payments for power delivered together posed a specter of inevitable payment default by MSEB.

⁵⁶ The opinion provided by Prof. W. Michael Reisman argues that, if governmental acts aggregate to a creeping expropriation, then "the §4.02(b) exclusion for commercial action does not apply" because "[b]y nature, a creeping expropriation is *jure imperi* and therefore falls outside the commercial action exception in §4.02(b)." OPIC would disagree. The point of the exception is not to exclude commercially-motivated acts that do not constitute, or contribute to, expropriations -- in which case, there would be no need for the exception -- but rather expressly to exclude those that do. It is precisely because of the concern that such mixed commercial/governmental actions, alone or in aggregation, could contribute an expropriation that leads to their explicit exclusion from coverage. As an underwriting matter, OPIC is not typically prepared to take the unfortunately high risk that governmental parties to projects might breach their contractual undertakings, unless that risk is specifically accepted. Here, for instance, OPIC was willing to be responsible for expropriation losses caused by governmental breaches of the PPA, or of the guaranties thereof, only if the special conditions set forth in the amendments to §4.02(b) were met. OPIC does not dispute, however, that an argument could be made outside the context of an OPIC insurance contract that the acts complained of violate international law. The contractual exclusion of Section 4.02(b) limits only the claims that the Insured can raise against OPIC as insurer.

⁵⁷ See Consolidated Claim Application at 30.

⁵⁸ Id.

⁵⁹ This commercial perspective is consistent with the terms of reference, and recommendations, of the Godbole Committee.

Other GOM authorities and politicians may not have objected to, and may well have encouraged, the actions that MSEB took, but one need not look further than MSEB's own financial straits to find adequate motivation for its payment defaults.

MSEB's actions — the payment defaults and the subsequent repudiation of the PPA, as well as the pursuit of an aggressive litigation strategy to avoid being held responsible for those defaults or that rescission — all appear to be in direct pursuit of MSEB's clear commercial interests. The disputes between MSEB and DPC largely pertain to the PPA, which the Insured described in the Response Letter (Exhibit E) as “plainly commercial” and “an ordinary contract, commercial by its very nature.”⁶⁰

The Insured also asserts that MSEB's actions were taken at the direction of the GOM. The GOM may be able to affect the behavior of MSEB (through its power to appoint MSEB's board of directors or otherwise), but this does not necessarily make each act of MSEB attributable to the GOM. The inference would be more tempting if we were trying to explain actions taken by MSEB against its own commercial interests, but this is clearly not the case. As the Godbole Committee's Report makes clear, MSEB was on the verge of being bankrupted by its payment obligations under the PPA.⁶¹ While it is certainly possible that actions of the GOM may have motivated the MSEB's actions, the facts presented by the Insured or otherwise available to OPIC do not show that MSEB's actions were the result of intervention by the GOM or, for that matter, any GOM or GOI authority. It is clear, however, that MSEB's obligations to DPC were putting it into a financially untenable situation. MSEB's own financial straits may have provided a sufficient motive for the actions it took.

Finally, and of most importance for application of the Contract, the Contract does not, in any event, exclude the listed acts only if undertaken for commercial reasons. Rather, it strictly excludes them, unless the stated conditions are met, which they undeniably were not. Thus, even if MSEB's rescission of the PPA was in response to political pressure, it was nonetheless an action by MSEB in its capacity, or through its power, as a purchaser from DPC and, therefore, is subject to the exclusion in Section 4.02(b).⁶² Whether MSEB'S rescission

⁶⁰ Response Letter at 42.

⁶¹ For instance, the committee noted that “[t]he anticipated commissioning of Phase II has been likened by DPC itself to an express train coming at you.” Godbole Committee Report at 87.

⁶² The Insured argues in the Initial Claim Application that the payment defaults by MSEB under the PPA and by GOM and GOI under the Guaranties were also covered expropriatory actions, not excluded by Section 4.02(b), because the defaults were politically motivated. This claim appears to have been dropped from the Consolidated Claim Application. In any event, OPIC would assert that the same analysis that applies to rescission of the PPA also applies to payments due under the PPA or the Guaranties. That is, these defaults were explicitly excluded from OPIC's coverage without regard to their underlying motivation.

might be justifiable under the terms of the PPA (as argued by MSEB) need not be resolved since this action is in any event excluded from the scope of the Contract's coverage.

