

**Why do some Foreign
Investors Avoid
International Protections
when their Investments
are in Trouble?**

Reasons for BITs and other Protections for Foreign Investors

- Expropriations (rare, now)
- Contract change (common)
- New laws or regulations that harm investment

What are the Principal Sources of External Protection?

- 1. Failure of multilateral negotiations
- 2. Arbitration
- 3. Official political risk insurance
- 4. Home government intervention

Frequency of Use?

- Arbitration at ICSID
 - 1972-1982 10 cases
 - 1982-1992 18 cases
 - 1992-1996 8 cases
 - 1997 -2004 71 cases
- Arbitration based on BITs but outside ICSID
 - Maybe 160 as of 2004

Why the Increase?

- 1. Spread of BITs and RTAs (but contracts often had arbitration clauses)
- 2. Private investment in infrastructure (half of cases)
- 3. Increase in raw material prices

Infrastructure Problem

- 1. New, inexperienced investors
- 2. Nature of contract (debt-like)
- 3. Political sensitivity
- 4. Lack of “bargaining power”

Learning from the Indonesian Power Projects

- 26 electricity generating projects (1994-1997)
- 19 foreign owned (13 w/ US participation)
- All but one with powerful local partners
 - 11 with Suharto children
 - 5 with relative of other officials, cronies, or military society
 - 2 with unknown partners
 - 1 with non-political partner, paid for shares
- US \$ pricing, take-or-pay
- Price (Paiton I) = 8.56 c/kwh
- Return: 32% on equity?

Asian Currency Crisis as Trigger

- 1. Exchange rate: 2,400 to 15,000+ (\$ contracts)
- 2. Recession (GDP down 14%): take-or-pay
- Demand for renegotiation and rescheduling

Outcomes in Indonesia (1)

- Renegotiated (power companies)
 - Paiton I: Mission Energy
 - Tanjung Jati B: Sumitomo
 - Paiton II: Siemens
 - Pare-Pare: ?

Outcomes (2)

- Renegotiated: oil/ gas companies
 - Sengkang: El Paso
 - Palembang Timur: Coastal
 - Salak: Unocal
 - Darajat: Amoseas
 - Sarulla: Unocal
 - Wayang Windu: (sold to Unocal
 - Sibayak: Enserch

Outcomes (3)

- Agreed to close out
 - Tanjung Jati A: Tomen/National Power (UK)
 - Tanjung Jati C: Gordon Wu

Outcomes (4)

Users of International Protection

- Dieng: CalEnergy/MidAmerican. Arbitration/OPIC claim
- Patuha: CalEnergy/MidAmerican. Arbitration/OPIC claim
- Karaha Bodas: Caithness, FPL. Arbitration (with private insurance)
- Pasuruan: Enron. MIGA claim

Arbitration Awards (1)

- Karaha Bodas (Caithness and FPL)
 - \$261 million on claimed investment of \$90 million
 - “Double dipping”
 - Insurance of \$75 million on top
 - Collected award, plus interest, about 8 years later

Arbitration Awards (2)

- CalEnergy/MidAmerican
 - Flawed arbitration
 - Requested \$3 billion
 - Awarded \$570 million
 - Collected \$290 from OPIC/private

Patterns

- Arbitration or insurance if:
 - No other business in country
 - And exiting business anyway

- Renegotiate if:
 - Other significant business in country (oil)
 - Japanese lead investor

Government Intervention

- United States
 - Threats to aid, GSP, votes in multilaterals
 - Reimbursement of OPIC
 - Change with end of Cold War
 - Future?
- Japan
 - Proposed low cost loan to Indonesia
 - Finally, lease arrangement, without precedent dangers

Are Japanese Attitudes Different?

- Only one Japanese firm in arbitration against host state
- No Japanese arbitrators at ICSID
- Not absence of BITs
- Not that Japanese firms avoid risky countries
- Not that Japanese firms avoid risky industries
- Not that Japanese firms always have diverse interests in country
- Culture, experience?

Problems with System of Arbitration

- Rigidity of view of contract
- Inconsistent results
- Lack of consideration of national goals
(environment, for example)
- Asymmetry
- Damages orientation

Can Arbitration be Improved?

- 1. Appeals process (with broad representation)
 - Consistency, better awards calculations, less rigid interpretation of contract, evolving

- 2. Make BITs symmetrical
 - Sense of fairness, less rigidity

- 3. Encourage settlement

Can Change be Effected?

- Entrenched interests in current system
- Yet, host countries withdrawing or fighting judgments (Argentina, Bolivia, Ecuador, Venezuela)
- Many investors see as in adequate

Will investors support change?