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THE LOGIC OF CONTRACT IN THE WORLD OF INVESTMENT TREATIES

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ABSTRACT

Investment treaties protect foreign investors who contract with sovereign states. It remains unclear, however, whether parties are free to contract around these treaty rules, or whether treaty provisions should be understood as mandatory terms that constrain party choice. While investment treaties clearly apply to contracts in some way, they are silent as to how these instruments ultimately interact. Moreover, arbitral jurisprudence has varied wildly on this point,

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creating significant problems of certainty, efficiency, and fairness—for states and foreign investors alike.

This Article reappraises the treaty/contract issue from the ex ante perspective of contracting states and foreign investors. I advance three main claims: one conceptual, one descriptive, and one normative. First, I argue that investment treaties must be understood as having generated a rudimentary, yet broad, law of contracts—governing agreements between states and foreign investors on pivotal issues, from substantive rights and duties, to damages and forum selection. Second, I argue that this emerging international law of contracts has developed sporadically, irregularly, and inconsistently, due in part to a tendency among tribunals to confuse the logics of contract and property. As a result, it remains undecided whether contracting parties should understand background treaty norms as defaults, sticky defaults, or mandatory terms—leaving the meaning of their contracts under a cloud of doubt. Third, I argue that the best way to resolve this problem for both states and investors, ex ante, is generally to privilege their contractual arrangements over background treaty rules. Even when these parties have different interests and values at stake, the treaty/contract problem is not zero-sum. Both sides usually stand to benefit from the freedom to negotiate around treaty rules as mere defaults—though I explore certain cases where treaty norms might justifiably exert a greater pull. In general, prioritizing party choice is not only optimal from the economic standpoint—it also provides states with the tools to secure their future capacities to regulate in the public interest.

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INTRODUCTION

A traditional maxim of international law holds that all contracts are purely instruments of some domestic legal order.[1] Until very recently a contract between a private party and a foreign state, like any contract between private parties, would create rights and obligations under only the domestic law chosen by the parties. Today, however, this maxim is no longer correct.[2] Most clearly in the realm of sales, the 1980 Convention on the International Sale of Goods (CISG) has established a robust regime governing transnational contracts for the sale of goods, supplementing such instruments with a host of default and mandatory terms.[3] More recently, and far more quietly, a regime of international contract law has emerged in the field of foreign direct investment (FDI). A great deal of international contracting takes place under a manifold of treaties for the protection of foreign investments, which augment contracts between states and foreign investors—in whole or in part—with international legal rules. The advent of this world of investment treaties has subtly brought into being a rudimentary law of contracts—a broad complex of default and mandatory rules that alter contracts between states and foreign investors in relation to all kinds of questions, from the conditions of breach and defenses, to damages and forum selection. However, unlike the CISG, this emerging law of contracts has developed only sporadically, inconsistently, and irregularly. Contracts between states and foreign investors are no longer purely instruments of national law. But a better international law of contracts is essential if we are to remain sensitive to both the needs of foreign capital and the vitality of local and global public values.

1. *See, e.g.*, Payment of Various Serbian Loans Issued in France (Fr. v. Serb.), Judgment, 1929 P.C.I.J. (ser. A) No. 14, at 41 (July 12) ("Any contract which is not a contract between States in their capacity as subjects of international law is based on the municipal law of some country.").

2. *See* Julian Arato, *Corporations as Lawmakers*, 56 HARV. INT'L L.J. 229, 229-30 (2015).

3. *See* United Nations Convention on Contracts for the International Sale of Goods art. 6, Apr. 11, 1980, 1489 U.N.T.S. 3, 60 [hereinafter CISG] ("The parties may exclude the application of the Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.").

The root of the problem is that investment treaties tend to say nothing, or only very little, about how they relate to contracts.[4] They often clearly apply to contracts between states and covered foreign investors (state contracts), either explicitly or by evident implication.[5] Some treaties even incorporate provisions that equate breach of a state contract with breach of the treaty (the "umbrella clause").[6] But for the most part, investment treaties do not spell out the consequences of their application to contracts—for questions of breach, defenses, forum selection, calculating damages, or the whole host of terms articulating the life of any contractual agreement.[7] From the perspective of contract theory, crucial questions remain totally unaddressed: Are treaty rules on such matters defaults that the contracting parties can simply negotiate around, or are they mandatory rules that take precedence over conflicting contractual provisions? If mere defaults, how difficult is it for the parties to opt-out? What level of clarity or specificity is required, and why? Are the answers the same for all kinds of treaty provisions, or are some mandatory and some merely default? Are some defaults "stickier" than others? And what about the parties' contractual choice of law—what is the proper relationship between the demands of the treaty and the whole host of rules selected by the parties by implication, through their choice of law clause?

The broad problem can be illustrated through a simplified hypothetical. Assume that two countries, Acadia and Ruritania, have established a bilateral investment treaty (BIT) to promote and

4. *See* James Crawford, *Treaty and Contract in Investment Arbitration*, 24 ARB. INT'L 351, 360-61 (2008); Arato, *supra* note 2, at 249.

5. *See* Arato, *supra* note 2, at 249.

6. *See* RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 166-78 (2d ed. 2012).

7. The closest these treaties come to defining their relationship to contracts is by requiring investor-state tribunals to apply both national law (contract) and international law (treaty), with priority to the latter in case of *conflict*. *See* Crawford, *supra* note 4, at 353. But this conflicts rule applies only if treaty provisions are presumed mandatory. *See id.* Express contract terms would not properly "conflict" with diverging defaults. *See* Richard Craswell, *Freedom of Contract* 1-2 (Coase-Sandor Inst. for Law & Econ., Working Paper No. 33, 1995). For a clear example of this relationship in international law, private parties are expressly empowered to contract around most provisions of the CISG—a multilateral treaty enacted exclusively by states. *See* CISG, *supra* note 3, art. 6. ("The parties," meaning the private parties to a covered sales contract, "may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.").

protect the flow of investment across their territories. The treaty lists contracts as covered investments, along with real property, intellectual property, and so on. It further guarantees foreign investors against expropriation, requiring that an expropriating state compensate the investor for the "fair market value" of her loss. As will be discussed below, in contract cases this standard of damages is generally taken to mean *expectation damages*.[8] By contrast, assume that the Ruritanian law of public contracts guarantees investors only reasonable *reliance damages* when the state breaches—so as not to bind the government's hands if future regulatory exigencies arise.[9] An Acadian investor contracts with the government of Ruritania to operate a dolomite quarry for twenty years. The contract comes under Ruritanian law and makes no express mention of damages. Ten years into the deal, Ruritania cancels the contract, citing newly discovered environmental concerns about dolomite mining. Assuming an expropriation occurred, which standard of damages controls? The domestic standard (reliance damages) or the treaty standard (expectation damages)? And what if the parties had included a provision in their contract expressly limiting damages (liquidated damages)? Surprisingly, international investment law does not adequately resolve these questions.

This Article grapples with the treaty/contract problem systematically as a question of contract theory. I argue that privileging party-choice in the context of transnational investment contracts is the best way to protect *both* the private law values of fairness and efficiency and the state's capacity to govern in the public interest.

From the ex ante perspective of contracting states and foreign investors, the ultimate relationship between treaty and contract will be of fundamental importance. As a purely commercial matter, the relative rigidity or flexibility of the treaty regime will bear strongly on the parties' ability to negotiate efficiently. At the same time, as a political matter, these questions will determine whether and how a state desiring FDI might effectively work protections for its future

8. *See infra* Part II.C.

9. *See* Christopher Serkin, *Public Entrenchment Through Private Law: Binding Local Governments*, 78 U. CHI. L. REV. 879, 957-58 (2011); *see also* Gillian Hadfield, *Of Sovereignty and Contract: Damages for Breach of Contract by Government*, S. CAL. INTERDISC. L.J. 467, 469 (1999).

capacity to regulate *into* its contractual arrangements with foreign investors. Thus it is unsettling that the treaty/contract relationship remains generally undecided and, moreover, that it is so often decided the wrong way.

Uncertainty is the more glaring problem. It is clearly undesirable for all parties if, ex ante, they cannot predict whether tribunals will give effect to their contractual efforts to opt out of treaty rules ex post. Yet, in the face of treaty silence on the treaty/contract issue, arbitral jurisprudence has been highly uneven and irregular—often resolving these questions merely on the level of assumptions.[10] As a result, the meaning of state contracts in the world of investment treaties remains under a cloud of doubt.

But the deeper problem is that tribunals too often slip into an overly rigid and formalistic approach, prioritizing treaty provisions over negotiated contractual bargains.[11] This tendency is usually bad policy, with negative implications for both states and investors. It undercuts the autonomy of the parties, thereby undermining their capacity to allocate risk as they see fit. For the investor, this means risks associated with the viability and profitability of the project. States share those commercial concerns but also bear responsibility for the full range of noncommercial values of import in their respective societies. States negotiating investment contracts thus have to seriously manage the risk that any such project might create future regulatory chill. In other words, the tendency of arbitral tribunals to implicitly prioritize treaty norms over states' and investors' contractual arrangements ultimately reduces both parties' ex ante flexibility to negotiate efficiently. At the same time, this weakens the state's capacity to define the scope of its potential future liability under an investment treaty *through* contract, which will tend to disincentivize openness to foreign capital in the long run—the very goal that investment treaties are meant to achieve.

Much of the confusion arises out of the fact that investment treaties apply to both foreign-owned property and contracts between states and foreign investors, without drawing much of a distinction between these categories. Investment treaties are designed and interpreted with property protection in mind—a Blackstonian vision

10. *See infra* Part II.
11. *See infra* Part III.

of property law, oriented around fixed rules for particular assets.[12] For example, they classically protect foreign-owned real and personal property from expropriation and other forms of interference. But these treaties typically apply to a much broader, open-ended category of "investments," including contracts between sovereigns and foreign investors.[13] What does it mean for a treaty to afford protection to a contract?

By contrast to property, the logic of contract is normally oriented around party choice. Parties choose the basic rules that bind them. To the extent that contracts are supplemented by default rules, or even altered by mandatory provisions under a particular domestic legal order, the goal is usually to give better effect to what the parties wanted,[14] or to impute what they would have wanted had they considered an issue.[15] Of course national laws of contract occasionally entail certain mandatory rules and sticky defaults that protect important areas of public policy rather than party choice—and some nations more than others.[16] But in essence, if the law of property is the realm of fixed categories and rigid rules, the law of contract is the realm of flexibility and choice.[17] One might think that, to the extent investment treaties apply to contracts at all, they would do so in a way tailored toward effectuating the parties' contractual arrangements. Yet investment treaties are often interpreted as applying to contracts in much the same way as they apply to property, imposing rules that take precedence over provisions agreed to by the contracting parties. Quite apart from the issue of

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12. *See* Arato, *supra* note 2, at 234, 238 & n.33. *See generally* Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L L. 397, 406 (2011).

13. *See* Arato, *supra* note 2, at 231; Yackee, *supra* note 12, at 402-03.

14. *See* CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 57-73 (2d ed. 2015).

15. *See, e.g.*, Jody S. Kraus, *The Correspondence of Contract and Promise*, 109 COLUM. L. REV. 1603, 1631-33 (2009); *see also* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989) (advancing the concept of "penalty defaults," which set background rules at levels the parties would *not* have wanted in order to incentivize parties to contract out—for example, to reveal information).

16. *See* HANOCH DAGAN & MICHAEL A. HELLER, THE CHOICE THEORY OF CONTRACTS (forthcoming 2017).

17. Arato, *supra* note 2, at 286; *see also* HANOCH DAGAN, PROPERTY: VALUES AND INSTITUTIONS 83-84 (2011).

uncertainty, this kind of rigidity poses significant problems for states and investors alike.

This Article makes three main claims: one conceptual, one descriptive, and one normative. Conceptually, I argue that investment treaties create contract law—if only informally. Their merits, in this regard, thus have to be analyzed and assessed in terms of contract theory. Critically, the treaty/contract issue cannot be properly understood without taking into account the ex ante perspective of the parties to an investment contract. It matters to contracting parties whether they are able to contract around treaty rules. Formalities aside, it must be understood that the resolution of the treaty/contract question will have a deep material effect on the meaning of any state contract negotiated against the background of an applicable investment treaty. These effects must be understood (and evaluated) from the point of view of those economic operators whose activity investment treaties seek to stimulate: foreign investors and states.[18] This perspectival shift helps illuminate the deep indeterminacy in the arbitral jurisprudence on the treaty/contract issue and reveals a better path.

This Article's descriptive claim is that, in the face of treaty silence, answers to these questions have been few, irregular, and generally thinly justified. Arbitral tribunals have come down on all sides of this issue, privileging treaty over contract here, and contract over treaty there.[19] If anything, tribunals slightly tend toward the former position—but they usually resolve the issue only implicitly. I argue that, as things stand, the vagaries surrounding the treaty/contract issue create real problems of predictability, efficiency, and fairness that are now beginning to come to light in practice.

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18. *Cf.*, *mutatis mutandis*, Panel Report, *United States—Sections 301-310 of the Trade Act of 1974*, ¶¶ 7.81-7.82, WTO Doc. WT/DS152/R (adopted Dec. 22, 1999) [hereinafter *Section 301*] (indicating, in the context of the WTO, that in interpreting a "treaty the benefits of which depend in part on the activity of individual operators," an interpreter must take the perspective of such operators into account in order to give effect to the treaty's object and purpose). Indeed, the Section 301 Panel noted that in the WTO/GATT context "[t]he rationale in all types of cases has always been the negative effect on economic operators." *Id.* ¶ 7.84.

19. *See infra* Part II.D.

Normatively, I argue that the prevailing interpretive tendency to subordinate contractual choice to treaty rules is usually bad policy.[20] It creates unjustified impediments on the state's ability to regulate, which in turn impedes both states' and investors' capacity to negotiate and contract efficiently ex ante. All this potentially hinders the very flow of foreign capital that investment treaties are meant to induce. I contend that, as a general principle, states and foreign investors should be able to freely contract around treaty rules—left, in other words, to manage their respective risks as they see fit. While there may be some cases where treaty rules should be difficult, or even impossible, to contract around, such instances must be carefully justified—either in terms of values immanent to the logic of contract (like information sharing) or external values (like environmental protection).