c. Interference with Arbitration Rights

The Claim Application identifies governmental interference with DPC's arbitration rights under the PPA as a third category of allegedly expropriatory acts.⁶³ Specifically, the Insured argues that the GOI's enactment of the legislation pursuant to which the GOM was empowered to establish MERC, the GOM's subsequent establishment of MERC, and the GOM's issuance of a notification under ERCA conferring on MERC the exclusive jurisdiction to adjudicate disputes under the PPA, followed by affirming decisions by Indian judicial bodies, had the effect of abrogating DPC's right to international arbitration of disputes under the PPA.⁶⁴

These acts are without doubt actions by a foreign governing authority within the meaning of Section 4.01. The question arises, however, whether the Indian governmental actions blocking DPC's efforts to bring MSEB to arbitration are excluded by Section 4.02(b) of the Contract. The issue is whether disputes with respect to matters themselves excluded from coverage might also be excluded.

OPIC believes, however, that the exclusion applies only to actions taken in the specifically enumerated capacities, so that other actions by the host government, including actions related, and even consequent, to excluded actions may, if distinguishable from the explicitly excluded actions, support a claim. Here, although the arbitration dispute arises in connection with actions of MSEB, the GOM and the GOI as purchasers from, or guarantors of obligations to, DPC -- which are excluded risks -- loss as a consequence of the government's failure to respect arbitration rights was not explicitly excluded from the Contract's coverage.

Further, in blocking DPC's arbitration against MSEB, the government acted in a capacity, and utilized powers, not meant to be excluded from coverage. That is, though the dispute arose in the context of an excluded risk, it did not represent a loss caused by acts by the government "in its capacity or through its power as a . . . purchaser from the foreign enterprise, or as a guarantor of any payment obligation to the foreign enterprise."

Finally, although the payment defaults at issue in the blocked arbitration[s] directly caused the financial crisis that brought the Dabhol Project's operations and construction to a halt, the Contract in Section 4.02(b) does not exclude classes of losses but rather classes of government actions that may lead to a loss.

⁶³ Consolidated Claim Application at 31-55.

⁶⁴ *Id.*

Consequently, OPIC has determined that losses resulting from action of the government in blocking arbitration of disputes arising under the PPA are not excluded by Section 4.02(b) from coverage under the Contract. Since these actions are not excluded from the coverage, the questions arise whether these actions violated international law and whether they constituted a substantial factor in DPC's failure to make scheduled payments. These questions are considered in Part III.2 below.

d. Obstruction of the Lenders' Security Arrangements

The Insured asserts that Indian governmental authorities (in the first instance MSEB and MERC, thereafter supported by the Bombay High Court and the Supreme Court of India) have blocked institution of certain arrangements under the Escrow Agreement whereby certain MSEB revenues were to go directly into an escrow account to provide for, among other things, payments due on the Loan.⁶⁵

The Insured also notes that governmental authorities blocked the Onshore Trustee's efforts to draw on the Canara Bank LC following payment defaults by MSEB, the GOM and the GOI.⁶⁶

OPIC acknowledges that the Insured's rights derived from the Escrow Agreement and the Canara Bank LC were material elements of the security arrangements meant to assure repayment of the Loan and that these rights were expropriated by Indian governmental authorities.

2. *The Acts Violate International Law*

Section 4.01 of the Contract requires the Insured to demonstrate that the expropriatory acts violate international law.

The Insured argues that the above-described actions "abrogating, repudiating, and impairing" DPC's contracts collectively constitute a "creeping expropriation" of the Dabhol Project without compensation and as such violate international law.⁶⁷ Although OPIC concedes that there may be merit to this claim under international law, so many of the alleged breaches are excluded by Section 4.02(b) that the question may become whether the remaining acts, standing alone, constitute creeping expropriation. It is, however, given the determinations made below, not necessary to resolve this question.

⁶⁵ Consolidated Claim Application at 15-16.

⁶⁶ Id. at 16.

⁶⁷ Id. at 23.

The Insured also argues that “a State is responsible under international law for rendering a company uncreditworthy.”⁶⁸ OPIC suspects that claim may be stated too broadly. Governments can and regularly do take actions (e.g., taxes, environmental regulations, fines and criminal penalties) that could lessen or destroy the creditworthiness of a company. The issue is whether the government actions constitute an improper taking of a right held by an investor.

