

# Rethinking International Investment Law: Form, Function & Reform

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## INTRODUCTION

International investment law (IIL) is at an “inflection point.”<sup>1</sup> Several States are abandoning it,<sup>2</sup> while others are meeting to debate and reform it.<sup>3</sup> This Article reconsiders the conventional debates and reforms by asking a simple question: What is the function of IIL in light of the next best alternative? The answer it arrives at—that it depends on the nature of investment subject to protection—reveals a new set of critiques and a new direction for reform.

IIL is a “hybrid” or “platypus”-like regime<sup>4</sup> “unlike any other subfield of international law.”<sup>5</sup> Nearly 3,000 (mostly bilateral) treaties oblige member States to protect foreign investment.<sup>6</sup> If member States fail to do so, the same treaties empower private investors to seek damages through international arbitration.<sup>7</sup> To date, IIL has led to over 1,000 arbitrations against States and tens of billions of dollars in damages for investors.<sup>8</sup>

IIL’s empowerment of private investors has made it one of the “most controversial” institutions in the international economic order.<sup>9</sup> Investors have used the regime to challenge climate change regulations in the

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1. Julian Arato, *A Private Law Critique of International Investment Law*, 113 AM. J. INT’L L. 1, 8 (2019) [hereinafter Arato, *Private Law Critique*]; Sergio Puig & Gregory Shaffer, *Imperfect Alternatives: Institutional Choice and the Reform of Investment Law*, 112 AM. J. INT’L L. 361, 361 (2018).

2. See e.g., *South Africa Begins Withdrawing from EU-member BITs*, INV. TREATY NEWS (Oct. 30, 2012), <https://www.iisd.org/itn/en/2012/10/30/news-in-brief-9/>; *Ecuador Terminates 16 Investment Treaties*, TNI (May 18, 2017), <https://www.tni.org/en/article/ecuador-terminates-16-investment-treaties>; Nicholas Peacock & Nihal Joseph, *Mixed Messages to Investors as India Quietly Terminates Bilateral Investment Treaties with 58 Countries*, HERBERT SMITH FREEHILLS NOTES (Mar. 16, 2017), <https://hsfnotes.com/arbitration/2017/03/16/mixed-messages-to-investors-as-india-quietly-terminates-bilateral-investment-treaties-with-58-countries/>.

3. Sixty States are meeting through a Working Group of the United Nations Commission on International Trade Law. *Working Group III: Investor-State Settlement Dispute Reform*, U.N. COMM’N ON INT’L TRADE L., [https://uncitral.un.org/en/working\\_groups/3/investor-state](https://uncitral.un.org/en/working_groups/3/investor-state) (last visited Apr. 7, 2023). See also Anthea Roberts & Taylor St John, *Complex Designers and Emergent Design: Reforming the Investment Treaty System*, 116 AM. J. INT’L L. 96, 98 (2022).

4. Anthea Roberts, *A Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT’L L. 45, 45 (2013).

5. Joost Pauwelyn, *Rational Design or Accidental Evolution? The Emergence of International Investment Law*, in THE FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW: BRINGING THEORY INTO PRACTICE 11, 18 (Zachary Douglas et al. eds., 2014).

6. See *United Nations Investment Policy Hub: International Investment Agreements Navigator*, U.N. CONF. ON TRADE & DEV., <https://investmentpolicy.unctad.org/international-investment-agreements> (last visited Apr. 7, 2023).

7. NIGEL BLACKABY, CONSTANTINE PARTASIDES, ALAN REDFERN & MARTIN HUNTER, REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION §§ 8.58, 8.59, 8.75, 8.79 (6th ed. 2009) [hereinafter REDFERN AND HUNTER].

8. *United Nations Investment Policy Hub: Investment Dispute Settlement Navigator*, U.N. CONF. ON TRADE & DEV., <https://investmentpolicy.unctad.org/investment-dispute-settlement> (last visited Apr. 8, 2023) [hereinafter U.N. CONF. ON TRADE & DEV.].

9. Rob Howse, *International Investment Law and Arbitration: A Conceptual Framework*, in INTERNATIONAL LAW AND LITIGATION 14 (Helene Ruiz-Fabri ed., 2019).

Netherlands,<sup>10</sup> antismoking laws in Uruguay,<sup>11</sup> Black empowerment laws in South Africa,<sup>12</sup> laws protecting indigenous lands in Bolivia,<sup>13</sup> laws protecting critical ecosystems in Colombia,<sup>14</sup> and sovereign debt defaults in Argentina.<sup>15</sup> These and other claims have led to the conventional critique that IIL's protections for investors come at the expense of States and the public.<sup>16</sup>

The most prominent reforms on the table today thus aim to “rebalance” the regime in favor of States and away from investors. They include proposals to limit investor protections,<sup>17</sup> carve out regulatory space for States,<sup>18</sup> and replace investment arbitration with a standing international court.<sup>19</sup> These reforms are worth considering, but they are limited by the

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10. *See* RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Neth., ICSID Case No. ARB/21/4, Request for Arbitration (Jan. 20, 2021); Uniper SE, Uniper Benelux Holding B.V. & Uniper Benelux N.V. v. Kingdom of the Neth., ICSID Case No. ARB/21/2, Claimants' Memorial (Feb. 17, 2022).

11. Philip Morris v. Uru., ICSID Case No. ARB/10/7, Award (July 8, 2016).

12. Piero Foresti, Laura de Carli & others v. Republic of S. Afr., ICSID Case No. ARB(AF)/07/1, Award (Aug. 4, 2010).

13. South American Silver Limited v. Bol., PCA Case No. 2013-15, Award (Nov. 22, 2018).

14. Eco Oro Minerals Corp. v. Republic of Colom., ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability, and Quantum (Sept. 9, 2021).

15. Abaclat & others v. Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Aug. 4, 2011); Ambiente Ufficio S.p.A. & others v. Argentine Republic, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility (Feb. 8, 2013); Giovanni Alemanni & others v. Argentine Republic, ICSID Case No. ARB/07/8, Decision on Jurisdiction and Admissibility (Nov. 17, 2014). *See also* Poštová Banka A.S. & Istrokapital S.E. v. Hellenic Republic, ICSID Case No. ARB/13/8, Award (Apr. 19, 2015).

16. *See, e.g.*, GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007); Lise Johnson et al., *Costs and Benefits of Investment Treaties: Practical Considerations for States*, COLUM. CTR. ON SUSTAINABLE DEV. STAFF PUBL'NS (2018), [https://scholarship.law.columbia.edu/sustainable\\_investment\\_staffpubs/81/](https://scholarship.law.columbia.edu/sustainable_investment_staffpubs/81/); Benedict Kingsbury & Stephan Schill, *Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest: The Concept of Proportionality*, in INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW 75 (Stephan Schill ed., 2010); William W. Burke-White & Andreas von Staden, *Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations*, 35 YALE J. INT'L L. 283, 297 (2010).

17. The US Model Bilateral Investment Treaty, for example, restricts the definition of “fair and equitable treatment” to the less protective customary international law standard of Minimum Standard of Treatment. *See* 2012 U.S. Model Bilateral Investment Treaty art. 5(2).

18. Approximately 100 treaties incorporate general policy exceptions, which (theoretically) exempt States from liability when the State measure relates to or is necessary to achieve a certain public policy objective, such as protecting the environment. *See* Tarald Laudal Berge & Wolfgang Alschner, *Reforming Investment Treaties: Does Treaty Design Matter?*, INV. TREATY NEWS (Oct. 17, 2018), [https://www.iisd.org/itn/en/2018/10/17/reforming-investment-treaties-does-treaty-design-matter-tarald-laudal-berge-wolfgang-alschner/#\\_ftn11](https://www.iisd.org/itn/en/2018/10/17/reforming-investment-treaties-does-treaty-design-matter-tarald-laudal-berge-wolfgang-alschner/#_ftn11).

19. *See The Multilateral Investment Court Project*, EUR. UNION COMM'N, [https://policy.trade.ec.europa.eu/enforcement-and-protection/multilateral-investment-court-project\\_en](https://policy.trade.ec.europa.eu/enforcement-and-protection/multilateral-investment-court-project_en) (last visited Mar. 18, 2023). *See also* EU Commission Wants to Reform ISDS; Germany Presents its Own Proposal, AUSTRIAN FED. CHAMBER OF LAB. (July 5, 2015), <https://www.akeuropa.eu/en/eu-commission-wants-reform-isds-germany-presents-own-proposal>. Other procedural reforms being considered relate to the creation of an appellate mechanism, code of conduct for arbitrators, the selection and challenge of arbitrators, a

conventional accounts of the regime in which they are grounded. Rethinking the regime in light of the alternative leads to a new perspective on the regime's form, function, and reform. I make three main claims.

My first claim is that the key function of international investment law is contingent on the nature of *investment*. According to conventional accounts, IIL has three key functions: to protect investment, to promote investment, and to enhance international cooperation.<sup>20</sup> But investment treaties are not necessary for achieving any of these goals.<sup>21</sup> States and investors can (and do) achieve the same ends through investor-State contracts. Investment-specific contracts can be costly to negotiate, however, whereas treaty protections apply to all covered investments in a blanket fashion. A more compelling account of IIL's function, therefore, is that it reduces the *cost* of investment protection by obviating the need for investor-State contracts.<sup>22</sup>

IIL's capacity to reduce transaction costs is not equal across all investments, however. Its capacity to do so is greatest with respect to investments—such as the purchase of private property—that do not naturally involve a contractual relationship with the State. With respect to those investments, IIL reduces costs by eliminating the need for an additional set of negotiations and agreements between the State and investor. Where, however, the investment *already* involves a contractual relationship with the State—and the State and investor can agree to bespoke protections at little or no cost—IIL has no compelling role to play. This Article thus suggests a different answer to the question asked by Jason Yackee in his article, *Do We Really Need [Investment Treaties]?*<sup>23</sup> Yes, I argue. But not for all investments.

My second claim is that the contingent functionality of IIL reveals a misalignment between its form and function. That is because while the function of IIL is contingent on the nature of investment, the coverage of IIL is not. Investment treaties tend to cover an extraordinarily broad set of assets and transactions, typically defined to include “‘all assets’ or ‘every kind

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procedure for the dismissal of frivolous claims, cost management procedures, third party funding of investor claims, counterclaims by States, and alternative procedures to arbitration. See U.N. Comm'n on Int'l Trade L., Working Group III (Investor-State Dispute Settlement Reform), Possible Reform of Investor-State Dispute Settlement (ISDS): Note by the Secretariat, U.N. Doc. A/CN.9/WG.III/WP.166 (July 30, 2019), <https://documents-dds-ny.un.org/doc/UNDOC/LTD/V19/081/95/PDF/V1908195.pdf?OpenElement>.

20. See *infra* Section I.

21. See Jason Webb Yackee, *Do We Really Need BITs? Toward a Return to Contract in International Investment Law*, 3 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 121 (2008); See also Howse, *supra* note 9, at 381; Sam F. Halabi, *Efficient Contracting Between Foreign Investors and Host States: Evidence from Stabilization Clauses*, 31 NW. J. INT'L L. & BUS. 261 (2011).

22. Cf. Howse, *supra* note 9, at 381; Anne van Aaken, *International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis*, 12 J. INT'L ECON. L. 507 (2009).

23. Yackee, *supra* note 21; see also Howse, *supra* note 9.

of asset,” including State contracts.<sup>24</sup> Investment treaties thus protect investments—established by contractual agreements with States—that could be efficiently protected by contract alone.

The redundant protection of State contracts is problematic because IIL protection is not free. IIL imposes costs on States that reduce returns for investors.<sup>25</sup> It moreover constrains States’ capacity to protect the environment and public health.<sup>26</sup> These costs and constraints are theoretically justifiable where treaties reduce the cost of protection to a greater extent. That is arguably the case with respect to property-like investments, for which contractual protections would be costly to establish.<sup>27</sup> But with respect to State contracts, the costs and constraints of mandatory treaty protection only reduce investment gains. Considering the nature of investment thus leads to a modification of the conventional *critique* of the regime. The problem is not just that IIL is unfair to States and the public. As it is currently designed, IIL is unnecessarily costly (and thus unfair) to all parties—investors included.

*How did we arrive at such a suboptimal arrangement?* My third claim is that the historical context in which IIL developed can help to explain. The jurisdictional scope of today’s IIL regime can be traced to the first investment treaties established in the 1950s and ’60s. At that time, a much larger share of international investment was made in the form of State contracts, including sovereign loans and concession contracts in oil and mining. But there was not yet a robust international commercial arbitration regime for resolving disputes arising from those contracts. And, moreover, investment treaties did not yet give investors the right to directly enforce their provisions. In that context, the treaty coverage of contracts made sense. It was not redundant, because there was not yet an effective alternative. Nor, as I explain further below, was it inefficient, as it did not yet allow investors to assert claims.

Today, however, that context has changed. State contracts no longer play an outside role in international investment flows. A robust international commercial arbitration regime that can resolve contractual disputes with

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24. See *Fedax N.V. v. Republic of Venez.*, ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, ¶ 34 (July 11, 1997) (citing Antonio R. Parra, *The Scope of New Investment Laws and International Instruments*, in *ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW* 27, 35–36 (Robert Pritchard ed., 1996)). See also Stratos Pahis, *Investment Misconceived: The Investment-Commerce Distinction in International Investment Law*, 45 *YALE J. INT’L L.* 69, 77 (2020) [hereinafter Pahis, *Investment Misconceived*].

25. See Stratos Pahis, *BITs & Bonds: The International Law and Economics of Sovereign Debt*, 115 *AM. J. INT’L L.* 242, 277 (2021) [hereinafter Pahis, *BITs & Bonds*]; Julian Arato, *The Logic of Contract in the World of Investment Treaties*, 58 *WM. & MARY L. REV.* 351, 360 (2016) [hereinafter Arato, *Logic of Contract*]; Halabi, *supra* note 21, at 303.

26. See e.g., VAN HARTEN, *supra* note 16; Howse, *supra* note 9, at 388.

27. See *infra* Section I.C.2.

States is well established. And investment treaties commonly allow investors to bring treaty claims through investor-State arbitration. Together these changes effectively undermined the case for the treaty coverage of contracts. But that coverage nevertheless remains today. The context of the regime has changed, in other words; but its form has not.

The time has come to update the regime's form and re-align it with its function. States should do so by keeping treaty protection where it is most valuable: namely, for property investments which do not involve contractual privity with the State. And they should remove treaty protection (or allow investors to opt into or out of such coverage) where it is most likely redundant and inefficient: namely, over State contracts. Such a reform would not only reduce costs for States and investors. It would provide an alternative means of "re-balancing" investment protections, by giving States the latitude to do so through direct negotiations with investors on a case-by-case basis.

The remainder of this Article is organized as follows: Section I reconsiders the regime's function and critiques in light of the contractual alternative. Section II reconsiders the regime's form from a historical perspective. Section III reconsiders the reforms of the regime and elaborates on a proposal to exclude State contracts from its coverage. The Conclusion then briefly summarizes my claims.

## I. RETHINKING FUNCTION

### A. *The Conventional Account*

It is axiomatic that IIL protects foreign investment. While each investment treaty may differ slightly from the next, most establish similar substantive protections for foreign investors of counterparty States. These tend to include guarantees of non-discriminatory treatment (including "national treatment" and "most favored nation treatment"), compensation in the event of an expropriation, "fair and equitable treatment" (FET), and in some cases so-called "umbrella clauses" that protect against contractual breach.<sup>28</sup> The weight of tribunals interpreting these protections have held that they are mandatory, meaning they apply independently of any

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28. REDFERN AND HUNTER, *supra* note 7, at §§ 8.59, 8.79, 8.98. Umbrella clauses are not contained in all treaties, and their wording tends to differ to a significant extent. But at least some tribunals have found that some umbrella clauses allow investors to bring claims predicated on a contractual breach. *See, e.g.*, Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEO. MASON L. REV. 137 (2006); *See also* Christoph Schreuer, *Travelling the BIT Route: Of Waiting Period, Umbrella Clauses and Forks in the Road*, 5 J. WORLD INV. & TRADE 231, 249–55 (2004).

agreement between the State and investor, and cannot be contracted out of.<sup>29</sup>

Nearly all of today's investment treaties marry those substantive investment protections with a private procedural remedy.<sup>30</sup> Most investment treaties allow foreign investors to assert private claims for treaty breaches directly against States by way of international arbitration.<sup>31</sup> The procedures for adjudicating these investor-State claims are influenced by the commercial arbitration model, including, with respect to the selection of tribunal members (which is made by the parties), the *ad hoc* nature of the process, and the lack of an appeals mechanism.<sup>32</sup> The resulting awards are highly enforceable in nearly every State on earth pursuant to two widely-adopted multilateral treaties<sup>33</sup>: the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention),<sup>34</sup> and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).<sup>35</sup>

The investment protection function of IIL helps to explain why capital exporting States—such as the US and European States—were interested in creating the regime: it protects the interests of their nationals abroad.<sup>36</sup> But why would so many capital *importing* States sign onto that same regime and expose themselves to the liability these treaties create? That question is conventionally answered by reference to two other functions that investment protection is instrumental to achieving.

