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Breach of Contract by Authorities

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INVESTMENT GUARANTEES OF THE
FEDERAL REPUBLIC OF GERMANY

► **Direct Investments Abroad**

► Breach of Contract by Authorities

DEFINITION OF COMMITMENT

Besides the regular cover under the General Terms and Conditions the Federal Republic of Germany (Federal Government) may as well include the breach of legally binding commitments made by the government or state-directed or state-controlled authorities in an investment guarantee to cover foreign investments of German enterprises. This breach of contract cover then is an extension of the regular cover as a specification of the political risk corresponding with § 4 para. 1 lit. b) of the General Terms and Conditions. Thus the investor receives for his foreign project an additional cover that exceeds the classical guarantee cover (i. a. for the expropriation and war risk).

The definition of commitment refers to contractual or unilateral formal obligations that entitle the project company to special benefits that are beyond the approval to general legal promotion schemes. Therefore it is possible “to let cover” unilateral and individual statements of the host country and its authorities as well as obligations due to bilateral contracts. Unilateral obligations may, for example, result from

- the creation of new infrastructure connections,
- supplies and purchase commitments,
- rights of use or
- concessions.

Moreover, in individual cases the Federal Government granted cover for commitments under bilateral contracts with government-controlled enterprises.

The Federal Government furthermore agreed under certain conditions to grant cover for governmental commitments for payments as well as commitments by sub-authorities.

Commercial commitments cannot be covered.

COVER FOR UNFORESEEABLE LEGAL EVENTS

By implementing the breach of contract cover the Federal Government intends to protect German investors from unforeseeable legal events in host countries with still imperfect legal systems. Thus the demand for breach of contract cover predominates for investments in developing and emerging countries.

DENOTATION OF THE COMMITMENT IN THE GUARANTEE

A requirement for cover is the explicit mentioning of the commitments in the guarantee policy. Therefore the applicant has to specify the commitments to be covered in the application form and he has to substantiate in detail the necessity for granting cover (cp. para. C. 6 of the application form).

BASIC PARAMETERS OF THE PROJECT

Whether the Federal Government can include a commitment in an investment guarantee depends on several preconditions. First of all, the commitment has to be a cornerstone of the project so that its breach can result in a total loss of the project company. Furthermore the commitment must be attributable to the political sphere of influence of sovereign acts. As a rule, this is the case when authorities act within the scope of their sovereignty. Yet cover can also be granted if state-owned or government-controlled enterprises enter into obligations, for example under purchase or supply contracts, and in doing so appear on a market that is extensively regularised by the state.

CLAIM TO COMPENSATION

A further condition for the inclusion of a commitment in an investment guarantee is that due to the breach of commitment a claim to compensation can be put in by the investor against the committing authority or the host country. If the investor has no entitlement to compensation, there is no indemnification by the Federal Government, predicated on the necessity that in case of an indemnification the Federal Government has to be provided for full recourse against the host country.

INDIVIDUAL CASE DECISION

The eligibility of the breach of contract cover and its type and volume is subject to a review of the project in which the Federal Government also considers the circumstances of each individual case.

OBLIGATIONS IN AN EVENT OF LOSS

In an event of loss the policyholder is obliged to prove the realisation of a risk according to § 4 para. 1 b) of the General Terms and Conditions. Therefore the policyholder has to substantiate the legal existence of the claim and the illegal breach of the covered commitment. Furthermore the policyholder has to circumstantiate evidence that the breach of contract resulted in the total loss of the project company and consequently an event of loss occurred in accordance with § 5 para. 3 of the General Terms and Conditions.

NO COVER FOR COMMERCIAL AND TECHNICAL RISKS

An indemnification by the Federal Government is excluded if the breach of contract is due to circumstances that are beyond the political sphere of influence of sovereign acts or their omission. This can be assumed when, for example, economic reasons, technical problems or natural phenomenon caused the breach of contract. In addition, the breach as a rule will not be of political character if the government can no longer influence the committing authority significantly.

Investment Guarantees: an instrument to promote foreign trade and investment provided by the



Federal Ministry
for Economic Affairs
and Climate Action

Commissioned to implement the federal funding instrument Investment Guarantees:



Investment Guarantees of the Federal Republic of Germany

Investment Guarantees have been an established and effective foreign trade promotion instrument of the Federal Government for decades. Investment Guarantees protect eligible German direct investments in developing countries and emerging economies against political risks. This promotion instrument plays an important role in fostering economic growth as well as in protecting and creating jobs both in the host country and in Germany. The Federal Government commissioned PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft to manage the federal funding instrument Investment Guarantees.

Information on other foreign trade promotion instruments of the Federal Government can be found at www.bmwk.de/en under the heading Promotion of foreign trade and investment.

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft

Postal address:
P.O. Box 30 17 50
20306 Hamburg, Germany

Office address:
Alsterufer 1
20354 Hamburg, Germany

Phone: +49 (0)40/63 78-20 66

investitions Garantien@de.pwc.com
www.investitions Garantien.de/en