Here, the Insured did have certain rights, or was reasonably relying on its assignment of rights granted to DPC, as security for the Loan. OPIC concurs with Prof. Reisman’s view that abrogation of such arrangements by a government would constitute a failure to meet its international law obligations.⁶⁹

The first such delict cited by the Insured is the failure of the GOI and the GOM to make payments due respectively under the GOI Guarantee and the GOM Guarantee. The merits of that claim need not be resolved by OPIC since, as previously noted, Section 4.02(b) expressly excludes losses from such guarantor defaults from the Contract’s coverage.

The blockage of the revenue collection arrangements under the Escrow Agreement and the injunction against drawing the Canara Bank LC are, however, different matters. These arrangements provided mitigation against the risk of non-payment by MSEB, a risk which events proved to be material. MERC’s blockage of the reactivation of the escrow arrangements and prevention of the Onshore Trustee’s drawing the Canara Bank LC, and the subsequent maintenance of those impediments by the Indian courts, have deprived the Insured of fundamental rights in its investment that bear directly on DPC’s capacity to make scheduled payments.

The Insured also argues that frustration of DPC’s arbitration rights under the PPA in and of itself constitutes a violation of international law that satisfies the requirements of Section 4.01. OPIC agrees that the actions of the GOM and the GOI in supporting MSEB’s efforts to avoid international arbitration as the forum for resolving PPA disputes with DPC, both directly and indirectly through actions of MERC and of Indian courts, constitute a denial of justice in violation of international law. Although in the Claim Application the Insured focuses on the blockage of DPC’s arbitration rights against MSEB, OPIC notes that the BHC injunction blocking DPC’s arbitration of its dispute with the GOM under the GOM Guaranty and the Delhi High Court’s more recent injunction blocking DPC’s efforts to pursue arbitration of its disputes with the GOI under the GOI Guaranty also constitute denials of justice in violation of international law.

⁶⁸ Id. at 35. See also Opinion by Prof. W. Michael Reisman (the “Reisman Opinion”) (Exhibit 4 to the Consolidated Claim Application), at 29-34.

⁶⁹ See Reisman Opinion at 31-34.

Indian “foreign governing authorities” permitted MSEB to enter into contractual provisions providing for offshore international arbitration — indeed, both the GOM and the GOI guaranteed MSEB’s payment obligations thereunder, and submitted to DPC and the project lenders, including the Insured, legal opinions asserting the enforceability of these arbitration rights.⁷⁰ Those same authorities subsequently have blocked access to those rights through injunctions, lawsuits and asserting contrary legal positions. While DPC has been granted formal appeal rights, these have been rendered ineffective by delays in the Indian courts. The Supreme Court of India recently waived the requirement that the BHC reduce its decision to writing prior to that long-standing oral decision being appealed, and DPC’s legal actions are now pending in the Supreme Court. Nonetheless, the cumulative effect of the government’s actions is that DPC has been blocked from prosecuting international arbitrations against MSEB, the GOM or the GOI in a fashion sufficiently timely to avoid collapse of the Project and substantial loss of the related investments.

While the acts of MSEB, the GOM and the GOI may have been taken in accordance with applicable Indian law, the legality (or illegality) of such acts in Indian courts is irrelevant to the determination of whether such acts are permissible under international law.⁷¹ The basic principle of international law that a state may not rely on domestic law as a defense to a breach of its international law obligations has been recently codified by the International Law Commission of the United Nations through its adoption of the Draft Articles of State Responsibility (the “Draft Articles”).⁷² Article 3 of the Draft Articles states that:

“[t]he characterization of a State act as internationally wrongful is governed by international law. Such characterization is not

⁷⁰ Consolidated Claim Application, note 35, at 13.

⁷¹ See *International Arbitration: Three Salient Problems*, by Judge Stephen M. Schwebel, p. 67, quoting Judge Lauterpacht that “[i]t is not enough for a State to bring a matter under the protective umbrella of its legislation, possibly of a predatory character, in order to shelter it effectively from any control by international law. There may be little difference between a Government breaking unlawfully a contract with an alien and a Government causing legislation to be enacted which makes it impossible for it to comply with the contract.”