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29. See Arato, *Logic of Contract*, *supra* note 25, at 360.

30. W. Michael Reisman & Anna Vinnik, *What Constitutes an Investment and Who Decides?*, in CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS 50, 70 (Arthur W. Rovine ed., 2010).

31. REDFERN AND HUNTER, *supra* note 7, at §§ 8.58, 8.59, 8.75, 8.79.

32. See Meg Kinnear, *Transparency and Third Party Participation in Investor-State-Dispute Settlement*, ICSID, OECD & UNCTAD 1, 1 (2005), <http://www.oecd.org/dataoecd/6/25/36979626.pdf>; cf. ANTONIO PARRA, THE HISTORY OF ICSID (2d ed. 2017) (noting that the ICSID procedures were based upon State-to-State arbitral procedures).

33. See GARY BORN, INTERNATIONAL ARBITRATION: LAW AND PRACTICE 378 (1st ed. 2012) (The New York “Convention establishes a ‘pro enforcement’ approach toward foreign awards.”); *id.* at 377 (“[I]he New York Convention provides for an award’s presumptive recognition, subject to only narrow, enumerated exceptions. Likewise, most arbitration statutes, including the UNCITRAL Model Law, presumptively require the recognition of awards, again subject only to specifically-identified exceptions . . .”).

34. Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force Oct. 14, 1966) [hereinafter ICSID Convention].

35. June 10, 1958, 21 U.S.T. 2517, 333 U.N.T.S. 38.

36. See Pauwelyn, *supra* note 5, at 12; KENNETH VANDELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION 58 (2010); JONATHAN BONNITCHA, LAUGE POULSEN & MICHAEL WAIBEL, THE POLITICAL ECONOMY OF THE INVESTMENT TREATY REGIME 23 (2017).



First, by protecting investment, IIL aims to *promote* investment and thus support economic development.<sup>37</sup> Underpinning this function is the premise that domestic legal systems of States, particularly developing States, are not sufficiently credible to assure potential foreign investors that their investments will be protected. After all, States can (and do) use their sovereign powers to change their national laws, nullify contracts, and expropriate investments. Moreover, States' judicial systems can be biased and fail to provide a fair hearing to foreign nationals.

Investment treaties address those deficiencies by allowing States to make international commitments that cannot be unilaterally altered or nullified, and whose enforcement is not dependent upon the State's own judiciary. These credible commitments are intended to reduce the risk of investing, and thus increase investment flows into member States' territories.<sup>38</sup> They likewise signal to foreign investors that member States intend to treat their investments fairly.<sup>39</sup> While the empirical evidence is mixed as to whether investment treaties actually promote investment,<sup>40</sup> their potential to do so has played a key role in convincing developing States to join the regime.<sup>41</sup>

Second, investment protection is instrumental to the enhancement of international cooperation.<sup>42</sup> Historically, powerful States have intervened diplomatically and militarily to protect the assets of their nationals abroad.<sup>43</sup>

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37. See, e.g., Puig & Shaffer, *supra* note 1 (describing that the normative goals of IIL are conventionally described as fairness, efficiency and peace); Nicholas DiMascio & Joost Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?*, 102 AM. J. INT'L L. 48, 88 (2008).

38. See Alan O. Sykes, *The Economic Structure of International Investment Agreements with Implications for Treaty Interpretation and Design*, 113 AM. J. INT'L L. 482, 491 (2019); Jeswald W. Salacuse, *Of Handcuffs and Signals: Investment Treaties and Capital Flows to Developing Countries*, 58 HARV. INT'L L.J. 127, 130 (2017) [hereinafter Salacuse, *Of Handcuffs*]; van Aaken, *supra* note 22; Stephan W. Schill, *Enabling Private Ordering: Function, Scope and Effect of Umbrella Clauses in International Investment Treaties*, 18 MINN. J. INT'L L. 1, 18–19 (2009); Henrick Horn & Pehr-Johan Norbäck, *Economic Aspects of International Investment Agreements*, 30 AM. REV. INT'L ARB. 11, 15–16, (2019); Henrik Horn & Thomas Tangerås, *Economics of International Investment Agreements* (J. Int'l Econ., Working Paper, Sept. 4, 2020), <https://www.ifn.se/media/cqvn3bvt/hh-tt-4sep2020.pdf>.

39. Salacuse, *Of Handcuffs*, *supra* note 38, at 140–43.

40. Multiple empirical studies have analyzed the question of whether BITs increase foreign direct investment generally, and “[o]n balance, although the evidence is not conclusive, one may say that the more recent of these studies tend to show a positive correlation” between BITs and foreign investment flows. *Id.* at 132.

41. See M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 227 (1994) (the principal motivation for developing countries to enter into investment treaties was to attract foreign investment); VANDELDELDE, *supra* note 36, at 57.

42. See generally C. LIPSON, *STANDING GUARD, PROTECTING FOREIGN CAPITAL IN THE NINETEENTH AND TWENTIETH CENTURIES* (1985).

43. See EDWIN BORCHARD, *THE DIPLOMATIC PROTECTION OF CITIZENS ABROAD* 4Ba (1915). Actual use of armed force, including by the United States, has “frequently been used for the protection of citizens or their property in foreign countries in cases of emergency where the local government has

The investment protection established by the IIL regime substitutes a rules-based order for such power-based interventions. By consenting to arbitrate investment disputes directly with investors, capital importing (or “host States”) obtain promises from capital exporting (or “home States”) to refrain from interfering in their internal affairs.<sup>44</sup> Investment protection also enhances international cooperation by strengthening economic ties and interdependence among member States.<sup>45</sup>

### *B. The Contractual Alternative*

Investment treaties are not necessary for achieving any of these goals, however.<sup>46</sup> Contracts can guarantee all of the same substantive and procedural protections as the current IIL regime and, therefore, offer the same capacity to promote investment as well. They can also foster international cooperation in similar ways.

Substantively, contracts can directly incorporate investment treaty norms as covenants. For example, States can contractually promise to treat investors fairly and equitably and to refrain from expropriation. Contracts may also indirectly incorporate those norms by selecting customary international law or existing treaties as applicable law.<sup>47</sup> Finally, contracts can achieve similar results through more tailored means, including, for example, by expressly allocating the risk of certain government interventions among the parties or incorporating guarantees that “stabilize” the regulatory

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failed.” *See id.* at 447, 448 (“Practically all the great powers have at different times resorted to a display of force to give moral support to a request for the protection of nationals in foreign countries or for the redress of injuries inflicted upon nationals); *id.* at 449 (“The United States has on many occasions, either alone or in conjunction with other powers, used its military forces for the purpose of occupying temporarily parts of foreign countries to secure adequate protection for the lives and property of American citizens.”). *See also* MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007); TAYLOR ST. JOHN, THE RISE OF INVESTOR-STATE ARBITRATION: POLITICS, LAW AND UNINTENDED CONSEQUENCES 53–58 (2018).

44. Pauwelyn, *supra* note 5, at 38 (“[F]or many host States, the choice was *not* between pristine national sovereignty and international arbitration, but between (i) unilateral enforcement and diplomatic protection by home States, or (ii) rules-based settlement.”). Home States are also “relieved of the tedious responsibility of claims processing” and from expending their diplomatic, economic and military resources to remedy wrongs against their nationals. *Id.* at 39.

45. *See, e.g.*, STEPHEN BROOKS, PRODUCING SECURITY: MULTINATIONAL CORPORATIONS, GLOBALIZATION, AND THE CHANGING CALCULUS OF CONFLICT (2005); Edward Mansfield & Brian Pollins, *The Study of Interdependence and Conflict: Recent Advances, Open Questions, and Directions for Future Research*, 45 J. CONFLICT RESOL. 834 (2001). The theory that economic interdependence led to peace was a driver of the creation of the post-war international economic order, including the General Agreement on Tariffs and Trade (GATT). *See also* 1 PETROS MAVROIDIS, THE REGULATION OF INTERNATIONAL TRADE 7–8 (MIT Press 2016).

46. *See* Yackee, *supra* note 21; Howse, *supra* note 9; Halabi, *supra* note 21.

47. I explore this possibility in *infra* Section D. Scaling Reform: Two Paths, Multiple Dimensions.

environment. Such clauses are already common in concession contracts in certain industries, including mining, gas, and oil.<sup>48</sup>

Procedurally, contracts can shield investments from biases or other deficiencies in national courts through agreements to arbitrate disputes in neutral forums. States and investors, for example, can agree to arbitrate disputes in international forums, such as the Stockholm Chamber of Commerce, or through the ICSID Centre, a more specialized investor-State forum created by the ICSID Convention.<sup>49</sup> Such international arbitration clauses are also common<sup>50</sup> and result in awards that are just as enforceable as those issued pursuant to investment treaties.<sup>51</sup>

Finally, contracts can provide these protections with the same level of credibility as IIL protections. Unlike national law protections, which can be unilaterally withdrawn or opportunistically changed by the host State, contracts can be governed by foreign or international law, which are out of the host State's reach. As such, contractual covenants can be insulated from host State interference in the same way that international treaty protections are.<sup>52</sup>

Because contracts can protect investments as effectively as treaties, they have the same capacity to promote investment as well. Indeed, bespoke contracts that are tailored to the specific needs of individual investors offer arguably superior protection (and thus are more likely to promote investment) than general treaty norms that leave significant discretion to tribunals.<sup>53</sup> They can also send more targeted (and thus more effective) signals as to the States' intentions vis-à-vis specific investments. And

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48. See Thomas Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L.J. 216, 226 (1996). For a practical example of how States and investors allocate risk in such circumstances, see, for example, *ConocoPhillips v. Venez.*, ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits, ¶ 124 (Sept. 3, 2013).

49. See ICSID Convention, *supra* note 34, arts. 1–24.

50. GARY B. BORN, INTERNATIONAL ARBITRATION: LAW AND PRACTICE 14 (2d ed. 2016).

51. International arbitration awards are enforceable under two “pro-enforcement” regimes: The ICSID Convention, *supra* note 34, and the Convention on the Recognition and Enforcement of Arbitral Awards art. 1(3), June 10, 1958, 21 U.S.T. 2517, 333 U.N.T.S. 38 [hereinafter New York Convention]. See BORN, *supra* note 50, at 377–78. Sykes argues that States will be more likely to comply with a treaty obligation than a contractual obligation. Sykes, *supra* note 38, at 500. But once rendered, an ICSID award has the force of international law and the defendant State has a treaty obligation under the ICSID Convention to “abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.” ICSID Convention, *supra* note 34, art. 53(1).

52. Howse, *supra* note 9, at 394. This is a key difference between contracts and national legislation protecting foreign investments. National foreign investment laws can be changed or withdrawn opportunistically by the host State, whereas contractual promises made pursuant to international or foreign law are out of their reach.

53. Van Aaken argues that the flexibility of investment law norms allows States to provide credible commitments without overly constraining future acts or expending the costs to negotiate over every eventuality. See van Aaken, *supra* note 22, at 516. But given that investment law norms can be incorporated directly into contracts, the benefit of flexibility does not advantage treaties over contracts.

because the ICSID Convention precludes diplomatic protection with respect to any disputes before the Centre,<sup>54</sup> contracts containing agreements to arbitrate disputes through ICSID offer the same geopolitical dividends that treaties do too.<sup>55</sup>

### *C. The Economic Function of Treaty Protection*

If contracts can achieve the same goals as investment treaties, then what is the function of IIL? Some scholars have argued that there is none at all and that we should simply do away with it.<sup>56</sup> Brazil, after all, has managed to attract significant foreign investment without a traditional investment treaty program.<sup>57</sup> Others have argued that mandatory treaty protections promote non-economic values, such as fundamental rights and fairness—a view that I address below.

The more compelling view is that treaties offer an economic benefit over contracts: they reduce the *cost* of investment protection.<sup>58</sup> Contractual protections, after all, must be negotiated and agreed on a case-by-case basis and therefore entail significant transaction costs. Over thousands of negotiations and thousands of agreements, such costs accumulate. By contrast, treaty protections obviate the need for any direct negotiation or agreement between States and investors. They imply mandatory “off the shelf” rules into every investment arrangement, and thus reduce the costs of investment protection and promotion.

#### *1. Cost Reduction and the Nature of Investment*

IIL’s capacity to reduce costs is not equal across investments, however. It is, instead, contingent on the nature of investment subject to protection.

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54. ICSID Convention, *supra* note 34, art. 27(1) (“(1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.”).

55. National law and political risk insurance are also widely cited as alternatives to IIL. *See, e.g.,* Howse, *supra* note 9, at 374; Puig & Shaffer, *supra* note 1, at 384–85. However, both suffer from deficiencies as substitutes for IIL. National laws protecting investments are no substitute for IIL because national law can be changed unilaterally and opportunistically by the host State. Political risk insurance, on the other hand, does not cover the same range of risks as IIL. Moreover, it does not directly discipline State behavior in the same way as contract or investor-State damages claims do. Political risk premiums are born by the investor. While higher premiums may dissuade investment and thus indirectly discipline State behavior (by incentivizing them to adopt reforms that lower risk), the mechanism is not as direct and thus likely less effective as incentivizing States to change behavior to lower investment risk. *See* Sykes, *supra* note 38, at 484.

56. *See, e.g.,* Yackee, *supra* note 21; *see also* Howse, *supra* note 9; Halabi, *supra* note 21.

57. *See, e.g.,* Yackee, *supra* note 21, at 138.

58. Sykes, *supra* note 38, at 500.

III's capacity to reduce transaction costs is greatest where the State is not a party to the investment—for example, where a private investor acquires property interests in land, a factory, or equity in a private company. With respect to such investments, obtaining investment protections via contract from the State would require an additional set of negotiations and agreements. Potential investors would need to contact the appropriate State agency, inform them of their interest in entering into a contract, and then negotiate particular protection provisions. States would need to evaluate the investment for value and risk, determine a price the State would be willing to accept, and negotiate with the potential investor. Because contractual protection of these investments is costly to obtain, treaty protection—which obviates the need for such contracts—has a significant cost-saving role to play.<sup>59</sup>

Where the investment *already* involves a contract with the State, however, the role of treaty protection is less obvious. With respect to such investments, particularly high-value State contracts that are most likely to give rise to an investment treaty arbitration,<sup>60</sup> States and investors are *already* in a position to agree to terms that are functionally duplicative of treaty protections, should they want them.<sup>61</sup> And because contractual protections can be designed with a specific investments in mind, they can be made more suitable, precise, and certain than general treaty protections. Indeed, it is commonplace for international contracts of all kinds to contain choice of law and forum selection provisions that can replicate investment treaty protections at greater specificity.<sup>62</sup> With respect to State contracts, treaties do not obviate the need for contractual negotiations and agreements. They simply layer on general protections whether the State and investor want them or not.<sup>63</sup>

It is true that investment treaty coverage of contracts eliminates the need for parties to incorporate investment treaty norms into their contracts, should they so desire them. That may in some circumstances reduce transaction costs of drafting some contracts to some extent.<sup>64</sup> But the

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59. It is worth reiterating here that national law cannot substitute for contracts in this scenario, because host States retain the capacity to opportunistically change it. That risk is the problem that III is meant to solve, and only contracts are capable of doing the same. *See supra* notes 37, 38, 55.