This Article proceeds as follows: Part I begins by exploring the meaning of a contract and attempts to analytically separate a number of ways in which we might think about the relationship between investment treaties and the contracts to which they apply. I start from the position that any contract is a complex legal instrument, often going far beyond its express terms. The codified choices of the parties are always supplemented by a great many default and mandatory provisions, drawn from the applicable "law of contracts." I argue that thinking in terms of default rules, sticky defaults, and mandatory terms provides the right rubric for understanding the possible interactions between investment treaties and state contracts.

Part II examines how investment tribunals have approached these questions in practice, and how they have justified their approaches (if at all). I focus principally on rules relating to the protection of investor expectations, damages, and forum selection. In each area it will become apparent that answers have been inconsistent, irregular, and almost always left implicit. However, the tribunals tend to assume that treaty rules are effectively mandatory, or at least highly sticky.

Part III advances a normative argument about how the treaty/contract issue ought to be approached when left ambiguous

20. *See infra* Part III.

by the treaty text. I argue that, in general, the principle ought to be that explicit contractual terms prevail over treaty provisions as the authentic expression of the contracting parties' division of risk. As a matter of treaty interpretation, the presumption that treaties create mere defaults hews closest to the object and purpose of investment treaties—namely, to protect *and promote* foreign direct investment. Moreover, there are strong policy reasons for understanding most treaty rules as mere defaults based in both the structure of private law (like efficiency and party autonomy) and extrinsic public values (such as public health, the environment, and the state's capacity to regulate and to control its liability for major privatization projects more generally). Yet all this should be taken only as a presumption. There may be good reasons why, in certain cases, treaty rules ought to be understood as sticky defaults—even when the treaty text gives no indication one way or the other. Here I explore the possibility that forum selection clauses and general exceptions provisions might be justifiable candidates. But, crucially, I argue that in all such cases adjudicators must justify constraining the principle of choice in light of the values of international investment law—a regime best understood as a system of private law *sensitive* to public values.

I. REGULATION AND CHOICE IN TRANSNATIONAL CONTRACT LAW

This Part briefly considers the meaning of a contract in both domestic and transnational legal orders. I first distinguish between formal and material conceptions of the contract in the context of diverse background rules in national legal systems. Second, I examine the meaning of a contract within the transnational system of international investment law, distinguishing between the logics of property and contract. I then provide an ideal-typical schema for exploring the possible relationships between treaty and contract to frame the analysis in the descriptive and normative Parts that follow.

A. Party Choice and Background Rules: Defaults, Sticky Defaults, and Mandatory Terms

As Robert Scott puts it, the express terms of a contract reflect only the tip of the iceberg.[21] In all national legal orders, contracts are formally (and sometimes informally) augmented by a manifold of legal rules, covering all kinds of matters—from basic obligations like good faith, defenses, and damages to procedural rights like forum selection.[22] For the parties, all of these matters have a value. They are all potential price terms—terms which parties factor into the price of the contract, and regularly dicker over in negotiating their deals. Thus, from both the legal and the economic perspectives, the full meaning of a contract can only be appreciated in light of a host of regulatory, legislative, and constitutional rules that affect its disposition.[23]

Though the parties may not have explicitly negotiated over the apposite background rules, all such terms must be considered part of the deal—and sophisticated parties will have to take this edifice into account ex ante in their negotiations. For an example from U.S. law, if a domestic company contracts with the City of Chicago to set up municipal parking meters, the private party will want to know whether the government retains the right to back out of the contract or to vitiate its value through regulatory action.[24] Absent any explicit agreement by the parties, the background rules of the Illinois law of public contracts will obviously affect the terms of the deal and will have to either be priced in or contracted around. Similarly, even if the government is not entitled to simply back out, the investor will want to consider whether any special rules about public contracts entitle the city to pay only limited damages in case of regulatory breach.[25] As it happens, in many domestic systems, including the United States, the law of public contracts often subjects states only to reliance damages by default—not expectation

21. Professor Scott uses this turn of phrase in his lectures. For the core idea, see Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 133 YALE L.J. 541, 544 (2003).

22. *See* Ayres & Gertner, *supra* note 15, at 88.

23. *See id.* at 87-88.

24. *See* Serkin, *supra* note 9, at 895.

25. *See id.* at 916.

damages.[26] Such background rules on damages are price terms, which sophisticated private parties must either stomach, price in, or contract around through express language on indemnification for regulatory change.

Not all background rules relate to contracts in the same way. Ian Ayres usefully distinguishes between defaults, sticky defaults, and mandatory rules.[27] Classically, default rules supplement contracts and fill gaps, and parties are free to contract around them.[28] Mandatory rules, by contrast, cannot be contracted around.[29] Sticky defaults lie somewhere in between.[30] They can be contracted around, but doing so requires more concerted action than with ordinary defaults—typically some requirement of clear statement or via the adoption of certain formalities in the contract.[31]

Mandatory rules are justifiable only where they protect some value, which might be intrinsic to the logic of contract (like equality of information or the protection of unsophisticated parties)[32] or extrinsic public goods (like the prohibition on slavery).[33] Like mandatory rules, sticky defaults are meant to protect certain values—though to a weaker degree.[34] Typically, the values concerned here are relational and would not be undercut if informed and sophisticated parties were to opt out.[35] Moreover, sticky defaults may be more or less difficult to contract around. Some may be subject only to clear statement rules.[36] Others might be stickier, requiring parties to use special language.[37] For example, in cases where parties are likely to have asymmetric information, stickiness can have the function of forcing better-informed parties to disclose information to their counterparties by insisting that attempts to

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26. *See id.*

27. *See* Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 YALE L.J. 2032, 2042, 2084 (2012).

28. *See id.* at 2034.

29. *See id.* at 2087.

30. *Id.*

31. *See id.*

32. *See* DAGAN & HELLER, *supra* note 16 (manuscript at ch. 10) (on file with author).

33. *See* Craswell, *supra* note 7, at 1-2.

34. *See* Ayres, *supra* note 27, at 2084.

35. *See id.* at 2088.

36. *See id.* at 2037.

37. *See id.*

contract out must use language that discloses the necessary information.[38] In general, however, mandatory rules and sticky defaults are the exception.[39] Absent compelling justification in intrinsic or extrinsic values, it is generally best to leave it to the parties to allocate risk and price amongst themselves as they see fit—choice is, after all, the central fundament of contract, key to the core private law values of autonomy, utility, and community.[40]

In transnational contracts the situation becomes more complex in a number of ways. First, it should be recognized that investment contracts are not always negotiated under the law of the host state; often, the parties negotiate over the law of the contract by incorporating a "choice of law" provision.[41] The parties' choice of law dictates, in the first cut, which national law will apply to their contract, thereby filling gaps through default rules and potentially augmenting its express terms via sticky defaults and mandatory terms.[42] Still so far, the situation is still basically similar to the above.

Second, such contracts may come under the ambit of an international treaty, which imposes its own set of default rules—as with transnational sales contracts coming under the ambit of the eighty-four party CISG. That multilateral treaty expressly imposes its own set of (mostly default) background contract terms, which displace any conflicting defaults or mandatory terms in the national law of the contract. Still, private contracting parties are able to contract around the CISG if they do so explicitly—hardly anything in it is mandatory. Given the multiplicity of legal orders involved, things are here already more complex—but at least in the context of the CISG the basic structure and hierarchy of norms is clear. The meaning of any covered sales contract can be ascertained only by careful analysis of the express terms of the contract (in the first instance), as supplemented by a web of background terms found in the CISG, and with any remaining gaps filled by the national law of the contract.

38. *See id.* at 2062.
39. *See id.* at 2087-88.
40. *See* DAGAN & HELLER, *supra* note 16.
41. *See* George A. Zaphiriou, *Choice of Forum and Choice of Law Clauses in International Commercial Agreements*, 3 INT'L TRADE L.J. 311, 311 (1978).
42. *See id.*

Investment treaties provide a more vexing wrinkle. Insofar as an investment treaty applies to contracts between the state and a foreign investor, it becomes—like the CISG—an additional source of background rules.[43] As with transnational sales contracts, any such investment contract may be augmented by defaults and mandatory provisions arising out of two legal orders—the chosen domestic law of the contract and any opposable international investment treaty. The problem here is that it is not at all clear how investment treaties, national contract law, and express contract terms are supposed to interact.

What is clear, however, is that these relationships matter to states and investors alike. The bottom line is that, from the ex ante perspective of the contracting parties, any background treaty rules that apply to the contract must be considered materially part of the deal. Without clarity as to how such treaties and contracts will ultimately relate, it is impossible for contracting states and investors to know just what kind of legal arrangements they are getting into.

B. Contract Versus Property in International Investment Law

One major source of the confusion surrounding the treaty/contract question arises out of the treaties themselves. In extending their coverage to a wide range of "investments," these treaties tend to muddy the lines between contract, classical forms of property, and a myriad other assets.[44]

Investment treaties are agreements between two or more states, governing interactions between each state and foreign private parties hailing from the other(s).[45] Their twin purposes are to protect foreign investors' assets and promote FDI.[46] They codify a number

43. *See Investment Treaties*, INT'L INST. FOR SUSTAINABLE DEV., http://www.iisd.org/investment/law/treaties.aspx [https://perma.cc/M8CN-V3ER].

44. *See* Arato, *supra* note 2, at 271. For a rare counterexample, see Philip Morris Brand Sàrl v. Oriental Republic of Uru., ICSID Case No. ARB/10/7, Award, ¶¶ 267-270 (July 8, 2016) [hereinafter *Philip Morris v. Uruguay*] (carefully distinguishing the trademarks at issue from classical real property, finding that, unlike the latter, the former generally do not include rights of use insulated from state action); *id.* ¶ 423 (distinguishing between trademarks and contracts, for purposes of determining the content of legitimate expectations protected under fair and equitable treatment (FET)).

45. *See* DOLZER & SCHREUER, *supra* note 6, at 13.

46. *See id.* at 22, 29-30.

of basic protections, framed largely in the style of property rules—in particular, guarantees against expropriation and standards like "fair and equitable treatment" (FET).[47] These protections are generally explicitly or implicitly linked to rules on damages.[48] Investment treaties also create important procedural protections for investors. Critically, they endow private investors with the capacity to sue states directly before international arbitral tribunals (investor-state dispute settlement), and they key into powerful mechanisms for the enforcement of foreign arbitral awards.[49] Put another way, investment treaties seek to promote FDI by mitigating three typical areas of risk: the risk that a host state will afford insufficient protection to the investment as time goes on; risks associated with suing a sovereign state, as a foreigner, before its own courts; and the risk that, upon losing at litigation, a state will simply refuse to pay up.

Though framed as treaties establishing rules for the protection of foreign property—in other words, property law—these treaties apply to a surprisingly broad range of assets, including not only real and personal property, but also intellectual property, going concerns, and a vast range of contracts with the state (state contracts).[50] There has been some debate about the extent of these treaties' scope.[51] But there has been precious little discussion about whether they apply to all covered assets in precisely the same way.[52]

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47. *See id.* at 13.

48. U.N. CONFERENCE ON TRADE AND DEVELOPMENT, FAIR AND EQUITABLE TREATMENT: A SEQUAL, at 88-89, U.N. Doc. UNCTAD/DIAE/IA/2011/5, U.N. Sales No. E.11.II.D.15 (2012), http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf [https://perma.cc/7SP7-FB9H].

49. DOLZER & SCHREUER, *supra* note 6, at 310.

50. *See id.* at 62-63.

51. *See* Poštová Banka, A.S. v. Hellenic Republic, ICSID Case No. ARB/13/8, Award, ¶ 333 (Apr. 9, 2015) (sovereign debt did not qualify as a covered asset); SGS Société Générale de Surveillance S.A. v. Republic of Para., ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶ 93 (Feb. 12, 2010) [hereinafter *SGS v. Paraguay*] (noting that a one-off contract for the sale of goods might not qualify as an investment).

52. This Article represents part of a broader project, in which I seek to disaggregate how investment treaties are applied to different categories of investment, in light of the varied values that different corners of private law seek to promote. *See* Arato, *supra* note 2, at 247, 292 (regarding contract and property); *see also* Zachary Douglas, *Property, Investment, and the Scope of Investment Protection Obligations*, *in* THE FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW: BRINGING THEORY INTO PRACTICE 363 (Zachary Douglas, Joost Pauwelyn, & Jorge E. Viñuales eds., 2014) (distinguishing between property, contract, and value as different categories of investment); Rochelle Dreyfuss & Susy Frankel, *From Incentive to Commodity to Asset: How International Law Is Reconceptualizing Intellectual Property*, 36

Here we are concerned with contracts specifically, and to draw out the treaty/contract problem it is enough to contrast the basic orientation of contract law with the law of real property. I put to the side the normative substantive question of how far these treaties ought to protect foreign property rights,[53] and focus only on the form of that protection. Whatever we think about the content of the various substantive and procedural treaty standards, it is fairly clear that they are meant to apply to foreign property holdings in much the same way that national property law would. Investment treaties afford a set of consistent protections to foreign property owners, in order to mitigate certain risks and induce FDI. In the context of property, it makes sense that these protections are relatively certain, rigid, and stable. This resonates well with the logic of property, where a putative investor relies on a *received* regime of property law in planning an investment, for example in land development.[54] The law of property affords only limited space for investors to choose how the law will apply to their holdings.[55] Investors may have options, but property law places little emphasis on choice.[56] The rules are not generally up for discussion—they just have to be known (or knowable) in advance.

The logic of contract has a different orientation. Here, the general principle is that parties have the capacity to regulate themselves—to negotiate and allocate risk as they see fit.[57] True, as explained above, they do so against a complex background of

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MICH. J. INT'L L. 557, 560 (2015) (exploring how investment treaties seem to "propertize" IP). *But see Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award, ¶¶ 267-270 (July 8, 2016) (distinguishing trademarks from classical forms of property).