⁷² See Draft Articles on Responsibility of States for Intentionally Wrongful Acts, adopted by the International Law Commission at its fifty-third session (2001) (extract of the Report from the International Law Commission on the work of its Fifty-third session, *Official Records of the General Assembly, Fifty-Sixth Session, Supplement No. 10 (A/56/10), chp.IV.E.1*), also available at: http://www.un.org/law/ilc/texts/State_responsibility/responsibilityfra.htm.

affected by the characterization of the same act as lawful by internal law.”⁷³

The obligation of a state to provide a foreign national access to arbitration or other judicial recourse is stated in the Restatement of Foreign Relations (Third). Comment h to Restatement §712 provides that:

“a state may be responsible for a denial of justice under international law if . . . having committed itself to a special forum for dispute settlement, such as arbitration, it fails to honor such commitment.”⁷⁴

The United States has held that a breach of a contractual right to arbitration gives rise to a denial of justice in violation of international law. For example, in support of certain international arbitrations in respect of concession contracts in Libya, the United States wrote:

“It is the position of the United States Government that contracts validly concluded between foreign governments and nationals of other states should be performed by the parties to those contracts in accordance with their terms. . . . Where the breach of such a contract by a foreign government is arbitrary or tortious or gives rise to a denial of justice, a violation of international law ensues. . . [and] the failure of a government to respect a contract with an alien to arbitration of disputes arising under that contract constitutes a denial of justice under international law.”⁷⁵

There is abundant evidence in this case that Indian foreign governing authorities (i) have denied DPC access to international arbitration of its disputes with MSEB, the GOM and the GOI, (ii) have obstructed DPC’s efforts to appeal denial of those arbitration rights, and

⁷³ In addition to the provisions of Article 3, Article 32 of the Draft Articles of State Responsibility states that “[t]he responsible State may not rely on provisions of its internal law as justification for failure to comply with its obligations under [Part II of the Draft Articles of State Responsibility]”.

⁷⁴ American Law Institute, *Restatement of the Law (Third), Foreign Relations Law of the United States* (1987).

⁷⁵ Diplomatic note 139 of the United States Embassy in Paris, quoted in R.B. von Mehren and P.N. Kourides, “International Arbitrations between States and Foreign Private Parties: The Libyan Nationalization Cases,” 75 *American Journal of International Law* (1981), at 487-488, note 44, as quoted in *International Arbitration: Three Salient Problems*, by Judge Stephen M. Schwebel, at 79.

(iii) have failed to honor their own commitments regarding access to international arbitration. OPIC concurs with the Insured that the actions of these authorities in committing to international arbitration and then failing to honor that commitment constitute a denial of justice that satisfies the Section 4.01 requirement of a violation of international law.

OPIC has also determined that the Insured is not required to prove that DPC has exhausted all local remedies (including completing an appeal of the MERC Order) in order to conclude that these acts of the foreign governing authority violate international law. In the present case, to require DPC to fully exhaust local remedies could expose DPC (and the Insured) to open ended postponements and delays that might indefinitely deny DPC access to its contractual rights.⁷⁶

Furthermore, DPC has in fact made all reasonable efforts to pursue its rights through the local courts, having (i) litigated its rights before MERC, (ii) challenged MERC's decision before the Bombay High Court, and (iii) appealed these actions to the Supreme Court of India for the second time. Therefore, OPIC has determined that DPC has waited long enough to expect its arbitration rights to have been recognized. Those rights are, after all, not contingent upon DPC investing endless resources in a domestic litigation that could continue indefinitely. Rather, it had those rights the moment the relevant contracts were signed. Notwithstanding the challenges to those rights that might be raised under Indian law in Indian courts, the failure of Indian governing authorities to recognize those rights constitutes a denial of justice in violation of international law for which, under international law, the GOI is responsible.

Finally, as previously discussed, OPIC has determined that the actions of the foreign governing authority in blocking DPC's arbitration rights against MSEB, the GOM and the GOI were not taken in a commercial capacity such as would require resort to particular local remedies as set forth in Section 4.02(b). Indeed, these acts were taken by the foreign governing authority in its capacity as legislator (through the creation of MERC) and as regulator (through the actions of MERC) and through the powers of its judiciary. Therefore, the exception in Section 4.01 (as amended by Section 10.04), which requires that the act violate international law without requiring resort to local remedies "unless exercise of local remedies is required pursuant to 4.02(b)," is inapplicable as the referenced provisions of Section 4.02(b) apply solely to acts of the foreign governing authority taken, among other functions, as guarantor or purchaser.