60. *See infra* note 74.

61. For reasons that States and investors may not want treaty protection, *see infra* Section 2. The Costs and Constraints of Treaty Protection.

62. *See* BORN, *supra* note 50, at 2, 14.

63. *See infra* Section 2. The Costs and Constraints of Treaty Protection.

64. Sykes hypothesizes that transaction costs are most significant to smaller investors, whose investments may not merit the costs of seeking bespoke protections. Sykes, *supra* note 38, at 500. It is unclear whether he has existing State contracts in mind, or he is considering a property investment in which no State contract already exists. In any event, if a State contract is too small to merit protections, it is, as a practical matter, most likely priced out of investment treaty protection anyway, given that treaty claims typically cost several millions of dollars adjudicate. *See infra* note 74.

reduction of transaction costs from treaty protection is likely to be *de minimus*, given the ease with which investment treaty norms could be incorporated (directly or indirectly) into contracts.<sup>65</sup> And moreover, investment treaties may *increase* the cost of contract drafting in another more substantial way. As Crawford has written, treaties and contracts are not “clean different things” and yet nothing is more “fundamental, or more disputed than the distinction between” them.<sup>66</sup> In some instances, tribunals have interpreted treaty norms to effectively displace contract terms.<sup>67</sup> But in others they have gone the other way and prioritized the contractual bargain.<sup>68</sup> The lack of clarity as to how tribunals will interpret a contract in light of treaty coverage can thus be expected to complicate, and therefore increase the cost, of contract drafting.

The case that treaties reduce transaction costs is stronger with respect to contracts entered into with regional and municipal governments and State-owned enterprises. Investment treaty protection extends to such contracts by making the host State liable for certain adverse acts by it or its subdivisions.<sup>69</sup> Sub-State actors could assume that same liability by way of contract, but that contractual commitment may be harder to obtain and worth less than a guarantee from the State. It may be harder to obtain because State subdivisions have fewer financial means and less control over the actions of other State actors than the State itself, and thus may be less willing to assume the liability. It may be less valuable even if obtained, because, unlike States, sub-State actors like municipalities can generally declare bankruptcy and discharge their financial obligations.<sup>70</sup> Obtaining protections via sub-State contracts that are truly equivalent to treaty protections would therefore require either that the State become a party to, or a guarantor of, the contract. Because such an arrangement could involve additional transaction costs,<sup>71</sup> investment treaties have a plausible role to

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65. See *supra* Section B. The Contractual Alternative.

66. James Crawford, *Treaty and Contract in Investment Arbitration*, 24 ARB. INT'L 351, 373 (2008).

67. Arato, *Logic of Contract*, *supra* note 25.

68. *Id.* at 357.

69. See G.A. Res. 56/83, Responsibility of States for Internationally Wrongful Acts, art. 4 (Dec. 12, 2001) (“(1) The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State. (2) An organ includes any person or entity which has that status in accordance with the internal law of the State.”). See also Jorge Viñuales, *Attribution of Conduct to States in Investment Arbitration*, 20 ICSID REP. 13, 40–41 (2022); Tethyan Copper Co. Pty Ltd. V. Islamic Republic of Pak., ICSID Case No. ARB/12/1, Decision on Jurisdiction and Liability, ¶¶ 725–26 (Nov. 10, 2017).

70. See Pahis, *BITs & Bonds*, *supra* note 25, at 246.

71. Despite these limitations, sub-State actors can agree to ICSID arbitration with approval from the State. ICSID Convention, *supra* note 34, art. 25(3) (“Consent by a constituent subdivision or agency

play with respect to such contracts. But where the State itself is already party to the contract, treaty protection is simply redundant.

## 2. *The Costs and Constraints of Treaty Protection*

The redundant coverage of State contracts is problematic because investment treaty protection is not free. Investment treaties impose costs and constraints that States and investors might rationally choose to forgo in favor of a more efficient alternative arrangement.

Procedurally, investment treaties impose costs by creating a forum for filing treaty claims in parallel to contract claims. This means that with respect to the same State contract, an investor can file a claim for breach of treaty in investor-State arbitration, while simultaneously filing a breach of contract claim against the State in national court or commercial arbitration (depending on the contract's forum selection clause). The doctrines of *res judicata* and *lis pendens* do not generally preclude such parallel actions, because treaty and contract claims represent different causes of action arising from different legal bases.<sup>72</sup> The costs of such parallel claims can be significant,<sup>73</sup> with the average costs of ICSID arbitration alone being approximately \$5.5

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of Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.”) Where a sub-State actor does so, however, it does not create liability for the State itself. The State's obligation is limited to enforcing the award against the subdivision. CHRISTOPH SCHREUER ET AL., *THE ICSID CONVENTION: A COMMENTARY*, art. 25(3), at 341 (2d ed. 2009) [hereinafter SCHREUER II].

72. Neither *lis pendens*, *res judicata*, nor “fork-in-the-road” treaty provisions that require investors to irrevocably choose between investor-State arbitration are likely to prevent parallel claims. Each of these doctrines require an “identity of the parties, object and cause of action in the proceedings pending before both tribunals,” which will not exist between investor-State arbitration (in which the cause of action arises from a BIT) and national court litigation (in which the cause of action arises from national law). See *Azurix Corp. v. Arg. Republic*, ICSID Case No. ARB/01/12, Decision on Jurisdiction, ¶ 88 (Dec. 8, 2003); Katia Yannaca-Small, *Parallel Proceedings*, in *THE OXFORD HANDBOOK OF INT'L INV. L.* 1008, 1013–14 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008); REDFERN AND HUNTER, *supra* note 7, at ¶¶ 8.57–8.61. Even mere allegations of breaches of contract, when asserted pursuant to an umbrella clause, have been treated as treaty claims, precluding the “identity of the parties, object and cause of action,” required to invoke *res judicata* and *lis pendens*. *SGS Société Générale de Surveillance S.A. v. Republic of Para.*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶¶ 131, 138–42 (Feb. 12, 2012).

73. Because the mandatory nature of investment treaty protection precludes investors from effectively disclaiming use of the investment treaty arbitration *ex ante*, the risk of an investment treaty claim—and the costs that it imposes—are always there and are thus always priced into the contract. Certain *claimants* who recover damages through the system *ex post* may indeed be made better off, but investors *writ large*, who face reduced returns, are worse off. See Julian Arato, *The Elastic Corporate Form in International Law*, 62 VA. J. INT'L L. 383, 421–22 (2022) [hereinafter Arato, *Elastic Corporate Form*] (discussing deadweight losses caused by shareholder claims). Additional deadweight losses accrue in specific types of investor-State claims, including in sovereign debt disputes, and corporate shareholder claims. See Pahiis, *BITs & Bonds*, *supra* note 25, at 277–80 (discussing deadweight losses in sovereign debt claims).

million for claimants and \$3.5 million for States.<sup>74</sup> Since the mandatory nature of IIL precludes investors from credibly promising to forego such claims in the event of a dispute *ex post*, the risk of such deadweight procedural losses increases the cost of investment *ex ante*.

Substantively, investment treaties impose costs by super-imposing covenants into the investor-State bargain. One of the most significant of those covenants is the requirement to guarantee fair and equitable treatment,<sup>75</sup> which has been interpreted to guarantee a stable regulatory environment for investors.<sup>76</sup> The guarantee is costly because it requires States either to refrain from adopting potentially beneficial regulations or pay damages in the event that they do.<sup>77</sup> Unlike the deadweight procedural costs associated with parallel proceedings, however, this promise can be understood as a transfer from States to investors that is not necessarily inefficient in and of itself. If the State judges the benefits of regulation to the public to exceed the costs of regulation to the investor, it can simply breach the treaty and pay damages.

In the context of IIL, however, even transfers from States to investors may result in deadweight losses because of the notorious unpredictability of the IIL regime.<sup>78</sup> The ad hoc nature of investment arbitration, the variation among treaties, and the vagueness and capaciousness of common treaty norms all inject considerable uncertainty into the process.<sup>79</sup> The result is that

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74. See Jeffery Commission, *The Duration Costs of ICSID and UNCITRAL Investment Treaty Arbitrations*, VANNIN CAP. (July 28, 2016), <https://www.lexology.com/library/detail.aspx?g=1cd4f7b6-204b-45bb-8728-e494d0d69082> (noting that average costs for a claimant in an ICSID arbitration between 2011 and 2015 were approximately \$5.5 million and approximately \$3.5 million for respondents; average duration was 3.75 years). See also SCHREUER II, *supra* note 71, art. 59, at 1214–15 (2d ed. 2009) (obtaining awards in investor-State arbitration can take years and cost several million dollars in legal fees).

75. See REDFERN AND HUNTER, *supra* note 7, §§ 8.58, 8.59, 8.75, 8.79.

76. See, e.g., CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award, ¶ 274 (May 12, 2005) (“There can be no doubt . . . that a stable legal and business environment is an essential element of fair and equitable treatment.”); Enron Corp. v. Argentine Republic, ICSID Case No. ARB/01/3, Award, ¶¶ 260–261 (May 22, 2007); Técnicas Medioambientales S.A. (Tecmed) v. Mex., ICSID Case No. ARB(AF)/00/2, Award, ¶ 154 (May 29, 2003). See also Rudolf Dolzer, *Fair and Equitable Treatment: Today’s Contours*, 12 SANTA CLARA J. INT’L L. 7, 20–29 (2013).

77. Indeed, investors have used the clause to challenge a raft of regulations—from climate change regulations and antismoking rules to laws protecting the right to water and laws protecting critical ecosystems. See Philip Morris v. Uru., ICSID Case No. ARB/10/7, Award, ¶¶ 108–32 (July 8, 2016); see also Suez, Sociedad General de Aguas de Barcelona S.A. & InterAgua Servicios Integrales del Agua S.A. v. Argentine Republic, ICSID Case No. ARB/03/17, Decision on Liability (July 30, 2010); see also Eco Oro Minerals Corp. v. Republic of Colom., ICSID Case No. ARB/16/41, Decision on Jurisdiction, Liability, and Quantum (Sept. 9, 2021).

78. See, e.g., Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1558–59 (2005).

79. Fair and equitable treatment has been interpreted in a variety of different ways, including to “(i) guarantee transparency of government regulatory processes; (ii) ensure the government acts in good faith and in a non-arbitrary manner; (iii) protect against discrimination; (iv) provide full protection



it is difficult for States and investors to efficiently price even the purely distributional impacts of IIL into the costs of investment.<sup>80</sup>

All of these costs decrease the profitability of investments. That means that on the margins IIL leads States and investors to forgo otherwise mutually beneficial investments—a result that is diametrically opposed to the goal of investment promotion. The opportunity costs of such unpursued investments fall on both States (who miss out on the benefits of the investment) and on investors (who miss out on the profits). With respect to investments that remain profitable, the costs of IIL must still be absorbed by someone. Whether that is the State or investor will depend on the parties' relative bargaining power (something explored below<sup>81</sup>).

Still, all of these additional costs are theoretically justifiable where the costs of the alternative are the same or greater.<sup>82</sup> That is plausible with respect to property-like investments, where the transaction costs of obtaining alternative contractual protection are relatively high. With respect to such investments, one-size fits all treaty protections may be preferable to contracts, even if they are sub-optimal, because they are cheaper than the alternative. But with respect to State contracts—where the cost of obtaining more efficient contractual arrangements are at best *de minimus*—the mandatory costs and constraints imposed by IIL serve no economic purpose at all.

#### *D. The Non-Economic Functions of Treaty Protection*

Investment treaties arguably provide benefits other than cost reduction that could otherwise justify their coverage State contracts. For example, investment treaties arguably promote non-economic values, such as equal treatment and fairness, that contracts do not. As I explore in this sub-Section, however, these other apparent advantages are either illusory, limited, or could be promoted more efficiently through alternative arrangements.

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and security to foreign investments; (v) protect the legitimate expectations of the investor; and (vi) guarantee a stable regulatory environment for the investment.” Stratos Pahiş, *Bilateral Investment Treaties and International Human Rights Law: Harmonization through Interpretation*, INT’L COMM’N JURISTS 34–35 (2011) [hereinafter Pahiş, *Harmonization*].

80. See Pahiş, *BITs & Bonds*, *supra* note 25, at 263; Arato, *Logic of Contracts*, *supra* note 25, at 393–94.

81. See *infra* Section I.D.2.

82. If, for example, a more efficient contractual arrangement did not exist, treaty protection might be suboptimal but not inefficiently so. Alternatively, if a more efficient alternative did exist, but its benefits were outweighed by the transaction costs of obtaining it, investment treaty protection would also be economically justifiable, notwithstanding its associated costs and constraints.

### 1. *Non-Discrimination*

The mandatory treaty protection of contracts arguably ensures that States do not discriminate against investors. By contrast, if left solely to the contracting parties, States could refuse to agree to any protections. Or they could discriminate against investors based on nationality, size, or political influence. Indeed, “leveling the playing field” for foreign investors, who are thought to face discrimination, is frequently cited as a core policy rationale for investment treaties.<sup>83</sup>

While facially persuasive, this function does not ultimately justify the treaty coverage of contracts, because the vast majority of treaties discipline States only after an investment is established.<sup>84</sup> As such, IIL already allows States to discriminate among investors when negotiating contract terms. The mandatory nature of IIL restricts States from specifically denying treaty protections to investors, but it leaves them free to choose several other, arguably more effective ways of discriminating, including through price setting or outright refusal to contract. A State that is intent on discriminating against an investor is thus free to do so at the pre-contract stage, regardless of whether the contract is covered by a treaty.

Fortunately, the incentives for States to arbitrarily discriminate at the pre-contract stage are limited.<sup>85</sup> The best explanation for why developing

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83. See, e.g., BONNITCHA et al., *supra* note 36, at 18.

84. See *id.* at 18 (“[E]ven with an investment treaty in place, a host state typically has discretion over whether or not to admit foreign investments to its territory and, if so, subject to what conditions.”). With very limited exceptions, the current IIL regime does *not* create a right to invest in a host State *ex ante*. The United States is the only country to require non-discriminatory treatment *ex ante*. See Jason Yakee, *Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties*, 33 BROOK. J. INT’L L. 405, 445 (2008); VANDELDELDE, *supra* note 36, at 58. Even U.S. investment treaties, which take the minority approach and contain provisions that apply to the pre-investment stage, carve out government procurement from non-discrimination disciplines. See 2012 U.S. Model Bilateral Investment Treaty, *supra* note 17, art. 14(5) [hereinafter U.S. Model BIT]. The US Model BIT defines “government procurement” as “the process by which a government obtains the use of or acquires goods or services, or any combination thereof, for governmental purposes and not with a view to commercial sale or resale, or use in the production or supply of goods or services for commercial sale or resale.” *Id.* art. 1.

85. In fact, there is at least some evidence that States provide *better* treatment to foreign investors than to domestic ones. See Emma Aisbett & Lauge Poulsen, *Relative Treatment of Aliens: Firm-level Evidence from Developing Countries* (Univ. of Oxford, Glob. Econ. Governance, Working Paper No. 112, 2016) (finding foreign firms receive *better* treatment than local firms in middle and low-income States); Magnus Blomström & Ari Kokko, *The Economics of Foreign Direct Investment Incentives 2* (Nat’l Bureau of Econ. Rsch., Working Paper 9489, 2003) (“An increasing number of host governments also provide various forms of investment incentives to encourage foreign owned companies to invest in their jurisdiction. These include fiscal incentives such as tax holidays and lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNCs, as well as measures like market preferences, infrastructure, and sometimes even monopoly rights.”); Jarrod Hepburn, Lauge N. Skovgaard Poulsen, Martins Paporinskis & Michael Waibel, *Investment Law Before Arbitration*, 23 J. INT’L ECON. L. 1, 3–4 (2020) (“Nationality-based discrimination still occurs also post-establishment, but it

States promise protections through investment treaties is that they want to attract foreign investment.<sup>86</sup> And for good reason: more investment typically means more jobs, tax revenue, technology transfer, and growth.<sup>87</sup> If IIL protections efficiently achieve that goal, States have the same reason to provide those promises through State contracts as through treaties.<sup>88</sup> (And if those promises do not efficiently promote investment, it makes no sense to force States to make them, as further discussed below.<sup>89</sup>) In any event, to the extent States are motivated by non-economic reasons to nevertheless discriminate against foreign investors, IIL already allows States to do so when negotiating contract terms.