53. As I have suggested elsewhere, arbitral tribunals have tended to assume an overly rigid "Blackstonian" vision of property in interpreting investment treaties, which may well go too far toward displacing the state's capacity to define the scope of property rights. *See* Arato, *supra* note 2, at 247. It is certainly up for debate whether the dominant conception of property in arbitral jurisprudence affords states sufficient flexibility, or—more crudely—whether investment treaties afford too much substantive protection to foreign property. However, these questions necessitate going too far afield for present purposes, and I confine a more systematic treatment of the concept of property in international investment law to a future paper.

54. *See id.* at 238 n.33.

55. *See id.*

56. *See id.* at 286.

57. *See* DAGAN & HELLER, *supra* note 16 (manuscript at 16); Arato, *supra* note 2, at 238 n.33; Schwartz & Scott, *supra* note 21, at 87-88.

norms—which fills gaps and occasionally nudges parties to contract in certain ways (sticky defaults) or even forces them to do so (mandatory rules).[58] But the basic principle is that parties get to choose how to govern their relations.

While it is perfectly clear how investment treaties apply to foreign property holdings, it is much less obvious how their varied provisions ought to act on a contract between a foreigner and a state. Clearly treaties apply to contracts, but it remains unclear whether and to what extent their provisions should augment contractual arrangements between the parties—or even displace them. The issue is almost invariably undecided in the treaties and is too often overlooked when it comes to arbitration.[59]

As will be discussed further in Part III, there are two main harms here. The first is more glaring—the jurisprudence on this issue is highly irregular and inconsistent, leaving significant uncertainty about the meaning of contracts between states and foreign investors where an investment treaty applies. Even assuming perfect rationality among states and foreign investors, such uncertainty provides a serious hurdle to efficient contracting and makes it extremely difficult for states to manage potential risks to their regulatory autonomy. The second potential harm lies in making the wrong choice about how treaties and contracts ought to interact. Too often, tribunals simply assume that treaties apply to contracts as they would to any other asset: on the property model.[60] In other words, there is a tendency in investor-state jurisprudence to treat contracts as assets subject to a fixed set of treaty rules.[61] As I argue in Part III, this confusion creates significant inefficiencies that harm both states and investors.

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58. *See* Ayres, *supra* note 27, at 2084.

59. Crawford and Abi-Saab are among the few authorities to have recognized the problem. *See* Crawford, *supra* note 4, at 352-53; ConocoPhillips Petrozuata B.V. v. Bolivarian Republic of Venez., ICSID Case No. ARB/07/30, Dissenting Opinion of Georges Abi-Saab to Decision on Jurisdiction and Merits, ¶ 32 (Feb. 19, 2015) [hereinafter *ConocoPhillips*] ("[A] treaty claim is necessarily based on a right that has been allegedly violated. If this right is created by contract, it is this contract that governs its legal existence *and the modalities of this existence, including its contents and limits*." (emphasis added)). Abi-Saab adds, "To assert, as does the Majority, that the treaty applies, without taking into consideration the terms of the contract, amounts to revising and rewriting the contract." *Id.* ¶ 29.

60. *See* Arato, *supra* note 2, at 231.

61. *See id.* at 271.

C. How Might Treaty and Contract Relate?

The starting point cannot be overstated: as soon as we decide that an investment treaty applies to contracts, we create an international law of contracts—even if only partial, thin, and rudimentary. This much international investment law has already done. What remains to be determined is what kind of law of contracts it is: whether this regime should be understood as thin or thick, rudimentary or sophisticated; and what values such choices might serve. As the next Part will suggest, these choices remain very much open, thanks to vague treaty language and highly varied jurisprudence. But before turning to the cases, it is worth conceptually schematizing the possible relationships between treaty and contract, to organize our analysis going forward.

In assessing how treaty and contract might interact, what matters are the material relationships. We must not only look at the treaty terms that are formally applicable to contracts, but also to any provisions that materially affect the disposition of the contractual deal—even if only implicitly. The most obvious formal provision is the "umbrella clause" which equates most breaches of contract with a breach of the treaty.[62] But provisions guaranteeing investors FET, or protecting their assets from regulatory takings ("indirect expropriation"), can also strongly affect the disposition of the contract—for example, by protecting an investor's expectations, by providing more favorable measures of damages than might be available under the law of the contract, or by providing access to advantageous international fora.[63] What matters from the ex ante point of view of the contracting parties, and what should matter from the point of view of dispute settlers ex post, is the material scope of the deal.

Schematically, there are four types of relationships available between a treaty provision and a contract. The first possibility is that a treaty rule has no effect on any contractual provision. The latter

62. *See* Katia Yannaca-Small, *Interpretation of the Umbrella Clause in Investment Agreements*, *in* INTERNATIONAL INVESTMENT LAW: UNDERSTANDING CONCEPTS AND TRADE INNOVATIONS 101, 102 (2008), https://www.oecd.org/investment/internationalinvestmentagreements/40471535.pdf [https://perma.cc/42V8-LFGJ].

63. *See* Rudolf Dolzer, *Fair and Equitable Treatment: Today's Contours*, 12 SANTA CLARA J. INT'L L. 7, 11-12 (2013).

totally contracts out of the former. Here the explicit terms of the contract take precedence, as do all default and mandatory terms incorporated therein through the choice of law provision. The entire meaning of the agreement is determined by domestic law, except in the rare instance where the treaty fills gaps left by both the express contract and domestic background rules. Note that this is close to the position that the treaty does not apply to the contract at all, and most forcefully separates the logic of contract from the logic of property rules. It is, however, difficult to square with the text of most treaties, which generally clearly indicate that they apply to contracts in *some* way—as covered investments.

The second possibility is that a treaty rule does not supplant any express choice by the parties but may augment background rules in the relations between the parties. By this view, the treaty rule displaces any conflicting background rules set by the domestic law of the contract but still only fills gaps in any particular contract.[64] The parties can contract out of the treaty rule with no added difficulty. The CISG explicitly adopts this approach for transnational sales contracts.[65] I suggest below that most of the time this also represents the better approach in the law of foreign direct investment—most resonant with both the goals of investment treaties and the logic of contract.

The third possibility is that a treaty rule creates a sticky default, which parties can contract around only under certain conditions—typically via requiring certain formalities, or a clear statement rule.[66] For example, if a treaty makes international arbitration available as a forum for resolving disputes, it might be held that the contracting parties can waive the treaty rule only if they do so in a certain way. The rule might require an exceptionally clear waiver.[67] An even stickier rule would require specific language to validate a

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64. *See* SGS Société Générale de Surveillance S.A. v. Republic of the Phil., ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 169 (Jan. 29, 2004) [hereinafter *SGS v. Philippines*] (finding that the contracting parties had contracted around the treaty provision providing for investor-state arbitration). Crawford and Douglas come closest to this view in discussing exclusive forum selection clauses. *See* Crawford, *supra* note 4, at 363; Douglas, *supra* note 52, at 363.

65. *See* CISG, *supra* note 3, art. 6.

66. *See* Ayres, *supra* note 27, at 2048 (discussing sticky defaults in domestic law).

67. *See id.*

waiver—that is, by only recognizing waivers of BIT jurisdiction that mention the treaty by name.[68]

Fourth, a treaty term might impose a mandatory rule that cannot be waived under any circumstances. Few explicitly argue that investment treaty provisions are fully mandatory, though occasionally commentators have explored whether it might not be possible to waive treaty protection by contract *in toto*.[69] However, this kind of approach is implicit in some of the cases, discussed further below, in which tribunals make assumptions that effectively render treaty provisions impossible to contract around.

Note that these categories are ideal types. There is no reason why answers need be the same for all treaty rules. But it is essential that the relationship between treaty and contract be certain and predictable vis-à-vis any particular treaty provision. Otherwise it becomes extremely difficult for contracting parties to plan ex ante. To that end, the ideal solution would be to clarify how each treaty norm relates to contracts in the treaty text—as is done in the CISG.[70] However, this would call for the amendment of thousands of treaties. What follows is thus primarily an argument for how adjudicators ought to approach the treaty/contract issue in the face of treaty silence. At the same time, it serves as a normative argument for how treaty drafters might best address the issue in tomorrow's treaties.

In the next Part, I suggest that tribunals have varied markedly in answering this question—usually without even considering the issue explicitly. This irregularity poses a serious harm for both states and investors as they seek to structure investment deals ex ante. The cases do, however, suggest a tendency toward privileging treaty over contract. In Part III, I argue against this tendency and conclude that the general rule should be respect for party choice—a baseline that best serves the interests of both investors and states. However, I suggest that this rule must be nuanced and flexible, and I explore the possibility that in limited instances sticky defaults and

68. *See id.* at 2048-49.

69. *See* S.I. Strong, *Contractual Waivers of Investment Arbitration: Wa(i)ve of the Future?*, 29 ICSID REV. 690, 691 (2014); Bart L. Smit Duijzentkunst, *Of Rights and Powers: Waiving Investment Treaty Protection*, EJIL: TALK! (Dec. 9, 2013), http://www.ejiltalk.org/of-rights-and-powers-waiving-investment-treaty-protection/ [https://perma.cc/H27K-QZ9P].

70. *See* CISG, *supra* note 3, art. 6.

mandatory rules may be justifiable in light of compelling intrinsic or extrinsic values.

II. THE TREATY/CONTRACT QUESTION IN INVESTOR-STATE JURISPRUDENCE

This Part examines how investment tribunals have approached the relationship between contract and treaty in practice, and how they have justified their approaches (if at all). To illustrate the uncertainty of the adjudicative status quo, I focus on three specific provisions found in most treaties: forum selection, the substantive guarantee of FET, and damages. Answers to the treaty/contract question have been inconsistent and irregular within and across each term. Any of these provisions may be price terms—and potentially important ones—relating to common questions which contracting parties regularly consider and dicker over in their negotiations. Nevertheless, investment treaties are almost invariably silent on how their terms interact with contracts, and tribunals have been highly inconsistent and unclear in grappling with these questions. At most, it appears that tribunals tend to assume that treaty rules are either mandatory or highly sticky—a tendency I challenge directly in Part III.

A. Forum Selection

Forum selection provides the clearest example of how tribunals have diverged on the relationship between treaty and contract. As it happens, tribunals have given closer attention to the relationship on this issue than in any other context. This is largely because the leading cases have turned on a relatively uncommon investment treaty provision known as the "umbrella clause," which has the effect of elevating contract claims to the level of treaty claims.[71] Disputes under such clauses necessarily put the treaty/contract

71. Noble Ventures, Inc. v. Rom., ICSID Case No. ARB/01/11, Award, ¶¶ 54-56 (Oct. 12, 2005) [hereinafter *Noble Ventures*]. Note that this question need not arise exclusively with regard to the umbrella clause—it can and does arise in FET and expropriation cases as well. *See, e.g.*, CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award, ¶¶ 296-303 (May 12, 2005) [hereinafter *CMS Gas*].

issue front and center. I discuss these controversial provisions in further detail elsewhere.[72] Suffice it to say, as generally understood, umbrella clauses transform at least some kinds of contractual promises between states and investors into obligations actionable under the treaty.[73] For our purposes, the issue is what happens when those underlying contracts include *exclusive* forum selection clauses, limiting jurisdiction to the national courts of the host state.

The leading cases here are *SGS v. Philippines* and *SGS v. Paraguay*—which, conveniently, involved the same company, similar BITs, similar contracts, and similar facts. Each of the contracts was executed under the law of the host state, and each contract provided that the local courts would have exclusive jurisdiction over any disputes over the contracts.[74] In each case, the main dispute concerned the failure of the state to pay substantial contractual fees, and, in each instance, the company ignored the contract's exclusive forum selection clause, seeking relief instead through investor-state arbitration by appeal to Switzerland's BIT with each host state.[75]

Both tribunals faced the same tension.[76] On the one hand, the umbrella clause expressly elevates contracts to the level of the treaty, creating arbitral jurisdiction under the treaty's dispute resolution clause. On the other hand, the contracts themselves expressly disclaimed any jurisdiction other than that of national courts. Each tribunal had to consider which provision controlled.

SGS v. Philippines provides a nuanced and uncommonly well-reasoned authority on the treaty/contract issue. Most importantly, it found that the umbrella clause only imposed an international legal obligation to perform, and converted the consequences of non-performance into an issue of international law. In the Tribunal's view, the umbrella clause

72. *See* Arato, *supra* note 2, at 251-58.

73. *See id.*; *see, e.g.*, *Noble Ventures*, ICSID Case No. ARB/01/11, ¶ 53.

74. *See SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶ 34 (Feb. 12, 2010); *SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 22 (Jan. 29, 2004).

75. *See SGS v. Paraguay*, ICSID Case No. ARB/07/29, ¶¶ 125-176; *SGS v. Philippines*, ICSID Case No. ARB/02/6, ¶ 67.

76. *See SGS v. Paraguay*, ICSID Case No. ARB/07/29, ¶ 125; *SGS v. Philippines*, ICSID Case No. ARB/02/6, ¶ 92.

> makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments. But it does not convert the issue of the *extent* or *content* of such obligations into an issue of international law.[77]

According to the Tribunal, the scope of these contractual commitments can only be ascertained in light of the contract's terms, supplemented by the default and mandatory rules of the law of the contract—that is, municipal law.[78] And, where the contract provides for an exclusive forum to resolve all contractual disputes, the existence of a breach and the amount of damage thereby caused can be authoritatively determined only by the contractually provided forum.[79] Forum selection is, after all, part of the deal—a price term that could have been negotiated nonexclusively but, here, was not. Noting that the contract provided exclusively for local court jurisdiction, the Tribunal issued a stay.[80] It held the claim inadmissible until such a time as the company submitted its claim before the Philippines courts and the latter rendered an authoritative judgment.[81] Only then would the state's compliance become a matter of international law.[82]

Six years later, *SGS v. Paraguay* departed from *SGS v. Philippines* on this issue, privileging the treaty provision providing investors with access to investor-state arbitral jurisdiction over the contract's exclusive forum selection clause opting for domestic courts.[83] The Tribunal's key assumption was that treaty and contract could be kept wholly discrete.[84] The Tribunal held that, once covered as an investment, state contract would simultaneously create both domestic legal rights and international legal rights under the treaty.[85] In the Tribunal's view it had no jurisdiction over

77. *SGS v. Philippines*, ICSID Case No. ARB/02/6, ¶ 128.
78. *See id.*
79. *See id.*
80. *Id.* ¶ 175.
81. *Id.*
82. *See id.* ¶ 128.
83. *See SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶¶ 131, 138-142 (Feb. 12, 2010).
84. *See id.* ¶¶ 177-184.
85. *See id.* ¶¶ 167, 176, 181.

the former, but it asserted full jurisdiction over the latter.[86] And, unlike *SGS v. Philippines*, it viewed the contract's exclusive forum selection clause as no bar to adjudicating the treaty claims.[87] For the Tribunal in *SGS v. Paraguay*, the umbrella clause required it to determine the disposition of the international legal rights generated by the covered contract, irrespective of the disposition of the national legal rights under the municipal law of the contract.[88] In its view, even an express, exclusive forum selection clause choosing local courts for the determination of all contractual disputes would only affect jurisdiction over the national legal rights generated by the contract—without affecting the Tribunal's jurisdiction over any and all claims of breach under the treaty.[89]

From the ex ante perspective of the parties to an investment contract, these cases differ markedly in their bearing on the parties' contractual autonomy. Under the rule adopted by *SGS v. Paraguay*, and others like it, treaty provisions offering investors access to investor-state arbitral jurisdiction attain something like mandatory status.[90] Even when the treaty claim at issue arises directly out of the underlying contract, via the umbrella clause, express and exclusive contract terms on forum selection will not displace the treaty's provision on dispute settlement. Rather, on this view, the treaty forum (or fora) will be available, irrespective of the parties' arrangements—a point which would be of obvious significance to parties negotiating contracts under the ambit of investment treaties. The approach in cases like *SGS v. Philippines*, by contrast, hews much more closely toward the arrangements negotiated by the contracting parties.[91] On this reading, treaty provisions on dispute

86. *See id.* ¶ 130.

87. *See id.* ¶ 174.

88. *See id.* ¶ 175 & n.104.

89. *See id.* ¶¶ 142, 174. Ultimately, the Tribunal ruled against the State on the merits—finding the State responsible for several breaches of contract, rejecting its contractual defenses, and assigning damages totaling $39 million plus interest. *SGS v. Paraguay*, ICSID Case No. ARB/07/29, Award, ¶¶ 182-184, 188 (Feb. 10, 2012).

90. For an example outside the context of the umbrella clause, see Parkerings-Compagniet AS v. Republic of Lith., ICSID Case No. ARB/05/8, Award, ¶ 332 (Sept. 11, 2007) [hereinafter *Parkerings*] (asserting a similar argument in a case turning on FET).

91. *See also* Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Republic of Para., ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, ¶ 142 (May 29, 2009) [hereinafter *BIVAC v. Paraguay*] ("Assuming that [the umbrella clause] does import the obligations under the Contract into the BIT ... [t]his would

resolution represent only a default, which can be contracted around via clear express language in the contract.[92]

The treaty/contract issue surrounding forum selection is not limited to umbrella clause cases. It has emerged in numerous cases invoking the standard substantive protections like expropriation and FET, though rarely as explicitly as the *SGS* cases. Of these, the very recent *Crystallex* Award represents an important precedent.[93]

Crystallex charts a clear middle ground between *SGS v. Philippines* and *SGS v. Paraguay*. This Tribunal acknowledged that it might be possible for parties to contract out of treaty dispute resolution, but it imposed a heavy burden of clarity on any contracting parties attempting to do so. If *SGS v. Paraguay* viewed treaty dispute resolution as effectively mandatory, and *SGS v. Philippines* understood it as a simple default, *Crystallex* understood it as something in between—a classic sticky default, which parties might be able to contract around if they did so in just the right way. In its words,

> [E]ven if [the Tribunal] were minded to find that an investor may waive by contract rights contained in a treaty, any such waiver would have to be formulated in clear and specific terms: a waiver, if and when admissible at all, is never to be lightly admitted as it requires knowledge and intent of forgoing a right, a conduct rather unusual in economic transactions.[94]

In this case, the contract contained an explicit and exclusive forum selection clause, opting to resolve all disputes in Venezuelan courts.[95] But this, for the Tribunal, was not enough to overcome its

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include not only the obligation to make payment ... [under] the Contract, but also the obligation (implicit if nothing else) to ensure that the Tribunals of the City of Asunción were available to resolve any 'conflict, controversy, or claim which arises from or is produced in relation to' the Contract." (quoting Agreement Between the Kingdom of the Netherlands and the Republic of Paraguay on Encouragement and Reciprocal Protection of Investments, Neth.-Para., art. 3(4), Oct. 29, 1992, T.S. No. I-39878)).

92. *See* Crawford, *supra* note 4, at 363-64; *see also* GUS VAN HARTEN, SOVEREIGN CHOICES AND SOVEREIGN CONSTRAINTS: JUDICIAL RESTRAINT IN INVESTMENT TREATY ARBITRATION 122-24 (2013).

93. *See* Crystallex Int'l Corp. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/11/2, Award (Apr. 4, 2016) [hereinafter *Crystallex*].

94. *Id.* ¶ 481.

95. *See id.* ¶ 482.

presumption against an investor's waiver of treaty fora.[96] Though waiver might be possible, even a clear contractual statement affirmatively opting for domestic courts to the exclusion of all other fora would not do the trick. As is typically the case with sticky defaults in domestic law, the Tribunal indicated that some special language would be required.

Importantly, the Tribunal gave some indication of the kinds of magic words that might make a contractual waiver effective to displace the background treaty fora. The Tribunal noted, in the negative, that the contractual forum selection provision "makes no mention of the Claimant's rights under the BIT, and no reference to the BIT in general terms or to the Claimant's right to seek recourse in arbitration for the alleged violation of those rights."[97] Though the Tribunal never came out and said that such references would have made a difference, it clarified that what it was looking for, and could not find, were "indices that the Parties did in fact contemplate such a set of circumstances," and that the investor affirmatively agreed to dispense with his right to a treaty-based forum.[98]

The Tribunal did not explain its rationale for viewing forum selection as a sticky default in any great depth, but we can reverse engineer some of its thinking from its cursory discussion of what language might have made such a waiver effective. In finding that an express, but *general*, exclusive forum selection clause was not enough, the *Crystallex* Tribunal tentatively suggested that what was missing was some express reference to the treaty as an indication that the Parties *specifically* contemplated discarding treaty arbitration. Conversely, to get around such a sticky default, the parties would have to include language evidencing their mutual awareness of what was being given up. As will be discussed further in Part III, below, the justification for such a rule might be to ensure that parties contracting under the ambit of a BIT share pertinent information in their negotiations.[99] Specifically, a sticky default of this kind would ensure that a party seeking to foreclose investor-state dispute settlement ensures that the other party is aware of his

96. *See id.*
97. *Id.*
98. *Id.*
99. *See* Ayres, *supra* note 27, at 2095-98.

right to compel international arbitration, and that the parties consciously agreed to give it up.[100]

Finally, it bears noting that, at the time of litigation, the claimant's and respondent's interests do not always fall on the same side of this issue. While in the above cases it was always the respondent state invoking the contract's exclusive forum selection clause, the same kind of clause stymied a respondent's efforts in *Oxus Gold v. Uzbekistan*.[101] There, the Tribunal ruled against the Respondent's attempt to bring counterclaims against the Claimant under a contract associated with the investment, in light of a provision in that contract vesting exclusive jurisdiction in national courts. The Tribunal considered that the contract's forum selection clause "constitutes a sort of carve-out from a potential jurisdiction under the BIT and deprives the Arbitral Tribunal of any jurisdiction over such counterclaims."[102] As in *SGS v. Philippines*, the BIT dispute resolution provision was, in the Tribunal's view, a mere default. Unlike in *SGS v. Philippines*, the Tribunal's emphasis of the contractual provision accrued to the Claimant's benefit.

B. Legitimate Expectations and Stabilization

The content of substantive investment treaty standards remains the gravitational issue in international investment law, and none more centrally so than the vague catch-all standard guaranteeing investors FET. The thorniest point of contention is whether it includes an obligation on states to protect an investor's "legitimate expectations," and, more specifically, to what extent that includes an obligation to compensate investors for losses arising out of regulatory change (a duty of "stabilization").[103]

Tribunals have disagreed fiercely on just how far FET entails a guarantee of regulatory stabilization (if at all).[104] To be clear, there

100. *See infra* Part III.C.

101. Oxus Gold PLC v. Republic of Uzb., UNCITRAL, Final Award (Dec. 17, 2015) [hereinafter *Oxus*], www.italaw.com/sites/default/files/case-documents/italaw7238_2.pdf [https://perma.cc/QF8U-V2SE].

102. *Id.* ¶ 958(ii).

103. DOLZER & SCHREUER, *supra* note 6, at 82-85.

104. *Compare* Enron Corp. v. Argentine Republic, ICSID Case No. ARB/01/3, Award, ¶¶ 260-261 (May 22, 2007) [hereinafter *Enron*] (holding that FET entails a strong obligation of legal stabilization), *with Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award, ¶ 423

is no need here to take a position on the debate over FET's precise substantive content. At issue here is a question hidden inside of the stabilization debate: whether and to what extent the treaty standard augments contracts between host states and foreign investors, and whether it is something that can be contracted around.

To contextualize the issue from the contracts perspective, absent any investment treaty, stabilization is something for which parties often can and do contract.[105] Most national legal orders have special rules for public contracts—meaning contracts with the government, subunits of the government, or in some cases with state-owned enterprises.[106] Usually the defaults are government-friendly.[107] It would be uncommon for a national legal order to guarantee an investor against legislative change by default. In the U.S. law of public contracts, for example, a private party is not guaranteed against general legislative changes that diminish the value of her contract with the government by default.[108] But to the extent that parties are sufficiently concerned about the risk of regulatory change, they can negotiate for a stabilization clause.[109] Stabilization is, in other words, a price term—one which investors are not entitled to by default, and which they will have to pay for. And the same goes for transnational contracts, absent an applicable investment treaty.

The usual question in international investment law is to what extent FET provisions impose a stabilization requirement on states

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(July 8, 2016) (holding that FET entails only a weak stabilization protection against general legislation), *and* Mesa Power Grp., LLC v. Gov't of Can., PCA Case No. 2012-17, Award, ¶ 502 (Mar. 24, 2016) (holding, in the context of the NAFTA, that "the failure to respect an investor's legitimate expectations in and of itself does not constitute a breach of [FET], but is an element to take into account when assessing whether other components of the standard are breached").

105. *See* INT'L FIN. CORP., STABILIZATION CLAUSES AND HUMAN RIGHTS 4-5 (2009).

106. *See generally* ROBERT MELTZ, CONG. RESEARCH SERV., R42635, WHEN CONGRESSIONAL LEGISLATION INTERFERES WITH EXISTING CONTRACTS: LEGAL ISSUES 7-9 (2012).

107. *See id.*

108. *See id.* at 9.

109. *See* Serkin, *supra* note 9, at 958. Note that such clauses are considered unconstitutional in some national legal orders, due to their potential to constrain future governments' ability to regulate. *See id.* at 886 n.27; Howard Mann, *Stabilization in Investment Contracts: Rethinking the Context, Reformulating the Result*, INV. TREATY NEWS (Oct. 7, 2011), http://www.iisd.org/itn/2011/10/07/stabilization-in-investment-contracts-rethinking-the-context-reformulating-the-result/ [https://perma.cc/Q44Q-HQK3].

at all, vis-à-vis any kind of asset.[110] Our question is related but conceptually independent from the issue of content. The question for us concerns how FET operates in contract cases—specifically where the investment is itself a *negotiated* agreement between the state and foreign investor reflecting their agreed allocation of risk. Does the treaty graft an obligation of stabilization on to such contracts? And, if so, to what extent can the parties contract around the treaty standard?

Notice that no such issue arises with pure property cases, in which it poses no problem that the treaty establishes received rules for the disposition of foreign property, binding the state over and above its own property law. With property, the point of the treaty is clearly to provide investor-friendly rules to attract investment.[111] The only debate vis-à-vis property claims is about how far the substance of the standard extends. But in contract cases an additional issue arises: how much to respect the parties' own efforts to allocate risk. Investor-state cases involving contracts have thus far tended to debate the issue of content vigorously; but they have generally disposed of the contracts-specific questions only on the level of assumptions.

As Professor Dolzer notes, jurisprudence on legitimate expectations is in a state of flux.[112] The case law can be usefully divided into two lines, reflecting broad and narrow approaches to legitimate expectations. The cases are quite a bit messier, but this simplified division serves to illustrate the underlying treaty/contract issue. Note at the outset that all of the cases seem to agree that normally, in protecting expectations, FET will materially add *something* to state contracts within its ambit. Clearly, the cases differ on how much FET adds (ultimately a question of substantive content). But, more importantly for our purposes, the cases further differ on how much the content of FET will depend on just what the contractual arrangements entail in particular cases—in other words, on

110. Dolzer, *supra* note 63, at 20-29; *see also* Moshe Hirsch, *Between Fair and Equitable Treatment and Stabilization Clause: Stable Legal Environment and Regulatory Change in International Law*, 12 J. WORLD INV. & TRADE 783, 805-06 (2011).

111. DOLZER & SCHREUER, *supra* note 6, at 19.

112. Dolzer generally supports the view that, under the legitimate expectations component of FET, contracts should establish *some* stabilization duty. *See* Dolzer, *supra* note 63, at 25-26. *But see* Crawford, *supra* note 4, at 373 ("The relevance of legitimate expectations is not a license to arbitral tribunals to rewrite the freely negotiated terms of investment contracts.").

whether and how much a tribunal must dig into terms of the contract to determine just what an investor can legitimately expect.[113] For one line of cases, FET contains a robust guarantee of legitimate expectations, applicable in full to investment contracts regardless of the underlying contractual arrangements; on the other view, FET imposes only a narrower minimal core on investment contracts, which may be expanded (and perhaps even constricted) by the terms of the underlying contract.