⁷⁶ See *International Arbitration: Three Salient Problems*, by Judge Stephen M. Schwebel, p. 118. Also, as provided in Comment f to §713 of the American Law Institute's *Restatement of the Law (Third), Foreign Relations Law of the United States* (1987), while exhaustion of domestic remedies is ordinarily necessary to consider a claim by another state for an injury to its national, this requirement is not present if "such remedies are clearly sham or inadequate, or their application is unreasonably prolonged."

3. *The Acts Were a Substantial Factor in Causing a Default on a Scheduled Payment*

As a condition to the payment of compensation, Section 4.01 requires that the act or series of expropriatory acts, in relevant part:

- “(a) prevent[s] the foreign enterprise from making a scheduled payment (or part thereof);
- (b) ...; or
- (c) [be] a substantial factor in causing a default on a scheduled payment (or part thereof), or deprives the Insured of its fundamental rights as creditor, including its rights against security or commercial guaranties of repayment.”

The Insured asserts that acts by Maharashtra governmental authorities collectively caused, or were substantial factors in causing, DPC to fail to make scheduled payments on the Loan. First, the Insured argues that certain actions of MPCB were a factor in DPC’s defaults on scheduled payments under the Loan. Specifically, the Insured points to the refusal by MPCB to (a) renew DPC’s consent to operate Phase I and (b) permit the testing and commissioning of Phase II except under certain additional conditions not initially required by MPCB.⁷⁷ MPCB’s failure to renew its consent to operate Phase I apparently did not, however, prevent DPC from operating Phase I, as MPCB expressly authorized DPC to continue operating Phase I under the original consent. It does not appear that DPC was materially damaged by this action within the relevant time frame — i.e., before other factors overshadowed this concern. Again, no causal relationship between MPCB’s actions and DPC’s defaults on scheduled payments on the Loan has been demonstrated. Similarly, the information provided by the Insured regarding the Godbole Committee fails to demonstrate how its activities were a substantial factor in causing any debt payment default.

Many factors contributed to the current suspension of the Dabhol Project. Several, such as MSEB’s payment defaults under the PPA, its rescission of the PPA, and the failure of the GOM and the GOI to honor their respective guaranties of MSEB’s payment obligations under the PPA, are excluded from OPIC’s coverage by Section 4.02 (as amended). Other actions of Indian governmental authorities of which the Insured complains, such as the establishment of the Godbole Committee and the failure of the MPCB to renew Phase I operating permits and to issue permits to test Phase II without imposing additional conditions are of questionable causal impact on the scheduled payment defaults which are the basis for the Claim.

⁷⁷ The Insured does not identify these additional conditions in the Claim Application.

The facts presented by the Insured do, however, include several actions by Indian governmental authorities that violated international law and that constituted substantial factors in the collapse of DPC's ability to make scheduled payments. These include the blockage of DPC's arbitration rights against MSEB, the GOM and the GOI. While it is certainly true that the inability to repay the Loan relates critically to MSEB's repudiation of the PPA — a risk excluded by Section 4.2(b) — the payment defaults might well ultimately have been remedied had the arbitration process been permitted to proceed, leading either to resolution of the conflict and completion and operation of the Phase II facilities or to determination of a Transfer Amount adequate to repay the Loan, among other obligations. Based on the facts described or referenced in the Claim Application, OPIC has determined that Indian governmental authorities' blockage of DPC's arbitration rights under the PPA, the GOM Guaranty and the GOI Guaranty were a substantial factor in the scheduled payment defaults that have occurred.

A claim can also be based on an act or series of acts in violation of international law that “deprives the insured of its fundamental rights as creditor, including its rights against security.” The MERC's blockage, supported by the Bombay High Court, of the implementation of the revenue collection and escrow account arrangements envisioned under the Escrow Agreement constitutes such a deprivation, as does blockage of the drawing of the Canara Bank LC. Because the Claim Application does not indicate the portion of a draw on the Canara letter of credit that would have been available to support a scheduled payment due to the Insured, it is not possible to determine whether the funds of which the Insured was deprived were material to any of the defaulted scheduled payments, but it is clear that the loss of the revenue escrow arrangements and the loss of arbitration rights against MSEB, the GOM and the GOI aggregate without doubt to a substantial factor in DPC's inability to make scheduled payments.