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is not nearly as pervasive today as when the investment treaty regime emerged. In fact, it is not uncommon for foreign firms to receive better treatment than locals, such as when receiving fiscal or regulatory incentives or favourable contractual terms. By 2020, only nine investment treaty awards had found breaches of national treatment provisions.”); Puig & Shaffer, *supra* note 1, at 371 (“[F]oreign investors may be in a much stronger position than other stakeholders in relation to the host state through their ability to lobby, bargain contractually, obtain insurance, and harness home state diplomacy.”).

86. See SORNARAJAH, *supra* note 41, at 227; VANDEVELDE, *supra* note 36, at 57. See also *supra* notes 37–38.

87. See Salacuse, *Of Handcuffs*, *supra* note 38, at 135 (noting the benefits of FDI in the form of jobs, exports, increased productivity, technology transfer and growth); *Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Dissenting Opinion of Professor Abi-Saab on Decision on Jurisdiction and Admissibility, ¶ 55 (Aug. 4, 2011) (noting for similar reasons that FDI is the “ideal type” of investment (in the Weberian sense of the term) for ICSID purposes). *But see* JESWALD SALACUSE, THE LAW OF INVESTMENT TREATIES 53 (3rd ed. 2021) [hereinafter SALACUSE, THE LAW OF INVESTMENT TREATIES] (noting that there are some costs to foreign investment, including “damaging competitive effects on local industry, possible interference in the domestic political process, security risks posed by the foreign ownership of strategic industries and companies, and the introduction of potentially injurious technologies and practices to the local environment, indigenous cultures, and the health and safety of its other inhabitants”).

88. The same reasoning applies to both large and small investors, though it is worth noting that the costs of investment arbitration—which can reach into the millions of dollars—likely price out smaller value investors already. See *supra* note 74.

89. The State’s incentives may change *after* those promises are made and an investment has been sunk. At that point, the State has received the benefit of the bargain (the investment), and, absent credible enforcement, may face incentives to renege on the promises that it originally made to induce it. This is the classic problem of the “obsolescing bargain” or “hold up” problem that investment treaty protection is designed to guard against. See Sykes, *supra* note 38, at 497; Salacuse, *Of Handcuffs*, *supra* note 38, at 140. But incentives to *make* promises are very different from the incentives to *abide* by them. Refusing to *make* efficient promises *ex ante*, for discriminatory or other reasons, would deprive States of the benefits of the bargain they presumably seek.

That is not to say States always act according to economic logic. In some scenarios, States may face political incentives to favor domestic investors over foreign ones, or large investors over smaller ones, even where there are no efficiency gains to be had. States, for example, may view foreign investors as competition for domestic investors, whom for political reasons they may want to protect. See SALACUSE, THE LAW OF INVESTMENT TREATIES, *supra* note 87, at 253. Or they may be inclined to favor larger investors with more political influence. But as discussed above, the vast majority of treaties already allow States to discriminate at the pre-contract stage should they so choose.

## 2. *Bargaining Power*

Mandatory investment treaty protection also arguably promotes fairness by enhancing the bargaining power of investors vis-à-vis the State. Investors may want protection, the argument goes, but absent treaty protection, they may lack the bargaining power to obtain it.

Putting aside the assumptions that States possess greater bargaining power than investors or that if they did that would be a problem to solve, this function is also illusory. As a general matter, sophisticated parties negotiate contractual terms that maximize efficiency, regardless of any bargaining power imbalances.<sup>90</sup> The same principle applies to investment protection. Where the benefits of protection (to the investor) outweigh the costs (to the State), protection increases the parties' joint surplus and can leave both parties better off. The investor can "pay" the State more for the protection than it costs the State to provide it, but less than the value the investor receives from obtaining it. Thus, to the extent investment treaty protections increase the parties' surplus (i.e., are efficient), States can be expected to include them in their contracts independent of which party has greater bargaining power, and independent of whether a treaty requires them.

Bargaining power does affect how any contract surplus is divided among the parties, with the more powerful party taking a larger share of the surplus by way of price terms.<sup>91</sup> But the vast majority of investment treaties have no impact on distribution, because they have no impact on bargaining power. Put simply, bargaining power is a function of each party's respective next best alternatives to the contract, information as to those alternatives, and

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90. See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 554 (2003) ("Bargaining power instead is exercised in the division of the surplus, which is determined by the price term. Parties jointly choose the contract terms so as to maximize the surplus, which the parties may then divide unequally."); ROBERT E. SCOTT & JODY S. KRAUS, *CONTRACT LAW AND THEORY* 58–60 (4th ed. 2007); Douglas G. Baird, *The Boilerplate Puzzle*, 104 MICH. L. REV. 933, 934, 938 (2006); George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1320–21 (1981); Alan Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1072–74 (1977) ("Given . . . three [weak] assumptions, a firm will produce the same level of product quality regardless of whether the firm is a monopolist or a perfect competitor."). But see Albert Choi & George Triantis, *The Effect of Bargaining Power on Contract Design*, 98 VA. L. REV. 1665 (2013) (theorizing that in some circumstances extremely unequal bargaining power can lead to inefficient contractual design); Sykes, *supra* note 38, at 487 ("Host country policies that impose costs on foreign investors can extract profits from those investors when the host country has monopsony power in relation to foreign investors, much as a tariff may extract profits from foreign exporters who reduce their prices in response to the tariff.")

91. Schwartz & Scott, *supra* note 90, at 554. Thus, where a State has greater bargaining power relative to the investor, the State can be expected to appropriate a larger share of the contract surplus by decreasing the price that the State pays for the investor's performance (and thus reducing the investor's returns). Conversely, where an investor has greater bargaining power, the investor can appropriate a larger share of the surplus by increasing the contract price.

discount rates (or patience to wait out a deal).<sup>92</sup> The vast majority of investment treaties do not affect any of these factors because they do not govern the pre-contract phase. Therefore, to the extent investment treaties affect distribution *ex post*, through damages or otherwise, those transfers will be priced into the contract according to the State's and investor's respective bargaining power at the time of contracting. And as long as treaties do not govern the pre-contract phase, that balance of power is unaffected by treaty protection.<sup>93</sup>

### 3. *Fundamental Rights*

A third arguable advantage of mandatory treaty protections is they advance fundamental values or rights that should be promoted regardless of their efficiency or distributional effects. In other words, they promote fundamental values that should not be up for negotiation at all.<sup>94</sup>

It is true that some IIL protections reflect important customary international law and human rights standards,<sup>95</sup> including the right to property.<sup>96</sup> But investment treaties go beyond those basic norms and, moreover, package those rights with a remedy available only to a select few. In contrast to customary international law and human rights norms, investment treaties cover only certain persons (those who make a foreign

92. ROGER FISHER, WILLIAM URY & BRUCE PATTON, *GETTING TO YES* 102 (1991) (“The better your BATNA [best alternative to a negotiated agreement] the greater your [bargaining] power.”); Schwartz & Scott, *supra* note 90, at 553 (identifying next best alternative and discount rate or “patience” as the two main determinative factors of bargaining power); Choi & Triantis, *supra* note 90, at 1675–76 (identifying risk aversion and negotiation skills as further determinants).

93. If treaties governed the pre-establishment or pre-contracting stage, they could conceivably equalize bargaining power to some extent. See Sykes, *supra* note 38, at 505 (“In [the] absence [of protections that apply pre-establishment], host countries retain the ability to exploit their monopsony power through up-front fees and related methods, even if they are limited in what they can do to extract profits once an investment is established.”). However, as discussed above, only a small minority of investment treaties apply pre-establishment. See *supra* note 84 and accompanying text.

94. See, e.g., Robert Volterra, *International Law Commission Articles on State Responsibility and Investor-State Arbitration: Do Investors Have Rights?*, 25 ICSID REV.–FOR. INV. L.J. 218, 220 (2010); JAN PAULSSON, *DENIAL OF JUSTICE IN INTERNATIONAL LAW* 149 (2005) (“Whatever the rosy rhetoric about the equality of treatment of nationals and foreigners, the very fact of being foreign creates an inequality. The foreigner’s obvious handicap—his lack of citizenship—is usually compounded by vulnerabilities with respect to many types of influence: political, social, cultural.”); W. Michael Reisman, *International Investment Arbitration and ADR: Married but Best Living Apart*, 24 ICSID REV.–FOR. INV. L.J. 185, 190–91 (2009).

95. See SALACUSE, *THE LAW OF INVESTMENT TREATIES*, *supra* note 87, at 63–80. See also DiMascio & Pauwelyn, *supra* note 37, at 51 (“[The] modern legal principles governing trade, investment, and human rights all share the same origin: the protection and treatment of aliens.”).

96. See, e.g., G.A. Res. 217 (III) A, art. 17, Universal Declaration of Human Rights (Dec. 12, 1948) [hereinafter “Universal Declaration of Human Rights”]; Protocol No. 1 to the European Convention on Human Rights, *opened for signature* Mar. 20, 1952, art. 1, 213 U.N.T.S. 262 (entered into force May 18, 1954) [hereinafter “First Protocol, European Convention on Human Rights”]; American Convention on Human Rights art. 21, Nov. 22, 1969, O.A.S.T.S. No. 36, 1144 U.N.T.S. 123 (entered into force July 18, 1978).

investment) of certain nationalities (those whose home States have a treaty with the host State). They exclude domestic nationals and all other foreign nationals.<sup>97</sup> Even within that privileged sub-group, as a practical matter, investment treaties protect only the most sophisticated and high-net worth persons whose investments are large enough to merit the multi-million-dollar expense of asserting an investment arbitration.<sup>98</sup> Justifying these protections and remedies on the basis of the values that they uphold would make them, as Alvarez quipped, “the most bizarre human rights treat[ies] ever conceived . . . human rights treat[ies] for a special-interest group.”<sup>99</sup>

Conceiving of IIL protections as a set of unwaivable fundamental rights is also fundamentally inconsistent with the nature of the activities and the persons that IIL purports to protect. The core motivation of investors is to seek profit.<sup>100</sup> But as discussed above, IIL protections are not free. They create costs that profit-maximizing investors might rationally choose to forgo. Forcing these costs on investors—even where they would prefer to avoid them—undermines the interest of those IIL putatively seeks to protect.

#### 4. *Hand-Tying*

A fourth arguable advantage of investment treaties is that they protect both investors *and States* from defects in the bargaining process. More specifically, investment treaties arguably correct for agency and information problems by “tying the hands” of State and investor agents with respect to investment protection.<sup>101</sup>

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97. See Christoph Schreuer, *The Future of Investment Arbitration*, in LOOKING TO THE FUTURE: ESSAYS ON INTERNATIONAL LAW IN HONOR OF W. MICHAEL REISMAN 787, 796 (Mahnoush H. Arsanjani et al. eds., 2010) (“For purposes of access to rights under treaties, especially to investment arbitration, nationality is decisive and much time and effort is spent in individual cases to prove or disprove a particular nationality. When the cases reach the merit stage the picture changes completely. Discrimination on the basis of nationality is prohibited.”).

98. See *supra* note 73.

99. Jose Alvarez, *Critical Theory and the North American Free Trade Agreement's Chapter Eleven*, 28 U. MIAMI INTER-AM. L. REV. 303, 308 (1997). See also Pauwelyn, *supra* note 5, at 39 (“If investment protection were about human rights or protecting the property or human dignity of people, it is puzzling to see that international investment law only protects aliens and, more specifically, aliens that own assets or an investment.”).

100. The predominant definition of “investment” includes that it is made for a profit. See, e.g., *Salini Costruttori, S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶ 52 (July 23, 2001) (defining an investment as including a “profit or return”); see also CHRISTOPH SCHREUER, THE ICSID CONVENTION: A COMMENTARY, at art. 25, ¶ 81 (1st ed. 2001) [hereinafter SCHREUER I]; see also Pahiš, *supra* note 24, at 72, 105 (noting that both legal and economic definitions of investment involve profit seeking).

101. Commitment theory is often invoked as an explanation for why States make international commitments in other contexts, including with respect to international trade. See DOUGLAS IRWIN, PETROS MAVROIDIS & ALAN SYKES, THE GENESIS OF THE GATT 197 (2008).

State agents, for example, might be unaware of international protections. Or they might be irrationally averse to granting them (because of nationalistic, political, or other reasons) even when it is in the State's interest to do so. Likewise, investors might lack information as to the availability of international protections or the capacity to inform States that they value them. Given the high-value of investments that give rise to treaty arbitration, assuming such lack of sophistication on the part of State and investor may be unrealistic.<sup>102</sup> But if the State contracting process was defective, such that States and investors could not be trusted to negotiate optimal bargains on their own, it could make sense to guarantee investment protections by way of treaties rather than to leave them up to the contracting process.

Even then, however, the case for mandatory treaty protections would be weak. As discussed further below, agency and information problems could be addressed more efficiently by establishing a set of default rules that covered investments unless both the State and investor consented to waive them.<sup>103</sup> Such an arrangement would check State agent discretion by preventing the agent from withholding protection without investor consent, ensure protection where States or investors lacked information as to their availability, and still allow the parties to select a more optimal arrangement if they so desired.<sup>104</sup>

##### 5. *Geopolitical Externalities*

One final arguable advantage of treaties over contracts is that investment protection generates positive geopolitical externalities that do not accrue to the contracting parties (the host State and the investor), but rather to the home State of the investor. Because the home State of the investor is not a party to contracts between the investor and host State, any geopolitical benefits of investment protection that accrue to the home State would not be internalized in a contractual bargain. As such, if left only to the contracting process, host States and investors may agree to less international protection than is optimal.

This is a plausible advantage of mandatory IIL protections, but it is likely limited in practice. As noted above, IIL aims to enhance international cooperation by creating a rules-based order for the resolution of international investment disputes that precludes military or diplomatic

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102. The median damages awarded by investor-State tribunals is approximately 29 million US dollars. U.N. CONF. ON TRADE & DEV., *supra* note 8.

103. *See* Arato, *supra* note 25, at 408–10.

104. *See* Section III.D.2.

intervention by States.<sup>105</sup> Pauwelyn hypothesizes that home States benefit from this arrangement because they are “relieved of the tedious responsibility of claims processing” on behalf of their nationals.<sup>106</sup> But those benefits surely pale in comparison to the benefits the host State receives in terms of guarantees against military and diplomatic interference in its territories and affairs. And those benefits, together with the benefits that investors gain from having access to effective international enforcement, would be considered in a contractual bargain.

Moreover, the mandatory nature of IIL protections may counteract the other way in which IIL enhances international cooperation. As discussed above, in addition to establishing a rules-based order, IIL enhances international cooperation by enhancing economic ties among States more generally.<sup>107</sup> The mandatory nature of IIL, however, imposes costs that may actually discourage cross-border investments and thus the growth of such ties.<sup>108</sup>

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In sum, the non-economic functions of investment treaty protection are either illusory, limited or can be accomplished more efficiently by other means. The vast majority of investment treaties do not prevent discrimination at the pre-establishment phase, equalize bargaining power between States and investors, or credibly promote fundamental values. The most plausible non-economic function of investment treaties is that they correct for possible deficiencies in State contracting processes. But as discussed above and further below, that function can be more efficiently replaced by an alternative arrangement. As compared to the contractual alternative, the most compelling function of IIL remains the reduction of the costs of investment protection. And for all the reasons discussed above, that function is contingent on the nature of investment subject to protection.

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105. Pauwelyn, *supra* note 5, at 38 (“[F]or many host States, the choice was *not* between pristine national sovereignty and international arbitration, but between (i) unilateral enforcement and diplomatic protection by home States, or (ii) rules-based settlement.”). Home States are also “relieved of the tedious responsibility of claims processing” and from expending their diplomatic, economic and military resources to remedy wrongs against their nationals. *Id.* at 39.

106. Pauwelyn, *supra* note 5, at 39.

107. BROOKS, *supra* note 45.

108. *See supra* Section II.C.2.