The broad approach to legitimate expectations in contracts cases is typified by a series of gas disputes against Argentina arising out of the 2001-2002 financial crisis, including *Sempra v. Argentina*, *Enron v. Argentina*, and *CMS Gas v. Argentina* (collectively, the *Argentine Gas Cases*).[114] Each of these disputes arose out of regulatory changes that severely devalued long-term gas distribution contracts between private investors and the Argentine State.[115] In the early 1990s, Argentina embarked on a comprehensive privatization program, part of which involved designing a regulatory framework covering the gas sector designed to attract FDI.[116] The framework included guarantees that companies could calculate rates in U.S. dollars and convert them to pesos at the prevailing exchange rate, to be recalculated every six months for the thirty-five-year life of the contract.[117] At the time, the peso was also pegged to the dollar.[118] As Argentina slipped into financial crisis in the l990s, the State took a series of emergency measures altering the regulatory framework for gas distribution: repealing the convertibility guarantees (requiring rates to be set in pesos); converting all rates from dollars into pesos at a rate of 1:1 ("pesification"); and subsequently devaluing the

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113. I owe this important clarification to Julianne Marley.

114. Sempra Energy Int'l v. Argentine Republic, ICSID Case No. ARB/02/16, Award (Sept. 28, 2007) [hereinafter *Sempra*]; *Enron*, ICSID Case No. ARB/01/3, Award (May 22, 2007); *CMS Gas*, ICSID Case No. ARB/01/8, Award (May 12, 2005). *See generally* José E. Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, *in* THE YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2008/2009, at 379 (Karl P. Sauvant ed., 2009) (discussing the decisions in the *Argentine Gas Cases*).

115. *See* Alvarez & Khamsi, *supra* note 114, at 379-88.

116. *See id.* at 388-89.

117. *Id.*

118. *See Sempra*, ICSID Case No. ARB/02/16, ¶ 82; Alvarez & Khamsi, *supra* note 114, at 389.

peso.[119] Needless to say, these measures severely depreciated the value of the underlying contracts and undermined their viability as investments.[120]

CMS, Sempra, and Enron each sued Argentina under the U.S.—Argentina BIT.[121] The key question in each case was whether the treaty guaranteed the investor rights of legal stabilization beyond what was contained in the contracts—whether, in other words, FET grafted a duty of stabilization onto the underlying contracts between the investors and the Argentine State.[122]

First, each case defined FET broadly to include a duty of stabilization.[123] The Tribunal in *CMS Gas* held that "[t]here can be no doubt ... that a stable legal and business environment is an essential element of fair and equitable treatment."[124] The *Enron* Tribunal concurred, adding that the standard protects investor expectations "derived from the conditions that were offered by the State to the investor at the time of the investment [and on which the investor relied]."[125] For Enron, such "offers" are not limited to the terms of the contract, but include the State's regulatory regime at the time of investment.[126] In each case, the Tribunal further noted that the stabilization component of legitimate expectations was an objective standard—to be assessed only in light of a measure's effects on the investor's bottom line, and not in light of the State's regulatory aims.[127] Each tribunal found Argentina had violated its obligation

119. *Sempra*, ICSID Case No. ARB/02/16, ¶ 116; *Enron*, ICSID Case No. ARB/01/3, ¶ 72; *CMS Gas*, ICSID Case No. ARB/01/8, ¶ 65.

120. *See Enron*, ICSID Case No. ARB/01/3, ¶ 81; *CMS Gas*, ICSID Case No. ARB/01/8, ¶¶ 69-72.

121. *See Sempra*, ICSID Case No. ARB/02/16, ¶ 5; *Enron*, ICSID Case No. ARB/01/3, ¶ 4; *CMS Gas*, ICSID Case No. ARB/01/8, ¶ 4.

122. Each of these contracts included some stabilization clauses of their own, but they fell short of the degree of stabilization being read into the treaty. *See* Alvarez & Khamsi, *supra* note 114, at 388-89, 391-92. The implicit issue here is whether the treaty clauses would afford investors greater protection than that available under the contracts.

123. Each tribunal was careful to note that the State might not be under a total stabilization requirement, but none clarified how far the requirement goes. *See CMS Gas*, ICSID Case No. ARB/01/8, ¶ 277; *see also Sempra*, ICSID Case No. ARB/02/16, ¶ 300; *Enron*, ICSID Case No. ARB/01/3, ¶ 261.

124. *CMS Gas*, ICSID Case No. ARB/01/8, ¶ 274.

125. *Enron*, ICSID Case No. ARB/01/3, ¶ 262 (footnote omitted).

126. *See id.* ¶ 264.

127. *See Sempra*, ICSID Case No. ARB/02/16, ¶ 304; *Enron*, ICSID Case No. ARB/01/3, ¶ 268; *CMS Gas*, ICSID Case No. ARB/01/8, ¶¶ 280-281.

to provide FET. As the *Enron* Tribunal stated, "[t]he measures in question ... have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented."[128]

What is hardly discussed in any of these cases is the relationship between FET and the underlying contracts, or the extent to which the tribunals' interpretations of the standard affect the contractual arrangement. Much like *SGS v. Paraguay*, *Sempra* merely waves the question away formalistically. According to the *Sempra* Tribunal, treaty claims and contract claims can be neatly separated.[129] In its view, the FET claim involves only the treaty, not the contract, because it arises out of the state's legislative action and is not exclusively and merely a commercial dispute about the contract—as if such things can be neatly separated.[130] Materially, on this view, FET protects investors' expectations to the same degree, no matter how they choose to invest; if the investment is structured through a contract, the treaty standard simply supplements that contract. In other words, the tribunals treat the contracts as generic assets, which are subject to additional treaty protections like "legitimate expectations" under FET on the pure property model.

If, however, we change our perspective to the point of view of the parties negotiating such a contract ex ante, it becomes clear that any such background rule must be considered as materially part of the deal. Where stabilization is permissible in national law at all, its presence or absence becomes a price term like any other. The assumption in the *Argentine Gas Cases* is that the treaty creates a background norm requiring the state to afford investors a degree of legal stabilization, whether or not they specifically negotiate a stabilization clause. At a minimum, on this interpretation of FET, stabilization becomes a default rule applying in contractual relations between states and foreign investors, regardless of whether or not the law of the contract includes any such principle. While it is not entirely clear whether this treaty-based default is something the parties could have expressly contracted around, the tribunals' strict

128. *Enron*, ICSID Case No. ARB/01/3, ¶ 264.
129. *See Sempra*, ICSID Case No. ARB/02/16, ¶ 310.
130. *See id.* ¶¶ 99-101.

separation of treaty and contract implies that the full measure of legitimate expectations under FET is effectively mandatory.

Another line of cases—typified by *Parkerings v. Lithuania*—presents a far narrower approach to FET in contract cases.[131] *Parkerings* concerned a 1999 contract between Parkerings, a Norwegian Company, and the municipality of Vilnius for the creation, operation, and enforcement of a new public parking system in the city.[132] The company was to retain, for a period of thirteen years, the rights to collect parking fees and to enforce the system through clamping delinquent cars and imposing fines.[133] Less than one year into the contract, however, the national government began taking measures that undercut Parkerings's rights under the contract—including the passage of national legislation that prohibited private companies from collecting parking fees and enforcing violations.[134] Lithuania eventually terminated the contract, and Parkerings sued the State under the Norway—Lithuania BIT.[135]

Parkerings claimed that Lithuania violated FET by frustrating the company's legitimate expectations.[136] The Tribunal was, however, fairly circumspect in its view of the treaty standard. In particular, the Tribunal found that a contract does not, of itself, give rise to expectations actionable under FET—nor does it create an obligation on states to stabilize their laws vis-à-vis the investor.[137] The Tribunal emphasized that a "State has the right to enact, modify or cancel a law at its own discretion," as a corollary to its "sovereign legislative power."[138] To the extent that FET entails any protection of an investor's expectations, no investor could legitimately expect that signing a contract with a state would entail a tacit promise of

131. *See Parkerings*, ICSID Case No. ARB/05/8, Award (Sept. 11, 2007); *see also* EDF Servs. Ltd. v. Rom., ICSID Case No. ARB/05/13, Award, ¶ 217 (Oct. 8, 2009) [hereinafter *EDF*] (objecting to the idea that FET might mean "the virtual freezing of the legal regulation of economic activities, in contrast with the State's normal regulatory power and the evolutionary character of economic life").

132. *Parkerings*, ICSID Case No. ARB/05/8, ¶ 82.

133. *Id.* ¶ 84.

134. *Id.* ¶ 328.

135. *Id.* ¶¶ 195, 201, 234.

136. *See id.* ¶¶ 196-197.

137. *See id.* ¶¶ 337-338.

138. *See id.* ¶ 332.

stabilization. To the contrary, the Tribunal stated that "any businessman or investor knows that laws will evolve over time."[139]

Importantly, the Tribunal focused on the deal as actually negotiated by the parties, emphasizing in particular the absence of a stabilization clause in the underlying contract.[140] As the Tribunal pointed out, in contract it is up to the parties themselves to allocate risk as they see fit.[141] If an investor wants to reduce risk, she "must anticipate that the circumstances could change, and thus structure [her] investment in order to adapt it to the potential changes of legal environment."[142] The Tribunal rightly analyzed expectations in terms of the parties' own risk allocation. Parkerings "could (and with hindsight should) have sought to protect its legitimate expectations by introducing into the investment agreement a stabilisation clause ... protecting it against unexpected and unwelcome changes."[143] If grounded in an express commitment in the underlying contract, it might indeed become legitimate to expect such stabilization for purposes of FET.[144] But, crucially, Parkerings would have had to pay for such a right, likely yielding a less attractive deal—assuming the state would have agreed at all. The Tribunal thus held, "By deciding to invest notwithstanding this possible instability, the Claimant took the *business risk* to be faced with changes of laws possibly or even likely to be detrimental to its investment."[145]

Nevertheless, the Tribunal did not entirely limit the effect of FET in contract cases. It considered that the treaty *does* impose a residual requirement on the state to refrain from exercising its legislative power "unfairly, unreasonably or inequitably" to the detriment of its private contracting partners.[146] But it viewed this condition minimally and found no evidence that Lithuania ran afoul of its

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139. *Id.*
140. *See id.* ¶¶ 334-338.
141. *See id.*
142. *Id.* ¶ 333.
143. *Id.* ¶ 336.
144. *See id.* ¶ 332.
145. *Id.* ¶ 336; *see also EDF*, ICSID Case No. ARB/05/13, Award, ¶ 217 (Oct. 8, 2009) ("Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework.").
146. *Parkerings*, ICSID Case No. ARB/05/8, ¶ 332.

obligations under the BIT.[147] In other words, for the Tribunal, FET imposes certain minimum levels of treatment on contracts, though the treaty standard's protection of legitimate expectations can be ratcheted up where the contract itself contains specific commitments like a stabilization clause or other heightened guarantee.[148] Left open is the borderline question of whether even the minimal vision of FET could be ratcheted down by the contracting parties by sufficiently explicit waiver. Nothing in the Tribunal's reasoning excludes the possibility that such conditions are themselves mere defaults (or sticky defaults). Ultimately, the line between the contents of FET and the treaty/contract question remains muddy. What is clear is that, for this line of cases, the content of an investor's legitimate expectations in contract cases depends mightily on what the state and foreign investor worked out in their deal.

The two lines of cases discussed above diverge sharply as to the *content* of legitimate expectations in FET. *CMS Gas*, *Enron*, and *Sempra* contemplate an objective test with strong stabilization effects.[149] *Parkerings* and its ilk contemplate a much more minimal test of fairness and reasonableness that is not based purely on the material effects of legislative change.[150] But they also differ on the separate issue of the relationship between treaty and contract. Abstracting from the substantive content of FET, both lines of cases seem to assume the treaty standard represents a background rule against which all contracting takes place. But they differ on whether and to what extent the underlying deal is relevant to determining just what the guarantee of legitimate expectations might entail. The implication of the *Argentine Gas Cases* is that legitimate expectations is comprehensive and effectively mandatory.

147. *See id.* ¶¶ 336-338.

148. *See id.* ¶ 332; *see also EDF*, ICSID Case No. ARB/05/13, ¶ 217; *Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award, ¶ 423 (July 8, 2016) ("[C]hanges to general legislation (at least in the absence of a stabilization clause) are not prevented by the fair and equitable treatment standard if they do not exceed the exercise of the host State's normal regulatory power ... and do not modify the regulatory framework relied upon by the investor at the time of its investment 'outside of the acceptable margin of change.'" (quoting Claimants' Memorial on the Merits ¶ 243, *Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7)).

149. *See Sempra*, ICSID Case No. ARB/02/16, Award, ¶ 304 (Sept. 28, 2007); *Enron*, ICSID Case No. ARB/01/3, Award, ¶ 268 (May 22, 2007); *CMS Gas*, ICSID Case No. ARB/01/8, Award, ¶¶ 280-281 (May 12, 2005).

150. *See Parkerings*, ICSID Case No. ARB/05/8, ¶¶ 336-338.

This is particularly clear in *Sempra*, which, like *SGS v. Paraguay*, forcefully frames FET as a treaty obligation totally distinct and severable from the contract—one which applies in full force on top of any investment contract, regardless of what the contract says.[151] By contrast, the implication of *Parkerings* and its ilk is that FET's contents depend mightily on what the contracting parties actually agreed. On this reading, FET includes a minimal core, but it clearly acts as a kind of default—it can be ratcheted up by the contracting parties and arguably even watered down.