OPIC notes that the impact of these government actions on the scheduled payments was somewhat indirect, since the financing plan for the Dabhol Project never called for these construction period interest payments to be made from the results of DPC's operations. Rather, they were to be funded by disbursements of the financing committed for Phase II construction. The direct and immediate cause of those payments defaults was the decision by the Phase II lenders, based on the totality of circumstances facing the Dabhol Project, not to disburse funds for those payments. That decision was a reasonable response however, to these government actions, which impaired the prospect of any additional disbursements would be repaid. OPIC accepts the Insured's position that these particular violations of international law by Indian government authorities were a substantial factor in the lender's decision to suspend further funding of the Project and consequently has concluded that they were, as required by Section 4.01(d) of the Contract “a substantial factor in causing a default in a scheduled payment”.

IV. COMPENSATION DUE UNDER THE CONTRACT

OPIC's determination with respect to the Claim Application is that actions attributable to Indian foreign governing authorities in de facto control of the region of India in which the Dabhol Project is located have violated international law, and that such actions were a substantial factor in causing DPC to default on the September 17 scheduled payment and each scheduled payment that has since come due. Consequently, the Claim Application with respect to such payments is determined to be valid.

Subject to the Insured making the assignments to OPIC required under Sections 8.02 and 10.09 of the Contract, OPIC will make a claim payment to the Insured of the scheduled payments due to the Insured on September 17, 2001, March 18, 2002, September 16, 2002, March 18, 2003, and September 15, 2003, which based on the Consolidated Claim Application and subsequent submissions from the Insured,⁷⁸ total \$3,929,284.59. OPIC will also pay interest on each such payment, as provided in Section 5.01 of the Contract, at the average daily federal funds rate from the later of the scheduled payment date or March 9, 2002 (which is the 90th day prior to OPIC's receipt on June 7, 2002, of the Insured's Initial Claim Application), through (and including) September 30, 2003, the date on which OPIC will pay such compensation. OPIC will also pay the principal amount of the Loan which became due in full on March 21, 2002, plus interest on that principal amount at the average federal funds rate from (but excluding) the most recent interest payment date (September 15, 2003) through (and including) September 30, 2003. These amounts, including final interest amounts, are set forth in the attached Schedule 1.

OVERSEAS PRIVATE INVESTMENT CORPORATION

By: signed by Peter S. Watson

Title: President and CEO

Date: September 30, 2003

⁷⁸ Consolidated Claim Application at 45. See however the Insured's subsequent adjustment of those figures as noted herein. See note 6.

Schedule I:
Compensation Payment

<u>Defaulted Payments</u>	<u>Amount (\$):</u>
September 17, 2001	\$1,078,261.61
Interest from March 9, 2002 (at 1.4212%): ⁷⁹	23,973.43
March 18, 2002	834,781.58
Interest from March 19, 2002 (at 1.4160%):	18,167.66
September 16, 2002	727,754.54
Interest from September 17, 2002 (at 1.2582%):	9,507.97
March 18, 2003	680,747.12
Interest from March 19, 2003 (at 1.1347%):	4,147.83
September 15, 2003	607,739.74
Interest from Sept. 16, 2003 (at 0.9436%):	235.67
Outstanding Principal:	\$24,144,825.23
Interest from Sept. 16, 2003 (at 0.9436%):	9,363.05
Total Claim Payment:	\$28,139,505.43
Premium Due from Insured: ⁸⁰	<u>\$ 525,919.33</u>
Net Payment Due from OPIC:	\$27,613,586.10

⁷⁹ Interest in each case is determined at the average daily federal funds rate as provided in Section 5.01 of the Contract.

⁸⁰ This amount is determined in the accompanying Schedule 2.

Schedule 2

Determination of Unpaid Premia

	Premium Due and Related Interest	# Days Unpaid	LIBOR + 3.25% ⁸¹
Premium payment for 9/15/2002	\$ 240,637.56		
Interest 9/16/02-9/30/03	\$ 12,633.30	379	5.0560%
Premium payment for 3/15/2003	\$ 245,648.47		
Interest 3/16/03-9/30/03	\$ 6,047.15	198	4.5380%
Premium payment for 9/15/2003*	\$ 20,913.85		
Interest 9/16/03-9/30/03	\$ 39.00	15	4.5380%
Total Premium Payments Due OPIC:	\$ 525,919.33		

*Amount reflects \$250,966.20 allocated pro rata from September 16 through September 30, 2003.

⁸¹ This interest rate is as provided in Amendment No. 2 to the Contract.