### *E. Rethinking the Conventional Critiques*

Rethinking the function of IIL in light of the contractual alternative has several subtle but important implications for the conventional critiques of regime.

First, it suggests that the form of IIL is misaligned from its function. As discussed above, IIL has a role to play with respect to property investments, where alternative contractual protection is costly to obtain. But investment treaties tend to cover an extraordinarily broad set of assets well beyond property, including State contracts,<sup>109</sup> which could be more efficiently protected by contract alone. In other words, while the function of IIL is contingent on the nature of investment, the form of IIL is not.

This misalignment in turn suggests one potential explanatory factor behind the inconclusive empirical evidence as to whether investment treaties actually promote investment.<sup>110</sup> For IIL's redundancy with respect to State contracts means that it has no (or even negative) impact on investment flows made pursuant to such contracts. That not only limits IIL's impact on investment flows in the aggregate. It could also make the relationship between treaties and investment flows harder to measure. That is because treaties might be redundant to different extents in different States, depending on the mix of investments made through State contracts versus non-State contracts. That mix is likely difficult to control for and could introduce noise into empirical studies.<sup>111</sup>

Second, rethinking IIL in light of the contractual alternative suggests a modification to the conventional critique that the regime is unbalanced in a way that favors investors at the expense of States and the public. Critics describe IIL as a “handout” or “subsidy” from States to investors.<sup>112</sup> That may indeed be true where the State is not a party to the investment and therefore cannot easily refuse the transaction or pass along the costs of treaty protection to investors. But with respect to State contracts, States can do both. To the extent, therefore, that IIL imposes costs on States, it may

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109. *See* Fedax N.V. v. Republic of Venez., ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, ¶ 34 (July 11, 1997) (citing Antonio R. Parra, *The Scope of New Investment Laws and International Instruments*, in ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW 27, 35–36 (Robert Pritchard ed., 1996). *See also* Stratos Pahis, *Investment Misconceived: The Investment-Commerce Distinction in International Investment Law*, 45 YALE J. INT'L L. 69, 77 (2020) [hereinafter Pahis, *Investment Misconceived*].

110. *See* Salacuse, *Of Handouts*, *supra* note 38, at 132.

111. There are proxies for such control, however, as explored below. For example, as explored below, investments in oil and mining are typically made through State contracts. *See infra* Section 1. The Nature of International Investment.

112. *See, e.g.*, Letter from Senator Elizabeth Warren to Ambassador Robert Lighthizer (Sept. 19, 2017), [https://www.warren.senate.gov/files/documents/2017\\_09\\_19\\_NAFTA\\_ISDS\\_letter.pdf](https://www.warren.senate.gov/files/documents/2017_09_19_NAFTA_ISDS_letter.pdf) (describing investor-State arbitration as a “huge handout to global corporations”).

also be reducing returns for investors. The problem, in other words, is not just that IIL is unfair to States and the public. It is that in its current form, IIL can be unfair to investors too.

Finally, the above analysis suggests a modification to the conventional critique that IIL chills environmental and public health regulations and therefore harms the public interest.<sup>113</sup> As discussed above, the main focus of this critique is the common investment treaty guarantee of fair and equitable treatment, which several tribunals have interpreted to have the effect of freezing or “stabilizing” a host country’s regulatory environment at the time an investment is made.<sup>114</sup>

As noted above, however, States can, and oftentimes do, voluntarily lock themselves into commitments to freeze their regulatory environment via contract.<sup>115</sup> Such practices, of course, may still be subject to criticism, but the important point is this: IIL increases regulatory chill only to the extent it imposes stabilization clauses that States and investors would *not* have otherwise agreed to in a bilateral negotiation. In other words, the regime’s harm to the public interest is not due to a set of rules that favor investors, but rather rules that lock States and investors into a bargain that neither would have chosen had they had the opportunity to freely negotiate.

## II. RETHINKING FORM

Why do investment treaties cover State contracts if it is unnecessarily costly and constraining? Why is the regime’s form apparently misaligned from its function?

### *A. The Conventional Account*

The conventional account is largely silent on the question, the implication of that silence being that the treaty coverage of contracts is a natural or inevitable part of the regime. Contractual transactions can, after all, constitute investments, and so it makes a certain sense that a regime designed to protect and promote *investment* would cover them.<sup>116</sup> Moreover, as discussed below, international legal protections have historically extended to State contracts, although sometimes not expressly and to varying degrees.<sup>117</sup> To the extent it is addressed directly at all, the treaty coverage of contracts is treated as the result of a broader desire by capital exporting

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113. *See supra* note 16 and accompanying text.

114. *See supra* note 76 and accompanying text.

115. *See supra* note 48 and accompanying text.

116. Pahis, *Investment Misconceived*, *supra* note 24, at 104.

117. *See infra* notes 134–41 and accompanying text.

States to cover every conceivable investment that their nationals might make.<sup>118</sup> But that just begs the question of *why*, given the analysis above, States desired such protection.

### B. *The Historical Account*

The historical context can help to explain. International investment law's coverage of State contracts can be traced to the very first investment treaties entered into in the 1950s and 1960s. At that time, in the wake of failed multilateral efforts, Germany, Switzerland, and the Netherlands began entering into bilateral treaties with developing States.<sup>119</sup> The first investment treaties tended to define their subject matter in one of two ways, both of which covered State contracts. Germany tended to define "investment" in expansive terms, typically as "every kind of asset," with a non-exclusive illustrative list that specifically included "business concessions under public law, including concessions regarding the prospecting for, or the extraction or winning of natural resources . . . ."<sup>120</sup> The Netherlands and Switzerland opted for a more general, though still broad, subject-matter scope for their treaties, as including "investments, goods, rights and interests."<sup>121</sup> The German asset-based definition would remain a fixture to the present day, with most treaties today using a similar formulation of "all assets" that includes State contracts.<sup>122</sup>

The coverage of contracts was at once a departure from, and a continuation of, prior practice. Investment treaties are commonly understood as the "successor" treaties to Friendship, Commerce, and Navigation (FCN) treaties.<sup>123</sup> FCNs covered a wide range of subjects,

118. See, e.g., VANDEVELDE, U.S. INTERNATIONAL INVESTMENT AGREEMENTS 114 (2009) [hereinafter VANDEVELDE, U.S. AGREEMENTS].

119. See ST. JOHN, *supra* note 43, at 92–93; VANDEVELDE, *supra* note 36, at 55–57.

120. E.g., Agreement Concerning the Promotion and Reciprocal Protection of Investments art. 1, Ger.-Malay., Dec. 22, 1960, 1110 U.N.T.S. 259. See also, e.g., Vertrag zwischen der Bundesrepublik Deutschland und dem Königreich Marokko über die Förderung von Kapitalanlagen [Agreement between the Federal Republic of Germany and the Republic of Morocco on the Promotion of Capital Investments], Aug. 31, 1961, BGBl II at 1645, art. 8.

121. See, e.g., Agreement on Economic Cooperation (with protocol and exchanges of letters dated on 17 June 1968) art. 5, Neth.-Indon., July 7, 1968, 799 U.N.T.S. 13; Convention Concerning the Encouragement of Capital Investment and the Protection of Property art. 1, Neth.-Tunis., May 23, 1963, 523 U.N.T.S. 237; Traité relatif à la Protection et à l'Encouragement des Investissements de Capitaux art. 1, Switz.-Tunis., Dec. 2, 1961, RS 0.975.275.8; Accord de Commerce, de Protection des Investissements et de Coopération Technique art. 7, Switz.-Côte d'Ivoire, Jun 26, 1962, RS 0.946.292.891.

122. Pahis, *Investment Misconceived*, *supra* note 24, at 72.

123. See John Coyle, *The Treaty of Friendship, Commerce and Navigation in the Modern Era*, 51 COLUM. J. TRANSNAT'L L. 302, 328 (2013); K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards*, 4 INT'L TAX & BUS. L. 105, 109 (1986) ("The

including navigation and trading rights<sup>124</sup> and the right to property.<sup>125</sup> Like the (first) investment treaties that would immediately succeed them, FCNs were bilateral and provided that disputes be settled on a State-to-State basis.<sup>126</sup> The first investment treaties departed from FCNs in two important ways, however. First, they narrowed their subject-matter scope by excluding provisions relating to trade, navigation, and other matters of foreign relations.<sup>127</sup> Second, they expanded FCNs' *property* protections by protecting "*investment*" more broadly, including State contracts.<sup>128</sup>

Investment treaties' coverage of contracts likewise departed from another antecedent of the modern regime, the multilateral Draft Convention on the Protection of Foreign Property (OECD Draft Convention), the failure of which is cited as the impetus behind the first bilateral investment treaties.<sup>129</sup> The OECD Draft Convention<sup>130</sup> provided nearly identical substantive guarantees as both early and modern investment treaties.<sup>131</sup> It moreover granted standing to foreign nationals to institute arbitration directly against States for treaty violations.<sup>132</sup> However, like FCNs, the express jurisdictional scope of the OECD Draft was limited to the protection of "*property*."<sup>133</sup>

The departure of investment treaties from the jurisdictional scope of FCNs and the OECD Draft Convention was in some ways more formal than functional. Historically, at least some tribunals whose jurisdiction was

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U.S. BIT program can fairly be characterized as the successor to the U.S. FCN treaty program."); Timothy A. Steinert, *If the BIT Fits: The Proposed Bilateral Investment Treaty Between the United States and the People's Republic of China*, 2 J. CHINESE L. 405, 405 (1988) (describing the bilateral investment treaty as "the modern day successor to the post World War II treaties of Friendship, Commerce, and Navigation").

124. Coyle, *supra* note 123, at 312.

125. VANDEVELDE, *supra* note 36, at 21. Initial U.S. FCNs addressed property protections only incidentally, but after World War II, those provisions expanded to include many of the standards in modern-day investment treaties. Wolfgang Alschner, *Americanization of the BIT Universe: The Influence of Friendship, Commerce and Navigation (FCN) Treaties on Modern Investment Treaty Law*, 5 GOETTINGEN J. INT'L L. 455, 462 (2013).

126. VANDEVELDE, *supra* note 36, at 25.

127. Alschner, *supra* note 125, at 466–67.

128. *Id.* at 462. Later investment treaties would also establish a private cause of action for investors. *See* Pauwelyn, *supra* note 5, at 18; Roberts, *supra* note 4, at 45.

129. ST. JOHN, *supra* note 43, at 88. Another multilateral project, the Multilateral Agreement on Investment (MAI), pushed in the 1990s, would meet the same fate. VANDEVELDE, *supra* note 36, at 69.

130. O.E.C.D. Draft Convention on the Protection of Foreign Property, *adopted on* Oct. 12, 1967, 7 I.L.M. 117, *available at* <https://www.oecd.org/daf/inv/investment-policy/39286571.pdf> [hereinafter OECD Draft Convention].

131. *Id.* art. 1 ("fair and equitable treatment"); *id.* (prohibitions against discriminatory and arbitrary treatment); *id.* art. 3 (the obligation to "observ[e] the undertakings given [by member countries] in relation to" foreign-owned property and the requirement that any takings be non-discriminatory and subject to "just compensation").

132. *Id.* art. 7.

133. *Id.* art. 1, art. 9(c), cmt. to art. 9.

limited to “property” accepted jurisdiction over contract claims. For example, the 1839 and 1849 U.S.-Mexican mixed claims commissions were established to settle “claims[] arising from injuries to the *persons and property* of citizens of the United States by the Mexican authorities.”<sup>134</sup> Nevertheless, both “commissions essentially took for granted that they had jurisdiction over contract claims.”<sup>135</sup> Some decisions made a point of noting that claims arising out of contracts required the showing of a “gross injustice” by the defendant. Other decisions, however, exercised jurisdiction over pure contract claims.<sup>136</sup>

That practice was more or less consistent with diplomatic practice.<sup>137</sup> Historically, the United States set a higher bar for diplomatic intervention with respect to contracts than property. As Borchard explained: “the general rule followed by the United States [was] that a contract claim cannot give rise to the diplomatic interposition of the government [until] after an exhaustion of local remedies.”<sup>138</sup> But even then, the U.S. view was that there

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134. Claims Convention, U.S.-Mex., Preamble, Apr. 11, 1839, 8 Stat. 526 (emphasis added), reprinted in 9 TREATIES AND OTHER INTERNATIONAL AGREEMENTS OF THE UNITED STATES OF AMERICA 1776-1949, at 783 (1972).

135. See 4 JOHN BASSETT MOORE, HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE UNITED STATES HAS BEEN A PARTY 3426–28 (1898) (discussing the cases of *Hunter*, *Nicholson*, *Livingston*, *Sims*, *Oliver*, *Hepburn* and *Welman*, *Tenant et al* and *Wheeler* and *Murray* decided by the 1839 commission). See also KATHRYN GREENMAN, STATE RESPONSIBILITY AND REBELS: THE HISTORY AND LEGACY OF PROTECTING INVESTMENT AGAINST REVOLUTION 71–72, 72 n.10 (2021) (citing MOORE, *supra*, at 3426–28, 3430–32) (“According to Moore, ‘no question was raised by the Mexican or American commissioners as to the competency of the [1839] commission to entertain such [contract] claims.’ Later, the 1849 commission relied on the practice of the 1839 commission to conclude that in establishing the 1849 commission it must have been the intentions of the parties to provide for the settlement of similar claims.”).

136. IVAR ALVIK, CONTRACTING WITH SOVEREIGNTY: STATE CONTRACTS AND INTERNATIONAL ARBITRATION 21 (2011). At the same time, international arbitration tribunals had begun to apply “general principles recognized by civilized nations” to disputes arising from concession contracts between States and investors, even where the contract was governed by local law. Andrea Leiter, *Protecting Concessionary Rights: General Principles and the Making of International Investment Law* 11 (Amsterdam L. Sch. Research Paper, Paper No. 2021-03, 2021) (discussing *Lena Goldfields Arbitration* 1930, the *Anglo-Iranian Case* 1953, the *Sheikh of Abu Dhabi Arbitration* 1951 and the *Ruler of Qatar Arbitration* 1953).

137. According to the Restatement (Third) of the Foreign Relations Law of the United States, a contractual breach may generate international State responsibility where the breach is “(a) . . . (i) discriminatory; or (ii) motivated by noncommercial considerations, and compensatory damages are not paid; or (b) . . . the foreign national is not given an adequate forum to determine his claim . . . or is not compensated.” Restatement (Third) of Foreign Rels. § 712(2), § 712 n.8 (AM. L. INST. 1987). See also SALACUSE, THE LAW OF INVESTMENT TREATIES, *supra* note 87, at 79–80 (“Contractual rights, like any other property rights, are protected by international law against confiscation by the state party to the contract.”).

138. BORCHARD, *supra* note 43, at 284 (“While the rule is fairly clear, its application and its exceptions are vague, due principally to the fact that the intervening government interprets for itself what is a denial of justice and frequently concludes that harsh treatment of its contracting citizen by the foreign government constitutes a tortious act which takes the case out of the ordinary rule.”).

was still a legal basis for intervening in contractual disputes between U.S. nationals and foreign States in the event of “a denial of justice[] or some flagrant violation of international law.”<sup>139</sup> European States went even further, drawing no real distinction at all between property and contract rights in their diplomatic interventions.<sup>140</sup> The first investment treaty designers—who were themselves European—effectively codified that practice into the investment treaty regime.<sup>141</sup>

Today, for all of the reasons I lay out in Section I, that decision appears misguided. But at the time, three contextual factors, which have since changed, made it far more defensible. Those include the prevailing nature of investment, the absence of a robust international commercial arbitration regime, and the lack of a pairing of investment treaties with investor-State arbitration. I explore each in turn.

### *1. The Nature of International Investment*

First, when the earliest investment treaties were agreed, the prevailing nature of international investment differed substantially from the prevailing nature of investment today.

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Borchard traces the U.S. approach to as far back as 1823, in the following statement by John Quincy Adams, then the US Secretary of State:

With regard to the contracts of an individual born in one country with the government of another, most especially when the individual contracting is domiciled in the country with whose government he contracts, and formed the contract voluntarily, for his own private emolument and without the privity of the nation under whose protection he has been born, he has no claim whatsoever to call upon the government of his nativity to espouse his claim, this government having no right to compel that with which he voluntarily contracted to the performance of that contract.

