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 inadequate

Will investors support change?