Louis T. Wells and Rafiq Ahmed.
Making Foreign Investment Safe: Property Rights and National Sovereignty. New York: Oxford University Press, 2007. Pp. x + 378. $49.95. ISBN: 9780195310627

The rapid rate at which bilateral investment treaties (BITS) have been signed throughout the world – by last count, there are some 2,800 of them – has not been matched by a depth of understanding of their implications for law, economy, and politics. Do investment treaties serve the interests of investors? Do they have the desired effect of attracting new inward investment? What impact might investment rules have on the capacity to develop local institutions for the administration of justice or on the capacity of states to take measures for societal self-protection? In the global rush to embrace a web of investor rights might investors and states have lost perspective on the proper balance between protecting capital investment and promoting state projects to advance the economic well-being of citizens? In a refreshingly honest assessment of investment rules, Wells and Ahmed declare the new

international investment law and its dispute resolution mechanisms – what they call the new international system of property rights – a less than effective and unbalanced mechanism for the protection of investor rights.

The book is comprised of a series of in-depth case studies of private investment infrastructure projects in Indonesia beginning in the 1960s. Wells, of Harvard's Business School, served for over 30 years as an advisor to the Indonesian government. His writing partner, Ahmed, worked for Exxon Corporation for 20 years and was stationed in Indonesia for some six years. They bring readers literally into the smoky backrooms where deals are made, and then broken, by a colourful array of characters. Much of the book covers the period when authoritarian strongman, Suharto, was in control, a period where '[c]orruption was widespread and the law did not rule' (at 11). The book documents, in stunning detail, the machinations of Indonesian officials and foreign investors, some of them seemingly in breach of anti-bribery laws like the US Foreign Corrupt Practices Act. The narrative carries on into the Asian currency crisis and the period of democratic transition, when the regime of international investment law would be expected to come to the rescue of investors. The new international system of property rights, they conclude, did not work so well and, unless revised, 'will collapse' (at 7).

Much of the argument turns on events described in Part I of the book, when the law did not rule. They concern the nationalization of Indosat in 1980, a wholly-owned subsidiary of International Telephone and Telegraph Company (ITT) established in 1967 to provide a telecommunications network for the island archipelago. Investor protections virtually were non-existent, nor was there any transparency in contractual processes. ITT could only rely on pay-outs to well-connected political operatives so as to extract favourable contractual concessions. The company did rather well, securing a 20-year term and minimum rates set in US currency, earning staggering rates of return. This success, the authors conclude, ultimately would work against ITT once the host government began to question the company's windfall. When Suharto requested that Indosat consider the construction of a connection between the northern Indonesian city of Medan and Penang in Malaysia, ITT executives baulked, citing enormous costs and minimal rates of return. This response, Wells and Ahmed surmise, amounted to a violation of the 'social contract' between investor and government (at 47). Having been rebuffed, the Indonesians took the opportunity to revisit the terms of the original 1967 agreement. Citing excessive profits and even illegality under Indonesian law – the contract likely was invalid under the 1945 constitution, having given up control over telecommunications to foreign capital investment (at 52) – the government chose to purchase Indosat from ITT in 1980. Indonesia sought to play fair, wishing to avoid damaging its reputation as a safe haven for investors. The multinational, in turn, had earned a reputation for mixing business and politics – having assisted, for instance, anti-Allende forces in Chile (at 27) – and so wanted to avoid any further bad publicity. Though negotiations were described as hard fought, ITT admitted that it was 'treated fairly' by the Indonesian government (at 64). So content were the parties that the press was never alerted to this nationalization. Wells and Ahmed contend that this is the first time the story has ever been told.

The longevity of ITT's investment, at a time when rapidly undertaken nationalizations in the developing world occurred with increasing frequency, is attributed to the company's grip on scarce technology. As the political risk literature makes plain,[1] once control over technology slips, control of export markets lost, or other sources of risk capital made available (at 68), ventures are vulnerable to state interference. That ITT was able to exit in this graceful manner – without access to a dispute settlement mechanism – is a lesson that managers need to learn, Wells and Ahmed maintain.

[1] See, e.g., C. W. Moon and A. A. Lado, 'MNC-Host Government Bargaining Power Relationship: A Critique and Extension within the Resource-Based View' 26 *Journal of Management* (2000) 85.