BORCHARD, *supra* note 43, at 287 (internal citations omitted). Borchard, himself, argued that three factors supported the distinction:

The first reason is that the citizen entering into a contract does so voluntarily and takes into account the probabilities and possibilities of performance by the foreign government. He has in contemplation all the ordinary risks which attend to the execution of the contract. In the second place, by going abroad, he submits impliedly to the local law and the local judicial system. The contract or the law provides remedies for breach of contract . . . In the third place, practically every civilized state may be sued for breach of contract.

*Id.* at 285.

139. *Id.* at 284.

140. *Id.* at 286.

141. Except for umbrella clause claims, investment law norms are not about enforcing contractual rights per se. But, in applying those norms, tribunals typically make little distinction between property and contract rights and have applied treaty rules equally to each. See Arato, *Logic of Contract*, *supra* note 25, at 352; Arato, *Private Law Critique*, *supra* note 1.

At that time, most international investment flows—approximately seventy to eighty percent—went directly to governments,<sup>142</sup> and most of those flows were in the form of bank loans.<sup>143</sup> Portfolio equity flows and foreign direct investment<sup>144</sup> (FDI) were “negligible.”<sup>145</sup> The limited amounts of FDI that flowed across borders were concentrated disproportionately in the natural resources sector, particularly in mining and oil,<sup>146</sup> and tended to involve concession contracts with States.<sup>147</sup> The even more limited amounts of FDI in manufacturing were concentrated in lower-value products such as chemicals, metals, construction, and electrical equipment.<sup>148</sup> FDI in services was concentrated in large infrastructure projects such as in transportation and utilities.<sup>149</sup>

That composition is nearly the direct opposite of the composition of international capital flows today. Today, the private sector, not government, receives approximately seventy percent of all foreign capital flows,<sup>150</sup> and

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142. MAURICE OBSTFELD & ALAN M. TAYLOR, *GLOBAL CAPITAL MARKETS: INTEGRATION, CRISIS, AND GROWTH* 81–82 (2004). This was a reversal of pre-war trends, whereby most investment went to private sector recipients, and it was driven to a large extent by an overall drop-off in private capital flows that followed the two world wars and fewer opportunities for foreign private investments. *Id.*

143. VANDEVELDE, *supra* note 36, at 60.

144. *See* OECD, *OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT* 234 (4th ed. 2008), <https://www.oecd.org/investment/fdibenchmarkdefinition.htm> (“Foreign direct investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor.”). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship; IMF, *BALANCE OF PAYMENTS MANUAL* 86 (1993) (“[A] direct investment enterprise is . . . an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 percent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise).”).

145. WORLD BANK, *GLOBAL DEVELOPMENT FINANCE: ANALYSIS AND SUMMARY TABLES* 121, 125–26 (2000) [hereinafter *WORLD BANK, GLOBAL DEVELOPMENT FINANCE*].

146. U.N. CONF. ON TRADE & DEV., *WORLD INVESTMENT REPORT: TRANSNATIONAL CORPORATIONS AND INTEGRATED INTERNATIONAL PRODUCTION* 61, 65 (1993) [hereinafter *UNCTAD, 1993 WORLD INVESTMENT REPORT*]. Half of global FDI—and between forty and fifty percent of the United States’ outward FDI—was invested in natural resources. *Id.* at 67; *see also* U.N. CONF. ON TRADE & DEV., *WORLD INVESTMENT REPORT: TRANSNATIONAL CORPORATIONS, EXTRACTIVE INDUSTRIES AND DEVELOPMENT* 100 (2007) [hereinafter *UNCTAD, 2007 WORLD INVESTMENT REPORT*]; Kevin O’Rourke, *Globalization and Inequality: Historical Trends* 13 (Nat’l Bureau of Econ. Rsch., Working Paper No. 8339, 2001) (internal citations omitted).

147. Pauwelyn, *supra* note 5, at 25; Charles Leben, *La théorie du contrat d’état et l’évolution du droit international des investissements*, 302 *RECUEIL DES COURS* 197, 359 (2003).

148. UNCTAD, *1993 WORLD INVESTMENT REPORT*, *supra* note 146, at 70–72.

149. Investments in those services were “no longer important” by the 1990s. GEOFFREY JONES, *MULTATIONALS AND GLOBAL CAPITALISM: FROM THE NINETEENTH TO THE TWENTY-FIRST CENTURY* 34 (2005).

150. WORLD BANK, *GLOBAL DEVELOPMENT FINANCE*, *supra* note 145, at 126–27.

FDI and equity flows (as opposed to bank loans) are “dominant.”<sup>151</sup> Today, the share of FDI in natural resources has dropped dramatically,<sup>152</sup> while investments in the manufacturing and services sectors make up the overwhelming share of all international investment.<sup>153</sup> Finally, manufacturing has shifted to include higher value knowledge-and technology-intensive industries, such as electronics and informatics,<sup>154</sup> and services have now shifted to finance, trade, consulting, air transport, restaurants and hospitality.<sup>155</sup>

Several factors help to explain these transformations, including decolonization,<sup>156</sup> advances in technology,<sup>157</sup> and reduced trade barriers.<sup>158</sup>

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151. *Id.* FDI, in particular is “by far the largest source of flows” and “the largest component of external financing to developing countries.” *Id.* at 127; *id.* at 42.

152. Today, “extractive industries account for a small share of global FDI flows.” See UNCTAD, 2007 WORLD INVESTMENT REPORT, *supra* note 146, at 82. For example, “in the 1990s only about six percent of EU FDI went to the primary sector.” O’Rourke, *supra* note 146, at 13 (internal citations omitted). In 1990, FDI in the primary sector made up eleven percent of outward FDI flows from developed countries. UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146, at 67. FDI has continued to grow in absolute terms in the primary sector, but at a slower rate and in mostly developed countries. UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146, at 61.

153. See UNCTAD, 2007 WORLD INVESTMENT REPORT, *supra* note 146, at xxi, 8. “By 1990, FDI in manufacturing was greater than the FDI in the natural resource and service sectors combined.” JONES, *supra* note 149, at 33–34. By 1990, manufacturing accounted for about forty percent of FDI stock from developed nations. UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146, at 69. That was up from fifteen percent during the pre-war period. O’Rourke, *supra* note 146, at 13. JONES, *supra* note 149, at 235. By 2000, services amounted to 63% of FDI. O’Rourke, *supra* note 146, at 13 (noting that with respect to just the U.S., approximately half of outward FDI is in services, while thirty-five percent is in manufacturing). This was up from only around twenty-five percent in the 1970s. UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146, at 61.

154. UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146, at 70–72.

155. JONES, *supra* note 149, at 33–34. See also *id.* at 39 (“85 percent of service FDI was in trade-related activities and financial sectors.”).

156. Nationalization campaigns in newly liberated former colonies reduced existing stocks and opportunities for investments in the primary sector. See UNCTAD, 2007 WORLD INVESTMENT REPORT, *supra* note 146, at 99. See also JONES, *supra* note 149, at 213. The nationalization campaigns were so successful that “[b]y the 1980s, half of the mineral production in the developing world was State-owned.” VANDELVELDE, *supra* note 36, at 44.

157. Advances in transportation, information, and communications technologies empowered investors to more effectively monitor and control foreign enterprises from afar and thus to make more direct investments in them. WORLD BANK, GLOBAL DEVELOPMENT FINANCE, *supra* note 145, at 122, 125–26. Technological improvements reduced the costs of communications, permitted the almost instantaneous transfer of large blocks of data, and increased the power of computers by reducing processing time and upgrading software. These advances improved investors’ ability to analyze information, enhanced the control of branch operations in far-distant places, and facilitated the outsourcing to developing countries of production stages that previously could only be located close to home. Technological innovations and reductions created new opportunities for FDI in manufacturing and services. UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146, at 61.

158. In particular, technological advances and reductions in trade barriers enabled firms to establish global value chains (GVCs) that allocated discrete parts of their supply chains across different States, depending upon the comparative advantages that each offered, and then sell the finished product or service around the globe. WORLD BANK, WORLD DEVELOPMENT REPORT: TRADING FOR DEVELOPMENT IN THE AGE OF GLOBAL VALUE CHAINS 1 (2020). This “[h]yperspecialization



But the important point is this: At the time that the first investment treaties emerged, State contracts played a more central role in international investment than they do today. Investors lent capital directly to host States,<sup>159</sup> extracted resources owned by host States,<sup>160</sup> and provided services directly to host States.<sup>161</sup> In contrast with today, a common characteristic of international investment was that it involved a direct *contractual* relationship with the host State.<sup>162</sup>

Given the prevailing nature of investment at the time, it made perfect sense for the designers of an “investment” regime to have State contracts at the top of their minds. This was especially so because concession contracts were the targets of expropriation by newly liberated former colonies and their governments. Beginning in the 1960s and 1970s, developing countries embarked on nationalization campaigns “heavily concentrated in petroleum, mining, other natural resources, and public utilities,”<sup>163</sup> often by cancelling the concession contracts agreed to by defunct colonial governments.<sup>164</sup>

## 2. *International Commercial Arbitration*

Second, at the time the first investment treaties were agreed, today’s robust international commercial arbitration regime had not yet been established.

This is critical, because the capacity of contracts to serve as an alternative to the current IIL regime is contingent on the existence of an effective alternative to domestic courts. Contracts can incorporate all of the substantive protections offered by IIL, or where preferable, include more bespoke covenants. But absent a neutral forum for resolving disputes and an international regime to ensure that any eventual awards are enforceable, contracts cannot serve as an effective substitute for modern investment treaty protection.

Today there is a highly robust global arbitration regime that serves that need. Both the New York Convention and the ICSID Convention establish

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enhance[d] efficiency” and increased the importance of FDI in the manufacturing and services. *Id.* at 1, 3. Global value chains in manufacturing, in particular, “grew swiftly from 1990 to 2007,” and became “responsible for an ever growing share of FDI.” *Id.* at 1; OBSTFELD & TAYLOR, *supra* note 142, at 82–83. See also Trang (Mae) Nguyen, *Hidden Power in Global Supply Chains*, HARV. J. INT’L L. (forthcoming). A sovereign debt crisis in the developing world and a corresponding banking crisis in the U.S. also led to a drop in bank lending to sovereign governments. VANDELDE, *supra* note 36, at 60–61.

159. *Supra* notes 134–35.

160. See UNCTAD, 2007 WORLD INVESTMENT REPORT, *supra* note 146; Leben, *supra* note 147, at 359; see also UNCTAD, 1993 WORLD INVESTMENT REPORT, *supra* note 146.

161. JONES, *supra* note 149, at 33–34.

162. UNCTAD, 2007 WORLD INVESTMENT REPORT, *supra* note 146, at xxi, 8; JONES, *supra* note 149, at 56, 118.

163. JONES, *supra* note 149, at 213.

164. VANDELDE, *supra* note 36, at 354 n.58.

“pro-enforcement regimes” for international arbitration awards.<sup>165</sup> The New York Convention provides for an award’s “presumptive recognition, subject to only narrow, enumerated exceptions,”<sup>166</sup> among its 170 member States.<sup>167</sup> The ICSID Convention allows no grounds for resisting the enforcement of awards at all. It requires that each of its 153 Contracting States enforce any investor-State arbitration award issued by the Centre “as if it were a final judgment of a court in that State.”<sup>168</sup>

At the time that the first investment treaties entered into force, however, today’s robust regime had not yet been established.<sup>169</sup> The ICSID Convention had not yet been adopted, and the New York Convention, which had only recently entered into force, counted only a couple dozen members;<sup>170</sup> even the United States would not join until 1970.<sup>171</sup> Instead, the prevailing global arbitration regime was created by the Geneva Protocol and the Geneva Convention (together the “Geneva Treaties”),<sup>172</sup> which failed to create an effective global enforcement regime for arbitral awards.<sup>173</sup> The Geneva Protocol, in particular, only required the enforcement of

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165. See BORN, *supra* note 50, at 378 (“The New York Convention establishes a ‘pro-enforcement’ approach toward foreign awards.”).

166. *Id.* at 377 (“Likewise, most arbitration statutes, including the UNCITRAL Model Law, presumptively require the recognition of awards, again subject only to specifically-identified exceptions . . .”).

167. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517 [hereinafter New York Convention]; see *Status: Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, U.N. COMM’N ON INT’L TRADE L., [https://uncitral.un.org/en/texts/arbitration/conventions/foreign\\_arbitral\\_awards/status2](https://uncitral.un.org/en/texts/arbitration/conventions/foreign_arbitral_awards/status2).

168. ICSID Convention, *supra* note 34, art. 54(1).

169. See SALACUSE, *THE LAW OF INVESTMENT TREATIES*, *supra* note 87, at 516 (“After World War II, with the growth of international business activity, arbitration became an increasingly common method to resolve international commercial disputes. Thus, arbitration agreements and clauses found their way with increasing frequency into international contracts for the sale of goods, the transfer of technology, and the undertaking of foreign investments. In certain particularly significant contracts with foreign companies, states might also agree to submit future disputes to international arbitration as well.”).

170. By 1966, when the ICSID Convention came into force, the New York Convention had only thirty member States. New York Convention, *supra* note 167. Likewise, the European Convention on International Commercial Arbitration only entered into force in 1964, only two years before the ICSID negotiations, whereas the Inter-American Convention on International Commercial Arbitration (aka the Panama Convention) entered into force in 1976. European Convention on International Commercial Arbitration, Apr. 21, 1961, 484 U.N.T.S. 349 (entered into force Jan. 7, 1964); Inter-American Convention on Commercial Arbitration, Jan. 30, 1975, 1438 U.N.T.S. 245 (entered into force June 16, 1976).

171. New York Convention, *supra* note 167.

172. Protocol on Arbitration Clauses, Sept. 24, 1923, 27 L.N.T.S. 157 [hereinafter Geneva Protocol]; Convention on the Execution of Foreign Arbitral Awards, Sept. 26, 1927, 92 L.N.T.S. 301 [hereinafter Geneva Convention].

173. See Jane L. Volz & Roger S. Haydock, *Foreign Arbitral Awards: Enforcing the Award Against the Recalcitrant Loser*, 21 WM. MITCHELL L. REV. 867, 875 (1996); REDFERN AND HUNTER, *supra* note 7, at 175.

arbitral awards in the State in which they were made.<sup>174</sup> The Geneva Convention, on the other hand, premised enforcement on the award being “made final in the country in which it has been made,” which established additional veto points and procedural hoops that impeded enforcement.<sup>175</sup> Both of these limitations reduced the utility of international arbitration and in turn created the impetus for the establishment of today’s more robust regime.<sup>176</sup> But before that regime came online, contracts could not achieve the goals of the investment treaties as they can today. In other words, at the time it emerged, the treaty coverage of contracts was not yet redundant.<sup>177</sup>

### 3. *Investment Treaty Arbitration*

Third, the treaty coverage of contracts did not present the same costs and constraints as it does today. That is because, unlike today’s treaties, the first investment treaties did not give investors the right to enforce treaty obligations or seek damages through arbitration. Instead, like the FCNs they succeeded, the first investment treaties tended only to provide for State-to-State dispute resolution.<sup>178</sup>

The earliest investment treaties to provide investors with a private procedural remedy were established only after the ICSID Convention had come into force.<sup>179</sup> And even then, most treaties through the 1960s and 1970s continued to include only State-to-State dispute settlement procedures.<sup>180</sup> It only became “common practice” to grant foreign investors a standing offer to arbitrate treaty disputes through ICSID in the 1980s.<sup>181</sup>

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174. Under the Geneva Protocol, arbitral awards were only effectively enforceable in the State in which the award was issued. *See* Volz & Haydock, *supra* note 173, at 875; REDFERN AND HUNTER, *supra* note 7, at 175.

175. Under the Geneva Convention, enforcement outside the jurisdiction of the arbitral seat required that the award be confirmed by national courts in the State in which the award was made. *See* Geneva Convention, *supra* note 172, art. 1(d) (requiring “the award . . . become final in the country in which it has been made”).