For analytical purposes I have tried to keep separate the question of FET's content and that of its relationship to investment contracts. However, it bears noting that in the real world—the world actually lived by parties engaged in negotiating investment projects— these questions surely interrelate. Indeed, the content of the FET standard will turn out to matter quite a bit, from the perspective of contract theory, when we turn to the normative question of how adjudicators *ought* to resolve the treaty/contract question.[152] If FET is an extremely robust standard of protection incorporating a stabilization requirement, then it will be critical to the state (and arguably to investors) to be *able* to contract around it. However, the sting of the problem dissipates as the interpretation of FET narrows. Even if the core of FET is mandatory with respect to contracts, but limited to something like a guarantee that the state will use its sovereign powers in good faith, its consequences would be far less intrusive.

C. Damages

The realm of potential interactions between treaty and contract on questions of substantive law goes well beyond standards of treatment like FET and expropriation. Indeed, investment treaties create fulsome regimes of background rules which, if applicable, would

151. *See Sempra*, ICSID Case No. ARB/02/16, ¶¶ 296-304. This formalistic recitation obscures the material relationship between these instruments. From the point of view of two contracting parties negotiating ex ante, the question of whether their deal will create a stabilization obligation for the state by triggering a treaty obligation will absolutely bear on the material meaning of the contract. If known and understood, it would be viewed as an implied price term that obviously affects the allocation of risk.

152. *See infra* Part III.

cover most aspects of the life of the contract. Of these, rules on the measure and calculation of damages are among the most important.

All contracts entail rules on damages—either in their express terms, or by default under the law of the contract. Often, in national legal orders, contracts with the state are not automatically subject to the fullest measure of expectation damages. In such instances, where the government opts to breach, investors are typically entitled to some lesser measure—like recuperation of reasonable reliance damages.[153] The rationale is typically an entrenchment concern about regulatory autonomy and the possibility of chill—a worry that one government might tie the hands of future governments through privatization contracts.[154] By contrast, the usual measure of damages in international investment law is, today, fair market value (FMV).[155] In cases involving the expropriation of property, FMV is typically measured in terms of the present value of the asset, taking into account its capacity to generate income over time.[156] Applied to contracts, this measure of damages is more or less equivalent to expectation damages. If the law of the contract calls for mere reliance damages by default, but the investment treaty calls for FMV, which controls? And what happens when the parties explicitly negotiate for a particular measure of damages, say in a liquidated damages clause? Here again, the cases display significant variation without much outright discussion of the issue.

Notably, investment treaties do not usually include express, general provisions on damages applicable to each and every treaty standard.[157] Typically, provisions on expropriation do include language on compensation—usually invoking FMV.[158] But standards like FET tend to be laconic on the issue, leaving much up to the adjudicator's discretion.[159] Suffice it to note, for present purposes,

153. *See* Serkin, *supra* note 9, at 916; *see also* Daniel R. Fischel & Alan O. Sykes, *Government Liability for Breach of Contract*, 1 AM. L. & ECON. REV. 313, 316 (1999).

154. *See* Serkin, *supra* note 9, at 894-96; *see also* Arato, *supra* note 2, at 273.

155. *See* Factory at Chorzów (Ger. v. Pol.), Merits, 1928 P.C.I.J. (ser. A) No. 17, at 47 (Sept. 13).

156. *See, e.g.*, *id.*

157. *See* Pierre-Yves Tschanz & Jorge E. Viñuales, *Compensation for Non-Expropriatory Breaches of International Investment Law: The Contribution of the Argentine Awards*, 26 J. INT'L ARB. 729, 729-30 (2009).

158. *See* SERGEY RIPINSKY & KEVIN WILLIAMS, DAMAGES IN INTERNATIONAL INVESTMENT LAW 78-79 (2008).

159. *See* Alvarez & Khamsi, *supra* note 114, at 404-05; Tschanz & Viñuales, *supra* note

that the tendency is to read FET in light of customary international law principles of compensation applicable in relations between states, which ultimately means FMV.[160]

Some cases simply assume that, once a treaty breach is involved, damages must be assessed under international law principles. *CMS Gas*, *Sempra*, and *Enron* are typical in this regard. Again, these Tribunals each found Argentina in breach of FET for enacting emergency measures that severely diminished the value of the investors' contracts.[161] Once these Tribunals determined that the state had violated FET, they simply assumed that the appropriate measure of damages was to be drawn from international law—meaning, in their view, FMV.[162] Under that rubric, the Tribunals measured each private party's losses in light of expected future earning potential over the thirty-five-year life of the contract, calculated via discounted cash flow (DCF) analysis—which amounts to a sophisticated approach to expectation damages in the context of long-term investment contracts.[163]

While each of the *Enron*, *Sempra*, and *CMS Gas* Tribunals took pains to explain why FMV was the appropriate measure for assessing violations of FET as a matter of international law, none even considered whether international law was the right place to look in cases arising out of contracts. None examined whether the appropriate measure of damages might rather be found in the underlying contract over which the claim arose—either in its express terms or in the default rules of the law of the contract (Argentine law in each case). They simply took as a given that international law supplied the answer.[164] Under this rule, contracting parties would have to

157, at 733.

160. *See* Alvarez & Khamsi, *supra* note 114, at 405; Tschanz & Viñuales, *supra* note 157, at 735.

161. *See Sempra*, ICSID Case No. ARB/02/16, Award, ¶ 304 (Sept. 28, 2007); *Enron*, ICSID Case No. ARB/01/3, Award, ¶ 268 (May 22, 2007); *CMS Gas*, ICSID Case No. ARB/01/8, Award, ¶ 281 (May 12, 2005).

162. *See Sempra*, ICSID Case No. ARB/02/16, ¶¶ 400-403; *Enron*, ICSID Case No. ARB/01/3, ¶¶ 359-363; *CMS Gas*, ICSID Case No. ARB/01/8, ¶ 410.

163. *See Sempra*, ICSID Case No. ARB/02/16, ¶ 416; *Enron*, ICSID Case No. ARB/01/3, ¶¶ 384-385; *CMS Gas*, ICSID Case No. ARB/01/8, ¶ 411.

164. A similar issue regarding investment contracts and FMV arose in *ExxonMobil v. Venezuela* and *ConocoPhillips v. Venezuela*. *See* Venez. Holdings B.V. v. Bolivarian Republic of Venez., ICSID Case No. ARB/07/27, Award (Oct. 9, 2014) [hereinafter *ExxonMobil*]; *ConocoPhillips*, ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits (Sept. 3,

assume, ex ante, that investment treaties displace domestic contract law on the question of damages in FET (and expropriation) cases, establishing expectation damages as the new background rule. And, while it is not entirely clear how sticky such a rule might be, from the way these tribunals formalistically severed treaty and contract, the strong implication is that expectation damages qua FMV should be understood as effectively mandatory.[165] It seems unlikely that these tribunals would have been swayed by even express contractual provisions on damages.[166]

Other tribunals have taken a more nuanced approach to damages in disputes arising out of investment contracts, more mindful of the parties' underlying contractual arrangements. *Kardassopoulos v. Georgia* addressed the issue in particularly clear dicta. Seemingly echoing the *Argentine Gas Cases*, the *Kardassopoulos* Tribunal noted that the claims were treaty-based—grounded in violations of

2013). These cases involved similar underlying oil contracts, which contained specific clauses limiting contractual damages. *ExxonMobil*, ICSID Case No. ARB/07/27, ¶ 61; *ConocoPhillips*, ICSID Case No. ARB/07/30, ¶¶ 375-376. In these cases, the contracts were between investors and state-owned entities. Like the *Argentine Gas Cases*, the *ExxonMobil* Tribunal held that the appropriate damages rule under the applicable BIT was FMV (for an expropriation claim). It ignored, and thereby effectively displaced, the contractual limitations on compensation explicitly incorporated in the contract—finding those limitations opposable only to the state-owned entity that was formally party to the contract, and not the State itself. *ExxonMobil*, ICSID Case No. ARB/07/27, ¶ 373. The issue has yet to be addressed fully by the Tribunal in *ConocoPhillips* (the Tribunal has yet to rule on damages at time of writing). Yet, Arbitrator Georges Abi-Saab raised the issue preemptively in a dissent to the Decision on Jurisdiction and Merits (prior to his resigning from the tribunal for health reasons). *See ConocoPhillips*, ICSID Case No. ARB/07/30, Dissenting Opinion of Georges Abi-Saab to Decision on Jurisdiction and Merits (Feb. 19, 2015). In Abi-Saab's view, even if the treaty imposes an FMV standard, any express limitations on profits must be considered in assessing the contract's fair market value for purposes of assessing compensation or damages. *Id.* ¶ 34 ("[T]he calculation of the market value of the nationalized investment *in casu*—consisting of contractual rights ... has necessarily to take into account (i.e., to pass by or be filtered through) the compensation clauses of these Agreements which quantify and limit those rights protected by the BIT."). In other words, for Abi-Saab, FMV cannot act to impose a measure of expectation damages blind to express provisions in the contract that limit compensation, because that would *overstate* the contract's value on the open market. Crucially, he explains that this conclusion rests "not only on legal, but also on economic grounds." *Id.* ¶ 35. Futher, he explains "how can any *homo economicus* exercising rational choice as a 'willing buyer' of ConocoPhillips shares or contractual rights in the Strategic Association Agreements, calculate the price he would be willing to pay, without factoring in (or taking into account) the terms of the compensation clauses of the Agreements?" *Id.* ¶ 37.

165. *See, e.g.*, *Sempra*, ICSID Case No. ARB/02/16, ¶ 401.

166. *See, e.g.*, *ExxonMobil*, ICSID Case No. ARB/07/27, ¶¶ 61, 373.

FET and expropriation.[167] As a result, for the Tribunal, "the relevant provisions for the purpose of both liability and quantum are contained in the treaties and, more broadly, international law"[168]—which, for both claims, turned out to be FMV.[169] However, the Tribunal did not treat the separation between treaty and contract as entirely strict. It noted that its "finding is without prejudice to a host State and an investor's ability to contractually limit the compensation which may be owed following an expropriation where a treaty is also in play."[170] The Tribunal added that it would be "loathe to accept the categorical denial of such an arrangement ... as a matter of law."[171] Clearly, in its view, the treaty rule on damages is only a default.

Going further, the Tribunal began to consider how informed parties might contract around a treaty on questions of damages—asking, in other words, how sticky the treaty default might be. The Tribunal drew attention to an exchange with the Claimants at oral argument, where the latter hesitantly acknowledged that investors and governments could contract around an investment treaty through a clear liquidated damages clause or other cap on damages.[172] One of the arbitrators (Vaughn Lowe) pressed the Claimants on this point, asking the crucial question of what such a clause would look like if the parties intended to contract around the treaty.[173] The Claimants responded that to validly contract out, the clause "would [have to] say, 'notwithstanding article 11 of the Energy Charter Treaty, the parties hereby agree that', or it would say, 'Notwithstanding the provisions of public international law.'"[174] The Claimants' point was similar to that of the *Crystallex* Tribunal in the context of forum selection: that contracting out would be possible if the contractual language indicated both parties' awareness of

167. Kardassopoulos v. Republic of Georg., ICSID Case Nos. ARB/05/18 & ARB/07/15, Award, ¶¶ 480-481 (Mar. 3, 2010) [hereinafter *Kardassopoulous*].

168. *Id.* ¶ 480.

169. *See id.* ¶¶ 501-504, 533-534.

170. *Id.* ¶ 481.

171. *Id.*

172. *See id.*

173. *See id.* (discussing Hearing Transcript at 71-75, *Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15 (Mar. 3, 2010)).

174. *Id.* (quoting Hearing Transcript at 71-75, *Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15 (Mar. 3, 2010)).

the existence of the relevant treaty standards.[175] Put in contract-theoretical terms, on the Claimants' understanding, the treaty rules on damages would thus represent a fairly sticky default, whose stickiness would be justified on an information-sharing rationale.[176]

Ultimately, however, *Kardassopoulos* did not decide the issue. In the end the Tribunal did not inquire into whether the contract or treaty took precedence in this case because it determined that the question would make no material difference.[177] In view of the particular stabilization clauses in the underlying contract, the Tribunal considered that "the result would be the same as the application of international law principles of compensation."[178] The Tribunal thus disposed of the damages issue under the FMV principles of the relevant treaties.

From the ex ante contracting perspective, the *Argentine Gas Cases* and *Kardassopoulos* offer two competing answers to the treaty/contract issue. Each of these cases accepts that FMV reflects the correct approach to damages under FET (meaning expectation damages in contract cases). However, the former cases simply assume that a violation of FET invokes the international law standard of damages, whatever the contract (or law of the contract) provides.[179] *Kardassopoulos*, by contrast, acknowledges that the contracting parties can control damages in their own arrangements if they do so expressly.[180] From the contracting perspective, the former approach positions treaty damages as something like a mandatory background rule. The latter rather understands treaty damages as a default—leaving it unclear just how sticky a default it might be.[181]

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175. *Compare id.*, *with Crystallex*, ICSID Case No. ARB(AF)/11/2, Award, ¶ 482 (Apr. 4, 2016).

176. The *Kardassopoulos* discussion is exceptionally helpful analytically because, like *Crystallex*, it raises the all important question of how a sticky default might be contracted around—a point even domestic courts frequently elide, but which strongly tests the rationale behind the rule's stickiness. *See* Ayres, *supra* note 27, at 2092-96.

177. *See Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15, ¶ 483.

178. *Id.* ¶ 482.

179. *See Sempra*, ICSID Case No. ARB/02/16, Award, ¶¶ 400-403 (Sept. 28, 2007); *Enron*, ICSID Case No. ARB/01/3, Award, ¶¶ 359-363 (May 27, 2007); *CMS Gas*, ICSID Case No. ARB/01/8, Award, ¶ 410 (May 12, 2005).

180. *See Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15, ¶¶ 480-481.

181. *See id.* ¶¶ 480-482.