The nationalization of Indosat, which under state ownership remained a profitable venture, was one of the last of its kind. Instead, the needs of developing and developed states were perceived to be different subsequent to the fall of the Soviet empire. International financial institutions no longer would lend to governments for public infrastructure projects. Private enterprise was considered a more reliable steward for the delivery of critical functions such as electricity and water. Wells and Ahmed in subsequent chapters explain how this largely was a mirage – that a government presence in near monopoly situations was inevitable. In need of capital to meet increasing demands for electricity, Indonesia succumbed to the new orthodoxy. The authors turn, in Part II, to negotiations leading to the establishment of the enormous Paiton I electrical power plant, serving as a model for 24 additional private power agreements (at 102), and draw important contrasts between the Paiton I and Indosat negotiations. One significant difference was the 'deep involvement' of the US government at various stages of the Paiton I process. It was not that US administrations in the early- to mid-20th century had not gone to bat for investors, rather, the US government then was less interested in intervening against governments that had joined in Washington's anti-communism campaign.[2] In this new era of 'consensus', the US government would press for guarantees while helping to facilitate financing of mega-deals, such as Paiton I led by US-based Edison Mission Energy and General Electric, together with Japanese-based Mitsui (at 131, 134). Private investment, moreover, was in this era dependent upon public involvement: two-thirds of the financing came from or was guaranteed by foreign governments (at 139). Investors took on less risk, brought little new technology, nor had more expertise in running electrical power plants than the public supplier, PLN, all of which hardly justified exaggerated rates of return. The return on investment should have been not much more than that incurred via sovereign debt, argue Wells and Ahmed. It turns out to have been an inordinately 'expensive way to obtain money to expand Indonesian power' (at 140). The Asian currency crisis and the collapse of the Indonesian rupiah underscored the debt-like character of these investments. Investors were guaranteed returns irrespective of exchange rates and the demand for electricity. Both PLN and Mission quickly embraced legal proceedings, came to their senses, dropped their litigation and turned to negotiations. Press accounts of a PLN-commissioned report, that costs associated with the construction of Paiton I were inflated by some 72 per cent (at 178), likely helped precipitate settlement. Both sides subsequently claimed victory.

Among the 27 other private power projects in abeyance as a result of the Asian financial crisis, renegotiation was more likely to result where investors were desirous of maintaining economic relations in Indonesia or in the developing world more generally. One half of the renegotiated contracts, for instance, concerned power projects owned by oil companies who were eager to pursue other economic activities in Indonesia (at 267). Japanese investors had other financial interests in the country and so were more open to renegotiation than insisting upon strictly-construed legal obligations (258). Where Japanese investors were only minority partners in projects controlled by US investors, as in Paiton I, the Japanese were content to ride the coat tails of more aggressive US investors and their home government.[3] The outcomes here, the authors maintain, were mutually beneficial in contrast to instances where arbitration was pursued.

[2] On the early 20th century, see C. Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (1985) and on the immediate post World War II period, see A. H. Amsden, *Escape From Empire: The Developing World's Journey Through Heaven and Hell* (2007).

[3] On the lobbying behaviour of Japanese firms abroad, see W. L. Hansen and N. J. Mitchell, 'Globalization or National Capitalism: Large Firms, National Strategies, and Political Activities' 3 *Business and Politics* (2001) 1 online at http://www.bepress.com/bap/vol3/iss1/art1.

Where negotiations were not seriously pursued, investors more likely had abandoned any future dealings within Indonesia or elsewhere in the global South. Seeking a quick exit and emboldened by the promise of compensation under the new system of international property rights, diminished returns under renegotiated contracts hardly were enticing. In the *Kahara Bodas* case,[4] US investors were ready to retreat from the developing world and made no effort to explore new contractual terms with $75 million in private insurance available to them (at 208). Under the auspices of the UN Commission on International Trade Law (UNCITRAL), the company was awarded $261 million in damages ($150 million of which was for lost profits) by a contract-based arbitration tribunal. Indonesia sought to vacate the arbitration award and legal proceedings ensued in other jurisdictions – the matter still has not been settled.

Calenergy, similarly, had no interest in maintaining Indonesian ties and swiftly filed a notice of arbitration. With a decision in hand, the investor then would be in a position to collect risk insurance from the US Overseas Private Investment Corporation (OPIC). It took two separate contractual arbitrations – first against the state contracting authority, PLN, and the second against the Republic of Indonesia – to secure an award of some $572 million, including future lost profits from an ad hoc UNCITRAL tribunal (at 235).[5] The procedural irregularities associated with the second arbitration – a Jakarta-court order enjoining the proceedings, precipitating a move to the Hague, and the subsequent withdrawal of the Indonesian-appointed arbitrator accompanied by whispers of a kidnapping – are detailed by the authors. With OPIC pursuing its right of subrogation, the US government commenced another full court press against Indonesia. Refusing the Indonesian offer to pay under Paris Club terms as if this were sovereign debt, OPIC ultimately extracted terms of repayment amounting to the largest settlement in the insurer's history.