176. *See* Volz & Haydock, *supra* note 173, at 875; REDFERN AND HUNTER, *supra* note 7, at 175. *See also* SALACUSE, *THE LAW OF INVESTMENT TREATIES*, *supra* note 87, at 516 (“After World War II, with the growth of international business activity, arbitration became an increasingly common method to resolve international commercial disputes. Thus, arbitration agreements and clauses found their way with increasing frequency into international contracts for the sale of goods, the transfer of technology, and the undertaking of foreign investments. In certain particularly significant contracts with foreign companies, states might also agree to submit future disputes to international arbitration as well.”).

177. Umbrella clauses have also been traced back to this same time period, and they were first included in treaties that had State-to-State dispute settlement procedures and that did not give investors a private cause of action. *See* Anthony Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, 20 *ARB. INT’L* 411 (2004).

178. BONNITCHA ET AL., *supra* note 36, at 23.

179. ST. JOHN, *supra* note 43, at 200 (“The first treaty to include a reference to ICSID was the Netherlands-Indonesia agreement of 1968.”).

180. BONNITCHA ET AL., *supra* note 36, at 23–24.

181. Pauwelyn, *supra* note 5, at 18; Roberts, *supra* note 4, at 45.

As a result, notwithstanding their broad definition of investment, the first investment treaties did not allow investors to initiate costly parallel proceedings. Nor did they put investors in a position to argue that their contractual bargains should be supplemented by substantive treaty protections. They instead left dispute settlement up to States, which have multiple reasons to be more reluctant in their enforcement strategies, including diplomatic and security concerns, as well as the prospect of facing their own future enforcement actions.<sup>182</sup> In sum, while the absence of a robust international arbitration regime meant that the treaty protection of contracts was not redundant, the lack of investment treaty arbitration meant that it was not inefficient.

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By the time investment treaties became widespread during the 1990s, however, all three of the contextual factors that had made the treaty coverage of contracts defensible changed dramatically. State contracts no longer played such an outside role in international investment flows. Both the ICSID Convention and a robust international commercial arbitration regime were well established. And investment treaties were commonly paired with investor-State arbitration. All three of these changes effectively undermined the case for the treaty coverage of contracts, and instead created the basis for the case I have made against it.

Notwithstanding this change in context, the jurisdictional parameters of the regime have remained largely static. Other than some tinkering around the edges,<sup>183</sup> the novel and broad definition of investment adopted by the German treaties of “every kind of asset,” have remained a fixture of the regime.<sup>184</sup> In other words, the context of the regime has fundamentally changed. But its jurisdictional scope has not.

### *C. The Political Economy Account*

What explains the lack of change in the jurisdictional scope of the regime?

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182. See SALACUSE, *THE LAW OF INVESTMENT TREATIES*, *supra* note 87, at 520–21; ZACHARY DOUGLAS, *THE INTERNATIONAL LAW OF INVESTMENT CLAIMS* 18 (2009). See, e.g., VAN HARTEN, *supra* note 16; BONNITCHA ET AL., *supra* note 36, at 23 (“[E]arly investment treaties thereby primarily established ‘focal points’ for mutual expectations without the backing of a strong enforcement mechanism.”).

183. See *infra* note 207 and accompanying text.

184. Pahiš, *BITs & Bonds*, *supra* note 25, at 277.

It may be a matter of simple path dependency, where the original jurisdictional scope has stayed largely intact because of inertia. That would be consistent with the “strong presence of status quo bias” in the drafting of investment treaties that other scholars have found.<sup>185</sup> Here, path dependency might be explained by the short-term transaction costs associated with reform, including the cost of amending treaties and of the potential changes in contracting practices that such reforms might generate. Path dependency might be further explained by the lag in impact of investment treaties more generally. For the first forty years of the investment treaty regime, investors filed only approximately fifty arbitrations.<sup>186</sup> By contrast, in the last twenty years, they have filed over *one thousand more*.<sup>187</sup> Thus, while all the factors of the misalignment were in place by the 1980s, its practical impact was not felt until more recently.

The resistance to change—or the treaty coverage of contracts in the first place—might also be explained by reasons routed in political economy. It is possible that because of a lack of capacity, host States are not pricing in the costs of treaty protection. If that is the case (or believed to be the case), investors and capital exporting States could view treaty protection as an investor subsidy worth obtaining.<sup>188</sup> There is, in fact, some support for the idea that capital-importing States originally underestimated the costs of entering into investment treaties, and that underestimation may have meant that historically, at least, the costs of treaty protection were not accurately priced into State contracts.<sup>189</sup> It is hard to imagine, however, that, after one thousand treaty arbitrations and tens of billions of dollars in damages, States *still* do not understand the costs of treaty protection. Instead, it is more likely (if this explanation has continued salience) that the “spaghetti bowl” of treaties and the challenges associated with ascertaining the nationality of investors make it difficult to accurately assign the cost of protection, as it is unclear *ex ante* which investors are covered by treaties and which are not.

It is also possible that a contingent of politically *influential* investors may have lobbied for the treaty protection of contracts because they would otherwise bargain for similar protections in their contracts. They may lobby for treaty protection even if it is suboptimal, because they prefer the

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185. See generally Cree Jones & Weijia Rao, *Sticky BITs*, 61 HARV. INT'L L.J. 358, 381 (2020); Wolfgang Alschner, *The Impact of Investment Arbitration on Investment Treaty Design: Myths Versus Reality*, 42 YALE J. INT'L L. 1 (2017). That path dependency can be explained by the transaction costs associated with reform, including the cost of amending treaties and of the potential changes in contracting practices that such reforms might generate.

186. BONNITCHA ET AL., *supra* note 36, at 25.

187. U.N. CONF. ON TRADE & DEV., *supra* note 8.

188. Note that where the State does not have the opportunity to pass the cost onto investors via contract, investment protection would in fact be a subsidy. See *infra* Section I.C.2.

189. See generally LAUGE POULSEN, *BOUNDED RATIONALITY AND ECONOMIC DIPLOMACY* (2015).

certainty of treaty protection to the uncertainty of contractual bargaining. Or they may not trust the State contracting process because of actual or perceived defects in State contracting practices.<sup>190</sup> This explanation finds some support in the design of the United States-Mexico-Canada Agreement (USMCA), which, as described in greater detail below, effectively limits investment protection to certain large and influential industries.<sup>191</sup>

However plausible the above explanations are for the current design of the regime, it is worth noting that none is persuasive *justification* for it as a matter of policy. Path dependency, even if due to short-term costs, is not a justification for maintaining a policy indefinitely. The failure to accurately price in the costs of IIL means that only the benefits but not the costs of treaty protection figure into investment decisions—a recipe for inefficiency. And the preference of some influential investors does not support making the treaty protection of contracts mandatory for *all* investors. Even defects, real or perceived, in State contracting processes fail to justify the current mandatory nature of the regime, if only because addressing those defects would not require mandatory protections, as discussed further below.

In short, like the history of investment treaty protection, political economy may help to explain, but does not justify, the design of the present-day IIL regime.

### III. RETHINKING REFORM

#### *A. The Conventional Account*

Today, reform of the regime is on the table, placed there by a crescendo of criticism.<sup>192</sup> The heart of the conventional critique is that IIL is too favorable to investors. Conventional critics claim that substantive protections for investors are too broad and too restrictive of States' regulatory authority.<sup>193</sup> Investment arbitration, which gives investors a role in enforcing treaty obligations and picking the arbitrators who hear their claims, is thought to be too favorable to investors as well.<sup>194</sup> To critics, the main defect in the form of the IIL regime is the way it “grafts” public international law onto a private dispute resolution mechanism.<sup>195</sup>

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190. Perhaps States limit contractual negotiations and thus the input that investors have in the contractual terms. That would not necessarily make the contracts inefficient, but it may leave agents unaware of what investors want. See ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 358 (6th ed. 2014).

191. See *infra* notes 201–02 and accompanying text.

192. See *supra* notes 1–3.

193. See, e.g., Johnson et al., *supra* note 16.

194. See, e.g., VAN HARTEN, *supra* note 16.

195. Roberts, *supra* note 4, at 45.

The most important reform projects on the table today thus aim to “rebalance” the regime toward States and away from investors. The European Union, for example, has proposed replacing the arbitration of investment disputes with a standing Multilateral Investment Court whose judges would be appointed exclusively by States.<sup>196</sup> Other States are moving to curtail some of IIL’s core substantive protections. For example, the U.S. Model BIT and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) both limit the extent of the “fair and equitable treatment” norm.<sup>197</sup> Still other States—including India, Ecuador, and South Africa—are exiting the system altogether.<sup>198</sup>

### *B. Another Way Forward*

This Article’s analysis points to a different set of critiques and thus a different set of reforms. For all of the reasons discussed above, while it once made sense, the treaty coverage of State contracts (particularly those with central governments) is now largely redundant and likely inefficient. It does little to reduce transaction costs, and instead increases costs by complicating contract negotiation, increasing uncertainty, and imposing deadweight losses on States and investors. It moreover unnecessarily constrains States’ regulatory behavior.

These revised critiques, in turn, suggest a different direction for reform: one based on realigning the form and function of investment treaties by excluding State contracts from treaty coverage. Such a reform would have three key benefits.

First, it would maintain treaty protection over those investments for which it is best suited—namely, property-like investments in which States and investors are not in a position to negotiate contractual protections. As discussed above, IIL’s blanket protections are most plausibly justified with respect to such investments, because alternative contractual protections are costly to negotiate and agree. Treaty protection obviates the need for such costs by providing investment protection independent of an investor-State contract.

Second, it would remove (or allow the removal of) protection over those investments for which it is most redundant and inefficient—namely, State contracts. This would reduce costs for both States and investors, and thus promote more investment—one of the key purposes of the regime.

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196. *See supra* note 19.

197. *See* 2012 U.S. Model Bilateral Investment Treaty, *supra* note 17; Comprehensive and Progressive Agreement for Trans-Pacific Partnership art. 9.6(2), Mar. 8, 2018, [2018] A.T.S. 23 [hereinafter CPTPP].

198. *South Africa Begins Withdrawing from EU-Member BITs*, *supra* note 2.

Moreover, it would preserve States' ability to signal to investors their intentions vis-à-vis foreign investments: by way of contracts for State contracts, and by way of treaties for other investments.

Finally, the exclusion of State contracts would "re-balance" investment protections by allowing States to do so on an investment-by-investment basis. As discussed above, IIL increases regulatory chill by constraining State regulatory authority in ways that States and investors would not have otherwise agreed bilaterally. Excluding State contracts from treaty protection would rebalance the regime by freeing States to refuse (or agree) to regulatory constraints where they see fit.

### *C. The Seeds (and Weeds) of Reform*

The seeds of this reform have already been planted, and, with a revised understanding of their rational, can grow into full-scale reform.

Ironically, the seeds of reform were first planted in the wrong place: the ICSID Convention. The ICSID Convention limits its jurisdiction to "legal dispute[s] arising directly out of an investment,"<sup>199</sup> but does not define the term "investment."<sup>200</sup> While the question of what constitutes an "investment" is "highly contested,"<sup>201</sup> there is one thing on which tribunals and commentators agree: "ordinary commercial transactions"<sup>202</sup> and "simple sales and purchases of goods . . . clearly do not qualify as investments."<sup>203</sup>

I have written elsewhere about the many defects of this consensus, including its lack of basis in the text and negotiating history of the Convention, and its incoherence as a conceptual matter.<sup>204</sup> Yet, at the same time, one can discern a different and more defensible justification for the exclusion of so-called commercial transactions than the one given by commentators and tribunals. It is not that commercial transactions are not investments. It is that, at least where they involve the State, "commercial

199. ICSID Convention, *supra* note 34, art. 25(1).

200. The Preamble to the ICSID Convention further states, in part, that the Convention was agreed by the Parties "[c]onsidering the need for international cooperation for economic development, and the role of private international investment therein." *Id.* at pmb. The Preamble thus qualifies that the ICSID Convention concerns "private international investment," as opposed to public investment, but provides no further definition of "investment" per se. *Id.*

201. Boaz Moselle, *Economics and the Meaning of Investment*, in JURISDICTION IN INVESTMENT TREATY ARBITRATION 7, 8 (Yas Banifatemi & Emmanuel Gaillard eds., 2018).

202. *Id.*

203. SCHREUER I, *supra* note 100, art. 25, ¶ 120. See also Malaysian Historical Salvors, SDN, BHD. v. Government of Malay., ICSID Case No. ARB/05/10, Decision on the Application for Annulment, ¶¶ 69, 72 (Apr. 16, 2009) (calling the exclusion of commercial transactions a "fundamental assumption" of the Convention's drafters).

204. Pahis, *Investment Misconceived*, *supra* note 24.



transactions” are the type of transaction that is most likely to already involve a State contract, and for which treaty coverage is most obviously redundant.

Of course, even if one subscribes to this revisionist theory, it would *still* not make sense to exclude such contracts from ICSID arbitration, as is current practice. For all the reasons discussed above, ICSID’s jurisdiction over State contracts is not the problem. To the contrary, as a highly enforceable arbitral mechanism that precludes the use of diplomatic interference, ICSID has a useful role to play in resolving disputes involving State contracts.<sup>205</sup> The problem is the investment treaty coverage of such contracts, and reforms should be targeted there.<sup>206</sup>

In that respect, there are other seeds of reform. The 2012 U.S. Model Bilateral Investment Treaty (U.S. Model BIT) clarifies that “claims to payment that are immediately due and result from the sale of goods or services, are less likely to have [the] characteristics” of an investment.<sup>207</sup> Again, the apparent justification for the exclusion—that the sale of goods or services is not an investment—is beside the point. What matters is that such sales can be efficiently protected by contract alone. And it is for this reason that the (soft) exclusion of sales from the U.S. Model BIT makes sense and provides the basis for further reform.

While the 2012 U.S. Model BIT gestures in the right direction, the United States-Mexico-Canada Agreement (USMCA), the successor to the North American Free Trade Agreement (NAFTA), goes in the *wrong* direction. The USMCA attempts to rebalance the regime by requiring the exhaustion of local remedies before investors can bring a treaty claim.<sup>208</sup> Because exhausting local remedies can take years and require significant expense, the requirement significantly weakens the investment protections offered by the treaty.

But the USMCA also makes an exception to the exhaustion of local remedies for investors with a “covered *government contract*”—defined as a contract with “a national authority” in the oil, natural gas, power generation,

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205. See *supra* note 54 and accompanying text.

206. Narrowing ICSID’s jurisdiction would also be ineffective, given that most treaties give claimants a choice between ICSID and UNCITRAL arbitration, the latter of which is not limited to disputes arising from “investments.” See Reisman & Vinnik, *supra* note 30, at 70.

207. 2012 U.S. Model Bilateral Investment Treaty, *supra* note 17, art. 1 n.1. See also CPTPP, *supra* note 197, art. 9.1 n.2 (providing the same qualification as the U.S. Model Bilateral Investment Treaty).

208. See also United States-Mexico-Canada Agreement art. 14, annex 14-D.5, annex E, Dec. 10, 2019, 134 Stat. 11 (entered into force July 1, 2020) (requiring the exhaustion of domestic remedies before proceeding with an international treaty claim, but exempting certain industries from that requirement, including oil, natural gas, power generation, infrastructure, and telecommunications) [hereinafter USMCA].

infrastructure, and telecommunications industries.<sup>209</sup> In other words, the USMCA's investment arbitration mechanism is most protective of those investments that need treaty protection least—State contracts. And it is least protective of those investments that need protection the most—property investments. If the 2012 U.S. Model BIT planted a seed of reform that should be cultivated, the USMCA planted a weed that should be uprooted.

#### *D. Scaling Reform: Two Paths, Multiple Dimensions*

There are two main paths for cultivating the seed planted in the 2012 U.S. Model BIT, each with several dimensions. My purpose here is not to define the “best” approach, but rather to identify the different paths, dimensions, and tradeoffs that States would need to consider.

##### *1. Mandatory Exclusion*

The first and most ambitious path is to mandatorily exclude State contracts from investment treaty coverage. There are at least three dimensions to this approach that require consideration.

The first dimension is whether the exclusion should be implicit or explicit. For example, under an implicit exclusion, the subject matter scope of investment treaties could be defined pursuant to an exhaustive list of assets or just plain “property.” Under an explicit approach, the subject matter scope of the regime could remain generally expansive, as including “all assets” or “any assets,” but would then expressly exclude State contracts (e.g., “not including State contracts”).