D. Jurisprudential Uncertainty

The jurisprudence on the treaty/contract issue lies in disarray. The question is handled irregularly within and across all treaty issues, from forum selection to substantive obligations and damages. Such uncertainty is a real problem in private law. From the ex ante perspective, states and foreign investors cannot be confident about the meaning of any contract they ultimately adopt. Will the contract be augmented by the background norms set by an applicable investment treaty? If so, are such provisions mandatory, or are they subject to negotiation—can the parties opt out of treaty arrangements if they prefer to allocate risk in a different way? And, if the treaty rules are mere defaults, how sticky are they? Must parties do anything specific to contract around their parameters, to ensure that tribunals give force to their choices? The cases give wildly different answers to these questions, typically without much explanation.[182] Such uncertainty is problematic, to say the least, in the sensitive realm of high risk, high value foreign investment projects—where it can strongly affect the state's regulatory capacities and where disputes often turn into "bet-the-company" cases.

As a first step, it is essential to see how tribunals' implicit choices affect investment contracts, and what they mean for future contractual negotiations between states and foreign investors. It is crucial, in this regard, to get past the formalistic idea that treaty and contract claims are on purely separate tracks. Treaty and contract cannot be neatly separated. In Crawford's words, "treaties and contracts are different things. But they are not clean different things ... between them there is no great gulf fixed."[183] And as Arbitrator Abi-Saab puts it, to simply "assert ... that the treaty applies, without taking into consideration the terms of the contract, amounts to revising and rewriting the contract."[184] Taking the ex ante perspective of states and foreign investors—as contracting

182. Only a handful of cases address the treaty/contract issue directly. *See, e.g.*, *Crystallex*, ICSID Case No. ARB(AF)/11/2, Award, ¶¶ 481-482 (Apr. 4, 2016); *Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15, ¶ 211; *SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 92 (Jan. 29, 2004).

183. Crawford, *supra* note 4, at 373.

184. *ConocoPhillips*, ICSID Case No. ARB/07/30, Dissenting Opinion of Georges Abi-Saab to Decision on Jurisdiction and Merits, ¶ 29 (Feb. 19, 2015).

parties—helps to clarify how these messy interactions might be better harmonized.

Under most interpretations, where a treaty claim arises out of a contract dispute, the treaty adds (or can add) *something* to the contract—whether a heightened standard of treatment under FET, a new measure of damages, or access to international fora. Cases like *SGS v. Paraguay* and the *Argentine Gas Cases* insist that these additions arise purely out of the treaty and are completely separate from the contract.[185] But this reasoning is overly formalistic—focused too much on the general relationship between international and national sources of law, and not enough on the private law logic of those very contracts the treaty seeks to protect.[186]

From the ex ante perspective of the parties to an investment contract, the strict separation refrain only obscures the treaty's material, economic effect on the contract. Formalities aside, if the contracting parties are aware that an overarching treaty will add to or alter their bargain, they will have to consider such alterations materially part of the deal. From their point of view, the treaty creates a fairly comprehensive set of background rules supplementing their arrangements. Parties with any sophistication will have to price these norms into their contract, or weigh whether to contract around them.

From this vantage point, it becomes clear how much it matters *how* we think about these background norms—a point distinct from the *content* of the treaty provisions, and obscured by the neat separation of treaty claims from contract claims. If, as in the strict separation logic, an investor's treaty rights cannot be affected or

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185. *See, e.g.*, *Sempra*, ICSID Case No. ARB/02/16, Award, ¶ 310 (Sept. 28, 2007); *see also supra* notes 83-89, 129-30 and accompanying text.

186. Contrast this to the logic of the CISG, as an international treaty which clearly seeks to erect international background rules to govern transnational sales contracts, but which explicitly allows private nonstate actors to contract around its terms. *See* CISG, *supra* note 3, art. 6. Nothing about the *general* relationship between international law and national law prevents an international treaty from envisioning—even encouraging—private parties to opt out through their transnational contracts. To the contrary, enshrining the capacity to opt out is one of the CISG's central features. Though investment treaties differ from the CISG in their silence on this issue, it is important to see how nothing about the general relationship between international and national law bars treaties from establishing a more integrated approach oriented toward private-party choice. The real question tribunals should be asking is what kind of relationship, between treaty and contract, BITs envision, interpreted in light of their object and purpose to protect and promote foreign direct investment.

disclaimed by the terms of the contract, then the treaty provisions act as mandatory investment protections and cramp the parties' ex ante ability to efficiently allocate risk. But if the treaty rules are defaults, as in the reading of *Kardassopoulos*, *Crystallex*, and *SGS v. Philippines*, the parties may then dicker over them in their negotiations as they would with any other price term.[187] On this reading, the treaty may well change the baseline for negotiations by supplanting potentially more lenient default structures in the national law of the contract, perhaps putting the state more on the back foot. But the parties will still be able to negotiate over the ultimate allocation of risk and reward.

It matters how investment treaties interact with contracts, and it is troubling that on this issue the cases have been irregular, inconsistent, and often markedly unclear.[188] There do seem to be trends. Tribunals apparently tend more toward making assumptions that render investment treaty provisions effectively mandatory, as in the *Argentine Gas Cases* and *SGS v. Paraguay*.[189] But a significant minority of tribunals have taken party choice in contract more seriously, viewing investment treaties as defaults of varying degrees of stickiness. As in *Kardassopoulos* and *Crystallex*, some tribunals have viewed treaty provisions as highly sticky defaults, which apply unless the contracting parties opt out with exceedingly clear and specific language.[190] And a handful of others buck the trend even further, as in *SGS v. Philippines* and *Oxus*, viewing treaty provisions as simple default rules, wholly subject to contracting party choice.[191] These variations are not limited to any particular

187. *See, e.g.*, *Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15, ¶¶ 216-223; *see also supra* notes 90-97 and accompanying text.

188. *Compare SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 134 (Jan. 29, 2004) (viewing treaty dispute resolution provisions as defaults), *with Crystallex*, ICSID Case No. ARB(AF)/11/2, Award, ¶ 482 (Apr. 4, 2016) (viewing treaty dispute resolution provisions as highly sticky defaults), *and SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶¶ 138-142 (Feb. 12, 2010) (viewing treaty dispute resolution provisions as mandatory).

189. *See also, e.g.*, *ExxonMobil,* ICSID Case No. ARB/07/27, Award, ¶¶ 61, 373 (Oct. 9, 2014); *see also supra* notes 86-88, 150 and accompanying text.

190. *See Crystallex*, ICSID Case No. ARB(AF)/11/2, ¶ 482; *Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15, ¶ 481.

191. *See SGS v. Philippines*, ICSID Case No. ARB/02/6, ¶ 134; *Oxus*, UNCITRAL, Final Award, ¶ 958 (Dec. 17, 2015); *see also BIVAC v. Paraguay*, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, ¶ 148 (May 29, 2009).

treaty provision or issue, and they are occurring with increasing frequency.

The main goal of this Part has been to highlight and analyze the disorder in the case law on the interaction between treaty and contract. One normative point should, however, already be obvious. The current state of uncertainty is hugely problematic from the ex ante perspective of contracting parties—states and foreign investors—who cannot be confident about the material meaning of any contractual arrangements under the shadow of an investment treaty. This makes planning extremely difficult and expensive, as rational states and investors will have to build insurance into their arrangements. And it adds significant transaction costs to the contracting process. If sufficiently well understood, such uncertainty risks seriously chilling contractual relations between states and foreign investors—precisely the opposite of what investment treaties seek to achieve.

The next Part shifts more fully from the descriptive to the normative. I start from the position that certainty and consistency of any kind would already be a boon.[192] However, I argue that tribunals' apparent tendency to privilege treaty norms over negotiated contract provisions reflects the wrong approach from the perspective of contract theory—in most, though perhaps not all, instances.

III. EFFICIENCY, AUTONOMY, AND THE FUNCTION OF CHOICE

Thus far I have argued that the moment investment treaties are made to apply to contracts, they establish some kind of international law of contracts. Given that the treaties are invariably laconic on this issue, however, it is difficult to determine just what kind of law they create. Investment treaties clearly establish full panoplies of substantive and procedural rules that relate to all investments in

192. Note that the problem of uncertainty is not likely to improve through arbitral action alone, given that investment tribunals are constituted on a one-off basis with total discretion to reinvent the wheel on this issue in each case. *See* Arato, *supra* note 2, at 289, 294. Treaty change is necessary—either to clarify the treaty/contract relationship as is done in the CISG, or—more radically—through instituting a centralized investment court along the lines recently championed by the European Union. But note, on this issue, change need not be systemic to have an important effect—it is not essential that all investment treaties change all at once. Clarifying the treaty/contract relationship in any one treaty will have the effect of enhancing certainty for its state parties and all covered investors. *See infra* Conclusion.

some way. Their application to contracts might be fully extensive—supplying norms ranging from breach, defenses, and damages to forum selection. Investment treaties might also be read more narrowly, as applying to contracts more minimally than they would to assets like real property. Likewise, these treaty rules might be read as rigid provisions that apply over and above the parties' choices, or more flexibly as defaults to be contracted around. On all these questions the treaties remain silent—and the jurisprudence has oscillated among these possibilities, compounding the uncertainty facing states and investors contemplating contractual relations. An international law of contracts is gradually emerging, but its contours are yet to be defined.

This Part examines how the treaty/contract issue ought to be approached. Contrary to arbitral tendencies, I suggest that it should generally be presumed that explicit contractual provisions prevail over treaty provisions as the authentic expression of the contracting parties' division of risk. In the first place, as a matter of treaty interpretation under international law, a general presumption that treaties create mere defaults is essential to the object and purpose of these treaties—to protect and promote foreign direct investment. There are also strong policy reasons for understanding most treaty rules as mere defaults, grounded in both the logic of private law and in concern for public regulatory values. But this conclusion is not an absolute. Even on these rationales there may be reasons why, in certain limited cases, treaty rules ought to be understood as sticky defaults. By hypothesis, I explore the possibility that forum selection clauses and the general exceptions provisions might be justifiable candidates. It may even be that some treaty provisions ought to be understood as mandatory. Still, crucially, I argue that these choices must be justifiable in light of both the positive law of the treaty and the private and public values it seeks to promote.

Especially since the nature of the treaty/contract relationship is generally undecided in treaty text, the first touchstone for treaty interpretation must be the investment treaty's object and purpose.[193] This entails, in most cases, the twin overarching goals of protecting

193. *See* Vienna Convention on the Law of Treaties art. 31(1), May 23, 1969, 115 U.N.T.S. 331, 340 ("A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.").

and promoting investments. Investment treaties are not solely about endowing foreign direct investment with protections as a matter of justice or fairness to the investors. Rather, states agree to afford such protections in order to *encourage* investment, which they view as essential drivers of development and a key component of diversified economic health.[194] If states did not want to induce investment, they would not sign modern investment treaties.

Yet different provisions may well serve these treaties' goals in different ways. There is no reason to assume that answers to the treaty/contract issue must be the same across all provisions of an investment treaty. Neither the treaties nor customary international law require any single generalizable approach. True, as Professor Crawford notes, the customary conflicts rule applies in investor-state arbitration—whereby international law prevails over domestic law in case of conflict.[195] But a conflict would arise only if we assume the treaty creates mandatory rules. As Professor Craswell explains, a contract does not conflict with a contrary default rule in any meaningful way, since the key function of default rules is to give way to the choices of the parties.[196] And the relationship between international law and national law poses no particular problem in this regard, as is clearly evident in the realm of transnational sale of goods. The multilateral CISG is, after all, almost completely comprised of default rules, which private actors can freely contract around.[197] The real problem in investment law is that, while the treaties expressly apply to contracts-as-investment, they completely fail to address how treaty and contract thus interrelate. In the absence of any other general rules of international law on point, the issue of how contract relates to treaty must be asked anew vis-à-vis each particular treaty, and each particular treaty provision, bearing

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194. *See* DOLZER & SCHREUER, *supra* note 6, at 22, 29-30; Anne van Aaken & Tobias A. Lehmann, *Sustainable Development and International Investment Law: A Harmonious View from Economics*, *in* PROSPECTS IN INTERNATIONAL INVESTMENT LAW AND POLICY 317, 329-32 (Roberto Echandi & Pierre Sauvé eds., 2013); Anthea Roberts, *Triangular Treaties: The Extent and Limits of Investment Treaty Rights*, 56 HARV. INT'L L.J. 353, 380 (2015); Yackee, *supra* note 12, at 398. For a more nuanced take, see José E. Alvarez, *A BIT on Custom*, 42 N.Y.U. J. INT'L L. & POL. 17, 41-42 (2009) (rejecting a "mono-causal" explanation of why States sign BITs, and advancing a number of important geo-political considerations in play).

195. *See* Crawford, *supra* note 4, at 353.

196. *See* Craswell, *supra* note 7, at 1.

197. *See* CISG, *supra* note 3, art. 6.

in mind the overarching object and purpose to protect and promote foreign direct investment. The outstanding question is whether there might yet be some guiding principle, and, if so, where to find it.

What is clear is that, to the extent treaties apply to contracts, the point is in part to protect the parties' contractual arrangements. Certainly investment treaties are meant to provide an added level of security to the parties' relations. But the point is just as surely to do so in a way that encourages contractual relations between states and foreign investors—to better enable the parties to plan together and allocate risk in their joint affairs—not to make planning more difficult. From this point of view, it would be quite problematic if treaties were to stand in the way of the parties' ability to allocate risk as they see fit—at least as a general matter. Bearing in mind that treaties apply to investment contracts *in order to protect the bargain*, and to promote such bargaining in the future, it stands to reason that treaty protections should not generally denature contractual arrangements freely negotiated by states and foreign investors. If the goals of the treaty are understood as calling for *respect* for investment contracts, then it stands to reason that the guiding principle to resolving the treaty/contract question should be drawn from within the private law logic of contract.[198]

A. The Function of Choice in the Logic of Contract

It is useful to consider more closely the core conceptual difference in the logics of contract and property, in light of the goals of investment treaties to protect and promote foreign direct investment. With property, protection and promotion demand a certain kind of application of the treaty rules. To act as inducements, the treaty rules will have to impose a regular set of protections for foreign-owned property. The regularity of these protections, along with the levels of protection and the availability of an international forum are the incentives to invest. With contracts, the situation is different. Here, foreigners and sovereigns negotiate the risks themselves in the first cut. They structure and govern their own

198. *See* DAGAN & HELLER, *supra* note 16; Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 LAW & SOC'Y REV. 239, 254-56 (1983).

relationships. In this context, it is no longer clear that superimposing treaty protections on the asset in question—a carefully negotiated allocation of rights, duties, and risks—will have a positive effect on promoting investment. For the most part, ex ante, states and investors alike will want their own choices to control. Anything they cannot control will have to be priced into the contract. Too much rigidity can seriously undercut the parties' ability to reach efficient outcomes, and too much stickiness can make the transaction costs of drafting intolerably high.