Access to arbitration and insurance, the authors claim, gives rise to moral hazard. If companies are assured compensation they may prefer to litigate rather than seek negotiated settlement (at 271). Companies might even rationally choose to invest in politically unpopular investments that are likely to give rise to state interventions, on the promise of a pay-out offered by investment rules guarantees. The lesson for host states is that contracts should be awarded to companies 'with deep and likely abiding commitments' to the host jurisdiction. They are, in Hirschman's terms, more likely to want to choose voice over exit.[6]

For Wells and Ahmed, the in-depth case studies reveal that the international system of property rights is in need of repair. In the contract-based arbitrations examined here,[7] arbitrators were arbitrary – unconcerned about fluctuating demands for electricity – rigidly applying contractual standards against vulnerable developing economies that are not enforced as rigidly in the developed world.[8] Investors in Indonesia, who drew on these processes, often faced 'bitter results' with 'long battles, huge legal fees, and spoiled

[4] *Karaha Bodas Company* v. *Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, Final Award (18 December 2000) (March 2001) 16 Mealey's International Arbitration Report C2-C17.

[5] *Himpurna California Energy* v. *PT. Perusahaan Listruik Negara* (December 1999) 14 Mealey's International Arbitration Report A1-A58; *Himpurna California Energy* v. *Republic of Indonesia* (February 2000) 15 Mealey's International Arbitration Report A1-A20, B1-B20.

[6] Choosing voice over exit, in Hirschman's terms, is the 'hallmark of loyalist behavior'. See Albert O. Hirschman, *Exit, Voice, Loyalty: Responses to the Decline in Firms, Organizations, and States* (1970) at 98.

[7] The authors do not examine treaty-based investment arbitrations in their case studies, but similar problems arise there. For discussion of the *CMS* case arising out of the meltdown of the Argentinean peso, see D. Schneiderman, 'Transnational Legality and the Immobilization of Local Agency' 2 *Annual Review of Law and Social Science* (2006) 387.

[8] Generally, on this latter point, see H.-J. Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (2002).

relations' (at 284). The last chapter is devoted to prescriptive measures which the authors anticipate will restore balance to the system: protecting both investors who are vulnerable to political risk and governments who may be the victim of changed circumstances beyond their control. Of interest to readers of this Journal is the authors express antipathy to the dominance of law in resolving investor disputes with governments. Reform, they write, should not be 'left entirely in the hands of lawyers'. They admit, nevertheless, that the cadre of investment lawyers pose a 'formidable obstacle' to the changes they suggest. In fact, there is little they can do to avoid the law in their prescriptive account. They propose, for instance, the adoption of a 'fair and just' standard (in contrast to the 'fair and equitable treatment' standard present in most BITS) in arbitration which would dispense with the strict application of treaty standards and admit the consideration by tribunals of changed circumstances, corruption, unreasonable terms, and incompetence (at 294). They admit the chances of this being embraced by investors and their governments is 'close to zero' (at 292). The authors alternatively suggest drawing on the WTO's non-discriminatory treatment standard accompanied by an Article XX escape clause as a model for rebalancing investor rights against state interests (the WTO Appellate Board has only recently found a measure that qualifies under this clause[9]). They propose a broadly available appeals process, preferably under the auspices of ICSID (a matter being debated amongst investment lawyers). All of these proposals appear to fall short, especially in light of the author's diagnosis that the system of international property rights needs reformation or it will self-destruct under the weight of its own rigidity. 'Failure to reform the system to redress the imbalance between its attention to the legitimate economic and social concerns of host countries and those of investors will surely mean a retreat by those nations from the system,' they write (at 299). Recent events bear out this pessimistic prognosis. In 2007, Bolivia tendered notice that it would withdraw from the ICSID convention. Ecuador in 2008 gave notice to terminate a number of BITS that it considers oppressive in their terms and with little return, so to speak, in attracting new inward investment. Despite the vaunted flexibility of international investment agreements, some states are beginning to check out. Wells and Ahmed have made an immensely important contribution to understanding why the system is vulnerable to breaking down. What remains to be seen, however, is whether the rules and institutions of international investment law, intended to bind states far into the future, are more resilient than the authors suggest.

David Schneiderman
University of Toronto, Visiting Professor
Georgetown University Law Center
Email: david.schneiderman@utoronto.ca
doi: 10.1093/ejil/chn037

[9] See Steve Charnovitz, 'The WTO's Environmental Progress' 10 *Journal of International Economic Law* (2007) 685 at 695.