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The Legal Protection of Foreign Investments against Political Risk:
The Case of Japanese Investments in the Power Sector of Asian Countries

4007S313-1
Papanastasiou Thomas Nektarios E. Chief Advisor: Prof. Urata Shujiro

Keywords: Legal assessment, standards of treatment, EPAs, political risk insurance, NEXI, contractual guarantees

The power sector (electricity) has been globally one of the most attractive infrastructure sectors for private participation and FDI. However, the interests and needs of host countries and foreign investors are diverging and sometimes controversial (an obsolescing bargain), becoming the source of uncertainty which triggers political risk. In particular, the power sector is by nature more prone to political risk than any other industry. The present study is unique with respect to its empirical research and its legal assessment. It selects five Asian countries as host states of power investments and Japan as the home country. How political risk can be legally managed and how one can assess the effectiveness of the legal responses to political risk is the central problem throughout this thesis, which deals with three areas of discussion: the notion of political risk, the legal framework for mitigating it and the method of assessing the effectiveness of each legal mean. In particular, this study asserts that political risk can be effectively managed through two legal regimes: public international law and contractual guarantees. In addition, it argues that there is a nexus among different tiers of the legal framework which has a complementary result on the mitigation of political risk.

Firstly, following on from the discussion of political risk determination, the present thesis broadly conceives the notion of political risk as the host government’s unwarranted interference with the foreign investment, an interference which should be political in nature and should cause damage to the investment’s economic interests. Secondly, reviewing previous research on legal means of risk mitigation, this study focuses on the role of a multi-tier framework consisting of international investment treaties (mainly EPAs) and contractual arrangements (mainly PRI-policies and investor-state guarantees). In connection with EPAs, it examines several standards of treatment that are determinants of political risk management. In particular, expropriation is the most traditional type of political risk. This study analyses in Chapter 2 what constitutes expropriation and the conditions that make a taking non-compensable, as well as examining what international arbitration tribunals require in order to accept a claim of expropriation and award compensation. Moreover, Chapter 3 assesses the role of general standards of treatment (NT, MFN, FET and FPS) and focuses on the protection of Japanese investments against political risk within the power sector. It argues that general treatment clauses have not received appropriate attention as a tool for securing foreign investments. Apart from the general standards, Chapter 4 assesses the role of specific standards of treatment – such as FTFs, protection from strike and umbrella classes – in mitigating political risk, as well as examining its deterrence through the provision of investor-state arbitration clauses and subrogation articles.

As for political risk management through contracts, Chapter 5 assesses the available legal means through PRI policy-tools provided by third-party actors such as NEXI and MIGA. It highlights the implications of the PRI policies (namely OII, OULI, and B/C Insurance) with regard to investors’ claims and asserts that signing a PRI contract does not constitute the elimination of all possible cases of political risk (especially in power investments). In addition, along with the PRI measures, Chapter 6 analyses and assesses the role of specific guarantees included in investor-state contracts with emphasis on the mitigation character of arbitration, stabilization, waiver of sovereign immunity and force majeure clauses. Finally, Chapter 7 combines the three legal-tiers into pairs, comparing the interactions between each pair, looking into the interface (overlapping) of political risk that can be mutually covered, as well as the nexus (complementary roles) of mechanisms that uniquely exist in each legal regime. In addition to these three nexuses, it examines the nexus among all three facets of legal means combined together.

Thirdly, this thesis is also unique in its method of assessing the effectiveness of the examined legal regimes. It follows a combined qualitative and quantitative method. The qualitative method is based on an analysis of the comprehensiveness of the legal countermeasures to political risks. Part I of the thesis consists of an analysis of recent EPAs (2006-2009) entered into force between Japan and five countries (Indonesia, Malaysia, Philippines, Thailand and Vietnam) and examines the wording of eleven standards of treatment along with the legal interpretation of secondary sources. For Part II of the thesis, the qualitative approach to PRI mechanisms is based on primary information obtained from interviews and meetings with NEXI and JBIC executives as well as on information contained on their annual reports, organisation laws and secondary studies. As for power contracts, the methodology is based mainly on primary data contained in five real-world power projects implemented by Japanese companies in Asian countries. In Part I, the quantitative methodology develops non-binary measures (a scoring card) to provide several snapshots of key legal elements for the protection of power investments in each of the five Asian countries, based on the investment and trade-in-services chapters as well as on the treaties’ appendices. In Part II, it undertakes a non-numerical evaluation of critical elements analysed in the power contracts, based on a five-scale index referring to the reservations or exceptions included in each case.

This thesis has found that the multi-tier legal framework can be effective in protecting against political risk, but such effectiveness depends on the wording of the legal components and on the nexuses among them. In particular, this analysis demonstrates that several factors – reservations in EPA clauses, lack of clarity in PRI tools and non-comprehensiveness in contractual guarantees – may weaken the protection against political risk. Finally, even if PRI (provided by NEXI) still plays the most dominant role in the protection of Japanese investments, this thesis asserts that the nexus of an institutionalised legal framework would be preferable in addressing future challenges of political risk mitigation.

References