Because it may be difficult to identify every type of asset or transaction that is not a State contract, an implicit exclusion may end up excluding a wider range of investments than desired. For example, an implicit exclusion that defined covered investments as limited to “property” could end up excluding some purely private contracts for which the treaty regime could still be beneficial.<sup>210</sup> An explicit exclusion, on the other hand, could be more tailored.

An explicit exclusion may have one other important benefit. As discussed above, international tribunals have assumed jurisdiction over contract claims even where the basis of their jurisdiction was limited to

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209. *Id.* at annex 14-E.6(a), (b) (“‘covered government contract’ means a written agreement between a national authority of an Annex Party and a covered investment or investor of the other Annex Party, on which the covered investment or investor relies in establishing or acquiring a covered investment other than the written agreement itself, that grants rights to the covered investment or investor in a covered sector”).

210. *See* Pahis, *Investment Misconceived*, *supra* note 24, at 120–21.

“property.”<sup>211</sup> Additionally, as discussed further below, investment tribunals could be faced with claims that involve both contractual and property rights.<sup>212</sup> An explicit exclusion would provide tribunals better guidance as to how to interpret their jurisdiction in such situations. Guided by a clearly stated intention to exclude State contracts, tribunals would presumably be less accommodating to claims which seek to impose treaty coverage through the back door, via property or equity investments or simply a broad understanding of what constitutes “property.”

<b>Dimension One: Implicit or Explicit Exclusion</b>	
<b>Implicit</b>	<ul style="list-style-type: none"> <li>• May exclude other non-contract investments</li> <li>• Does not provide opportunity to define exclusion</li> </ul>
<b>Explicit</b>	<ul style="list-style-type: none"> <li>• Provides opportunity to define the term State contracts</li> <li>• Provides more guidance to tribunals for disentangling contracts and property rights</li> </ul>

The second dimension is the definition of “State” in “State contract.” Under a narrow definition, State contracts could be limited to contracts with or guaranteed by a central government. As discussed above, the capacity of investment treaties to reduce transaction costs with respect to such contracts is weakest, and thus the case for their exclusion is strongest.<sup>213</sup> More liberally, State contracts could be defined to include contracts with regional and municipal governments and State-owned enterprises.<sup>214</sup> As discussed above, however, the case for excluding such contracts is less strong, because sub-State entities may be less willing and able to provide the same guarantees as national governments.<sup>215</sup>

The third component is the definition of “contract.” Again, a range of possibilities presents itself. On the one hand, contracts can be defined as limited to agreements where both parties are acting as commercial actors and exchanging goods or services for money. On the other hand, contracts could be defined more broadly to include any agreement between a State

211. See *supra* Section II.B.

212. See *infra* Section III.D.2.

213. See *supra* Section I.C.1.

214. Each of these entities, in particular State-owned-enterprises, might require further definition.

The definition of State-owned enterprises has been a subject of major controversy and subject to evolution in international trade law. See ANDRÉ SAPIR & PETROS MAVROIDIS, *THE WTO AND CHINA: WHY MULTILATERALISM STILL MATTERS* 41, 59 (2021).

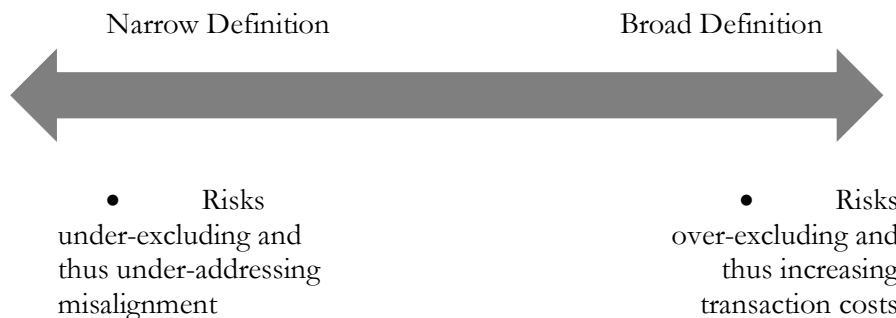
215. See *supra* notes 69–71 and accompanying text.

and investor, including licenses and permits granted to the investor to operate.<sup>216</sup>

With respect to the definition of each component of “State contract,” there is a clear trade-off to consider. On the one hand, narrower definitions will leave additional contracts subject to treaty protection, and thus leave in place more costs associated with treaty coverage. On the other hand, broader definitions will exclude more agreements, including some that may not serve as natural substitutes for investment treaties, and thus may further increase transaction costs.

Finally, regardless of whether it is broad or narrow, any definition of a State contract could lead to disputes as to whether an investment is or is not covered by an investment treaty. While *ex ante* it may be in both parties’ interests that the investment be or not be covered, *ex post* their interests will diverge. The investor will have an interest that the investment be covered, and the State will have an interest that it not be. An explicit exclusion dependent on defining “State contract” thus carries some risks, as a failure to precisely define the term could lead to uncertainty and disputes over whether an investment is covered, and thus create additional costs.

#### **Dimensions Two and Three: Definition of State Contract**




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216. The distinction between business agreement and license is not always a clear one. The CPTPP provides some guidance for making the distinction, however. *See* CPTPP, *supra* note 197, art. 1 n.4 (“Whether a particular type of licence, authorisation, permit or similar instrument (including a concession to the extent that it has the nature of such an instrument) has the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder has under the Party’s law. Among such instruments that do not have the characteristics of an investment are those that do not create any rights protected under the Party’s law. For greater certainty, the foregoing is without prejudice to whether any asset associated with such instruments has the characteristics of an investment.”).

## 2. *Optional Exclusion (Default Rule)*

The second path for reform is for States to establish a default rule with respect to treaty coverage. Two default options are available. First, treaties could create a default rule that State contracts are *not* covered, but offer an option for States and investors to opt in. Second, treaties could create a default rule that State contracts *are* covered, but allow an option to opt out.

This more modest proposal has several advantages over a mandatory exclusion. First, to the extent States and investors want treaty protections to apply to their contracts, a default rule would minimize the already low transactions costs of incorporating them by simplifying the means of doing so. Instead of needing to draft IIL-like protections into contracts, States and investors could use contracts to simply elect one way or another whether they want the contract to be subject to treaty protections.

Second, a default option would resolve any defects in State contracting that could otherwise prevent States from agreeing to international protections even where those protections are efficient and in both parties' interests. As noted above, one of the potential justifications for the suboptimal treaty coverage of contracts is that State agents may be unaware of international contracting practices or may be reluctant to agree to international protections for arbitrary reasons. The default coverage of contracts would address this (real or perceived) problem by allowing States to refuse protection only where the investor agreed to forego it.

Third, a default option could help to avoid wasteful parallel proceedings that could arise from investments comprised of both contract and property rights. It is widely accepted in IIL that “[a]n investment is frequently a rather complex operation, composed of various interrelated transactions.”<sup>217</sup> ICSID tribunals have nevertheless treated investments as “an economic unity.”<sup>218</sup> According to Schreuer, the principal motivations of this approach are the goals “of settling investment disputes finally and comprehensively” and procedural economy.<sup>219</sup> To the extent an investment involves State

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217. *Czeskoslovenska Obchodni Banka (CSOB) v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction, ¶ 72 (May 24, 1999).

218. *See, e.g., Ambiente Ufficio S.p.A. & others v. Argentine Republic*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, ¶ 428 (Feb. 8, 2013) (“The doctrine of the ‘general unity of an investment operation’ is well-established in international investment law.”). In practice, this has meant that certain transactions, which are not investments in and of themselves, may nevertheless be subject to investor-State arbitration if they are “an integral part” of a qualifying investment. *See Czeskoslovenska Obchodni Banka (CSOB) v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction, ¶ 72 (May 24, 1999); *see also Holiday Inns S.A. & others v. Morocco*, ICSID Case No. ARB/72/1, Decision (Sept. 23, 1974).

219. SCHREUER II, *supra* note 71, art. 25, at 565 (“A situation in which an ICSID tribunal addresses some of the issues between the parties but leaves other closely related ones to be litigated elsewhere is unsatisfactory. Partial decisions are uneconomical and not conducive to the settlement of

contractual rights not subject to the treaty, and property rights that are, a default option would allow States and investors to subject the whole economic unity to the same forum, and thus maintain procedural economy. A mandatory exclusion, on the other hand, might prevent an investor from joining its contract-based claim with the property-based one.

A default rule presents one final advantage: it could avoid all of the pitfalls of defining the exclusion of State contracts discussed above. Specifically, a default rule that applied to all investments would capture State contracts without having to define them. There are downsides associated with such an approach, however, particularly if it required investors to opt into the regime. Applying an opt-in solution to all investments could dramatically *increase* transaction costs or sub-optimally reduce treaty coverage, as it would force investors holding property investments to enter a new agreement with the State to obtain protections. An opt-in approach would further risk that smaller or unsophisticated investors lack knowledge of available rights and thus fail to bargain for them even where they were efficient (a risk that would also exist with a mandatory exclusion). Applying an opt-out solution to all investments would avoid both of these pitfalls, assuming that opting out required an express agreement by both parties. On the other hand, an opt-out solution could risk that State agents would *extend* treaty protections without being fully aware that they are doing so, a risk that already exists under the current regime.<sup>220</sup>

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disputes.”). *See also* DOMINQUE CARREAU, THIEBAULT FLORY & PATRICK JUILLARD, DROIT INTERNATIONAL ECONOMIQUE 570 (3rd ed. 1990) (the lack of definition in ICSID was due to the “desire to disturb neither the formal nor the material unity of litigation regarding certain investments: the flexibility of contractual stipulations allows for global submission to the Centre of transactions whose nature and structure are complex but whose legal form splits them into a multitude of contractual arrangements, some of which might escape the Centre’s jurisdiction”).

220. *Cf.* LAUGE POULSEN, BOUNDED RATIONALITY AND ECONOMIC DIPLOMACY: THE POLITICS OF INVESTMENT TREATIES IN DEVELOPMENT COUNTRIES (2015) (arguing that at the time of entering into investment treaties, many States overestimated the benefits and underestimated the costs).

<b>Default Rule</b>	
<b>No Coverage (Opt-In)</b>	<ul style="list-style-type: none"> <li>• Expanding default of no coverage to all investments would obviate the need to define “State contracts,” but would require contracts for all investments and thus increase the transaction costs of coverage for property investments</li> <li>• Risks investors unknowingly leaving rights on the table, but ensures States are aware of the rights they are granting</li> </ul>
<b>Coverage (Opt-Out)</b>	<ul style="list-style-type: none"> <li>• Expanding default coverage to all investments would obviate the need for defining “State contracts,” without increasing transaction costs with respect to property investments</li> <li>• Ensures investor is informed of the rights they are waiving, but risks State agents unknowingly granting rights</li> </ul>

### *E. A Necessary Parallel Reform*

Both of the above proposals to exclude State contracts from investment treaty coverage have a potential downside: they could displace disputes from investor-State arbitration and national courts to international commercial arbitration forums. Investors who are currently willing to eschew contractual arbitration agreements, knowing that they may have recourse to investor-State arbitration, might insist on such agreements should the backstop of IIL be removed. Investors who have contractual arbitration agreements, but who might instead choose to bring a dispute under an applicable investment treaty, would no longer have that option.

This displacement of disputes to international commercial arbitration forums could be problematic because international commercial arbitration tends to be governed by stricter rules of confidentiality than national courts or investor-State arbitration.<sup>221</sup> Investor-State arbitration in particular has

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221. Confidentiality is one of the main selling points of international commercial arbitration. While different arbitral institutions have different rules, the default rule is generally that all proceedings, documents and awards are confidential unless both parties agree to the contrary. *See* BORN, *supra* note 50, at 12, 205. For example, the Swiss Rules of Arbitration provide that “all awards and orders as well

been subject to recent (if incomplete) transparency reforms.<sup>222</sup> The displacement of disputes away from the IIL regime toward international commercial arbitration may thus reduce transparency and remove disputes of public concern from the public view.

Any States pursuing this proposal should, therefore, couple it with transparency provisions in law and in contract, requiring that *any and all* disputes between States and private investors be completely transparent and public. In other words, any reform that shifts State contracts out of the international investment law regime should be accompanied by reforms that increase the transparency of the international *commercial arbitration* regime.

### CONCLUSION

What is the function of international investment law in light of the alternative? As this Article shows, that simple question reveals a new perspective for thinking about the regime's form, function, and reform.

The conventional account is that IIL has three key functions: to protect investment, promote investment, and enhance international cooperation. But as this Article shows, States and investors can achieve those same goals through investor-State contracts. Contracts can be costly to negotiate and agree, however, whereas treaties protect a wide range of investments in a blanket fashion. As compared to the contractual alternative, therefore, IIL's function is not to protect investment, but rather to reduce the *cost* of protecting investment.

The conventional account is that IIL's functions apply to all investments—an understanding that can explain the regime's expansive form. This Article shows, however, that the function of IIL is contingent on the nature of the investment subject to protection. Investment treaties

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as all materials submitted by another party in the framework of the arbitral proceedings not already in the public domain," shall be kept confidential "[u]nless the parties expressly agree in writing to the contrary." SWISS RULES OF INTERNATIONAL ARBITRATION, SWISS ARBITRATION CENTRE, art. 44(1) (2021).

222. The UNCITRAL Rules on Transparency in Treaty-Based Investor State Arbitration now require the publication of certain filings. However, unless otherwise agreed by the parties, those rules apply only to disputes arising from treaties concluded after April 1, 2014, and moreover do not apply to exhibits, nor necessarily to witness or expert testimony. U.N. COMM'N ON INT'L TRADE L., UNCITRAL RULES ON TRANSPARENCY IN TREATY-BASED INVESTOR STATE ARBITRATION art. 1, 3 (2014), <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/rules-on-transparency-e.pdf>. But note that ICSID only publishes awards if the parties do not object; where the parties do not consent, ICSID limits its publication to excerpts of the award of the legal reasoning. *Confidentiality and Transparency – ICSID Convention Arbitration (2006 Rules)*, INT'L CTR. FOR SETTLEMENT OF INV. DISPS., <https://icsid.worldbank.org/procedures/arbitration/convention/process/confidentiality-transparency/2006> (last visited Apr. 8, 2023). See also Emelie M. Hafner-Burton & David G. Victor, *Secrecy in International Investment Arbitration: An Empirical Analysis*, 7 J. INT'L DISP. SETTLEMENT 161 (2016) (showing transparency reform efforts are failing to increase transparency in practice).



have a significant capacity to reduce the costs of protection of property-like investments, where the State and investor are not in privity, and therefore where contractual protections would be costly to achieve. But where the State and investor are already in a contractual relationship and thus able to agree to investment protections at little cost, IIL has no compelling role to play.

The conventional *critique* of the regime is that it is “imbalanced,” and that its substantive and procedural protections for investors come at the expense of States and the public. This Article argues, on the other hand, that the problem with IIL is that its form is misaligned from its function. By establishing mandatory coverage over investments that could be more efficiently protected by contract alone, IIL unnecessarily imposes costs on all parties—investors included. And by locking States and investors into bargains that they would not have otherwise agreed to, IIL unnecessarily constrains the regulatory authority of States to no one’s benefit.

Because this novel account presents a different diagnosis of the regime’s defects than the conventional critique, it also calls for a different set of reforms. Conventional reforms call for rebalancing the regime away from investors by replacing investor-State arbitration with an international court and curtailing substantive protections for investors. This Article calls instead for re-aligning the regime’s form and function by keeping treaty protection where it is most valuable—over property-like investments—and removing treaty protection where it is most redundant and inefficient—over State contracts. Moreover, it calls for rebalancing the regime by allowing States to do so in direct negotiations with investors on an investment-by-investment basis.

This novel perspective and proposal come at a critical time for the IIL regime, which faces a growing chorus of criticism and a growing number of State departures. Several worthwhile reforms are already under consideration. This Article proposes that reformers add one more to the list. To rebalance and ultimately save the regime, States should refocus it on what it does best: protecting property, not contracts.

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