Put another way, in most instances, the closer that treaties come to imposing property-style rules on contracts, the more pressure they will put on the desirability of contracting in the first place. And herein lies the problem with the current tendency among investment tribunals, who do just that when they assume that treaty rules simply prevail over contract provisions negotiated by the parties.[199] Property and contract have quite distinct organizational logics—and only the logic of contract serves to adequately guide the disposition of investment treaty provisions in relation to investment contracts. In light of the objects and purposes of investment treaties, there is good reason to distinguish between property and contract here and to treat contract claims with quite a bit more nuance than we have seen.

The basic organizing principle in the logic of contract is choice. There are, of course, great debates about the ultimate value (or values) of contract—whether it is the autonomy of the parties,[200] or a more utilitarian vision of efficiency.[201] This is not the place to wade deep into that discourse. Suffice it to say that, across all these visions of contract, *choice* is ultimately fundamental. The centrality of choice is obvious for those that emphasize autonomy and promise as the moral and legal core of contract.[202] But choice has just as

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199. *See, e.g.*, *SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶¶ 37-42 (Feb. 12, 2010); *Sempra*, ICSID Case No. ARB/02/16, Award, ¶¶ 372-373 (Sept. 28, 2007); *Enron*, ICSID Case No. ARB/01/3, Award, ¶¶ 202-209 (May 27, 2007); *CMS Gas*, ICSID Case No. ARB/01/8, Award, ¶¶ 115-123 (May 12, 2005).

200. *See, e.g.*, DAGAN & HELLER, *supra* note 16 (manuscript at chs. 4-7); FRIED, *supra* note 14, at 71-73; Kraus, *supra* note 15, at 1611-19; Seana Valentine Shiffrin, *Promising, Intimate Relationships, and Conventionalism*, 117 PHIL. REV. 481, 520 (2008).

201. *See, e.g.*, Schwartz & Scott, *supra* note 21, at 552.

202. *See, e.g.*, FRIED, *supra* note 14, at 71-73; Kraus, *supra* note 15, at 1611-19; Shiffrin, *supra* note 200, at 520.

significant a function in utilitarian theories of contract. In the law and economics approach of scholars like Professors Schwartz and Scott, efficiency is the central value—not autonomy—but, critically, efficiency is left up to the market.[203] Party choice is still given as much respect as possible because, on this view, the parties are usually themselves better positioned to allocate risk efficiently than courts or legislatures—particularly in the case of sophisticated parties engaged in commercial contracts.[204] Cutting a middle path between these classic theories, one recent and compelling account makes choice the centerpiece. Professors Dagan and Heller's liberal "choice theory of contract" gives autonomy pride of place but builds efficiency into the theory as one of the primary goods contracting parties seek to achieve (along with community).[205] This approach usefully distinguishes between types of contracts as an important aspect of choice. In at least some kinds of contracts, particularly commercial contracts between sophisticated parties, efficiency is all the parties seek to achieve—and we can assume that their choices are oriented toward such outcomes.[206] In other kinds of contracts, values like community might be emphasized—as with marriage contracts or nonprofit charters.[207] Thinking about contracts in terms of types may affect our assumptions about just what the parties have chosen in particular instances and may give reason to nudge parties one way or another through sticky defaults and mandatory rules. But ultimately, on this theory, the point of contract law is to prioritize choice—to make choice meaningful. The bottom line is, whether we emphasize efficiency or autonomy and whatever values particular parties emphasize in particular contracts, it should be clear that choice lies at contract's heart.

The logic of contract law is thus inextricably oriented around respect for party choice: choices about what kinds of contract to adopt, and choices about the terms within any particular contract.[208] To the extent that investment treaties apply to contracts, they create contract law—and this law should resonate with contract's basic

203. *See* Schwartz & Scott, *supra* note 21, at 618.
204. *See id.*
205. *See* DAGAN & HELLER, *supra* note 16.
206. *See id.* (manuscript at ch. 6).
207. *See id.*
208. *See id.*

logic. In determining the interaction between investment treaty and state contract, the first principle should be respect for the contracting parties' own choices—though this surely means treaties will apply differently to contracts than other assets like real property, or, for that matter, sovereign debt or intellectual property.[209] Treaties, in other words, should not normally be used to rewrite contractual arrangements.[210] Whatever their content, the basic presumption should be that investment treaty norms apply to contracts as no more than defaults, which the parties are free to contract around.

B. Valuing of Choice in the Law and Policy of Foreign Direct Investment

Beyond bringing the burgeoning investment treaty law on contracts into greater coherence with contract theory, the choice-oriented approach advocated here offers tangible policy payoffs for international investment law. Most debates in the field treat the interests of states and investors as essentially zero-sum. The battle lines tend to be drawn over how much investment treaties constrict the state's policy space,[211] or how much they undercut its sovereign authority.[212] Too often this debate is portrayed as a conflict between

209. *See Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award, ¶ 481 (July 8, 2016) (recalling that trademarks are not normally insulated from regulatory interference, the Tribunal explained that "if investors want stabilization they have to contract for it").

210. *See* Crawford, *supra* note 4, at 373.

211. *See, e.g.*, Markus Wagner, *Regulatory Space in International Trade Law and International Investment Law*, 36 U. PA. J. INT'L L. 1, 8-10 (2014).

212. Critics have tried to reconceive international investment law in public law terms in hopes of rebalancing the regime toward states. *See* 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, 304-08 (2010) (invoking the "margin of appreciation"); Mattias Kumm, *An Empire of Capital? Transatlantic Investment Protection as the Institutionalization of Unjustified Privilege*, EUR. SOC'Y INT'L L. REFLECTIONS, May 25, 2015, at 1, 4 n.2, 7 (invoking "proportionality" and "subsidiarity"); Alec Stone Sweet, *Investor-State Arbitration: Proportionality's New Frontier*, 4 LAW & ETHICS HUM. RTS. 47, 76 (2010) (invoking "proportionality"); *see also* Stephan W. Schill, *Deference in Investment Treaty Arbitration: Reconceptualizing the Standard of Review*, 3 J. INT'L DISP. SETTLEMENT 577, 579-80 (2012). I am sympathetic to public law scholars' concern about the threat the regime poses to public values. But I am skeptical of the too-easy invocation of national or transnational public law doctrines as a panacea for global investment law—for both principled and contingent reasons, given current institutional arrangements. *See* Julian Arato, *The Margin of Appreciation in International Investment Law*, 54 VA. J. INT'L L. 545, 548-52 (2014); *see also Philip Morris v. Uruguay*,

commercial lawyers who tend to be "investor-friendly" and "state-friendly" public lawyers—as if private law is intrinsically insensitive to public regulatory values.[213] The approach advocated here belies this false distinction, to the benefit of states and investors alike. The treaty/contract issue is not zero-sum. The question of whether a treaty or contract norm gets priority does not easily divide into "investor-friendly" and "state-friendly" approaches. At least from the ex ante perspective, neither rigidity nor flexibility clearly favors one party or the other. Indeed, rigidity generally undermines *both* sides' interests ex ante, while flexibility is generally the optimal approach.[214]

The basic problem is that too much rigidity prevents states from adequately managing the significant risks entailed in high-value contracts with private parties—not least to their long-term regulatory autonomy. And this in turn constricts investors' capacity to bargain in inefficient ways. Take, for example, a typical damages rule. It is usually understood that the proper measure of damages for a violation of FET is FMV, which amounts to expectation damages in contract cases.[215] But the parties might want to negotiate over contractual damages. What if the parties would prefer to limit damages in some way? What if, for example, capping damages turns out to be the key to achieving an optimal price—or even to securing a deal at all?

From the state's perspective, the stickier the FMV rule, the more difficult it becomes for states to manage risks to their capacity to

ICSID Case No. ARB/10/7, Concurring and Dissenting Opinion of Arbitrator Gary Born, ¶¶ 190-191 (July 8, 2016) (rejecting the majority's transposition of the margin of appreciation into international investment law).

213. This is assuredly not true. As this Article has sought to demonstrate in one particular area, a nuanced approach to private law can be highly sensitive to public values. *See, e.g.*, DAGAN, *supra* note 17. Particularly in the transnational context, the power of contract can be highly liberating for states concerned to protect their public values.

214. Notably, even ex post, it is not clear that any particular resolution to the treaty/contract issue will always hew toward one party or the other. Take, for example, a rule that treaty dispute resolution clauses are mere defaults. This cut against the Claimants in *SGS v. Philippines*, where the exclusive forum selection clause in the underlying contract prevented bootstrapping the contract claims to the level of the treaty via the umbrella clause. *See supra* notes 77-82 and accompanying text. But the same rule cut against the Respondent in *Oxus*, where the Respondent was equally barred from bringing counterclaims against the Claimant under a contract that exclusively selected domestic courts for dispute resolution. *See supra* notes 101-02 and accompanying text.

215. *See* Tschanz & Viñuales, *supra* note 157, at 737.

regulate in the future. High-value contracts with foreign investors will have an unavoidable chilling effect on subsequent regulation, which may in turn chill the prospect of contracting. This is all the more problematic when it comes to contracts in sensitive areas like the extractive industries or water services, which are perennially likely to generate risks to health and environment. And the chilling effects will be felt all the more acutely by emerging economies. With an overly rigid rule, a rational state will have to price such risks into their contracts.

And herein lies the problem for investors, who may well want to shoulder more risk—or certain kinds of risk—in the hopes of securing a better price. While it may seem, at the point of litigation, that any investor would want an investment treaty to offer as much protection to the private party as possible, the matter has to be assessed ex ante. If the treaty protections imposed on a contract are too great, the state may be pushed into offering investors less attractive investment opportunities in order to insure itself, or it may even be dissuaded from contracting under the shadow of the treaty altogether. Such chilling effects are precisely the opposite of what these treaties seek to achieve: the protection *and promotion* of foreign direct investment.

By contrast, much of the sting of even highly investor-friendly rules would be removed if they merely provided default baselines—if, for example, the parties can contract around the presumption of FMV, that is, expectation damages, inhering in the treaty. True, the state might find itself on the back foot in contract negotiations—as compared to negotiating a similar contract with its own national, where the domestic law of the contract entails a lesser measure (such as reliance damages) by default.[216] But, much more importantly, the power would still lie with the contracting parties to allocate the risks between themselves.

Prioritizing choice in investment contracts benefits the state by enabling it to control the scope of possible future liability. Contract represents the crucial tool for states to structure projects with investors in ways that allocate risk at tolerable levels. To the extent that states are concerned about the possible effects of high-value investment contracts on their capacity to regulate in the future,

216. *See* Serkin, *supra* note 9, at 916.

they ought to be able to insure against such risks in the structure of the deal. But these strategies only mitigate risk if such contractual choices are ultimately given effect. If highly protective treaty provisions are treated as mandatory rules, as is apparently implied by the rigid interpretations of investment treaties espoused by cases like *CMS Gas* and *SGS v. Paraguay*, it becomes much more difficult for states to manage their risks ex ante. The consequences of such a rule are not limited to regulatory chill, but also inefficient contracting and potentially contractual chill. If treaty provisions, like a robust version of legitimate expectations or expectation damages, are effectively mandatory, states will have to price these background norms into their deals with foreign investors in order to insure themselves—and, in some instances, the risks might dissuade them from contracting at all. Perhaps counterintuitively, the basic rule that contractual choices ought to be given priority over treaty norms *enhances* the autonomy of the state.

The choice-oriented approach benefits investors as well. It might seem that foreign investors would want investment treaties to afford as much protection as possible. This would certainly appear to be the case from a glance at any investor's brief at the point of litigation, when investors are often engaged in bet-the-company cases. And it may be that, as far as assets like real property go, the more treaty protection offered, the better the inducement to invest. But this is not the case in contract. Ex ante, particular investors may be happy to bargain over certain provisions. For example, an investor may not assign high value to the availablity of international fora if she trusts the state's national courts. To the extent that the state party values avoiding international arbitration, the investor should be able to offer waiving investor-state dispute settlement to secure some other benefit. More generally, investors may *want* to take on some risk—no business venture is risk free, and in at least some cases and the appeal of foreign investment is the possibility of taking on elevated risks in the hopes of high rewards. As importantly, sometimes such risks can be more efficiently managed in other ways, for example through political risk insurance.[217] Investors surely want some measure of security in

217. Public and private insurers offer investors insurance against political risks. DOLZER & SCHREUER, *supra* note 6, at 228-29. The Multilateral Investment Guarantee Agency (MIGA)

engaging with foreign sovereigns but may not value maximizing security at the expense of everything else. Certainly, at the least, rational investors will want states to be *able* to negotiate over risk. If treaties create rigid rules that mandate certain allocations of risk, investors may not be able to secure the risk profile they want. If the investor wants to shoulder some of the risk, say, by waiving arbitration or agreeing to a liquidated damages provision, she should be able to make a meaningful offer to do so.

Finally, generally speaking, neither party would want too many treaty provisions to be sticky, at risk of ballooning the transaction costs of drafting. There may be some special exceptions where good policy reasons require making certain provisions more difficult to contract around—which I consider further below.[218] But, in general, all parties should prefer to have confidence that their choices will be enforced without having to engage in too many drafting acrobatics.

The point is that, at least ex ante, investors and states alike should prefer an arrangement in which the treaty enables them to allocate risk as they see fit. The investor still gets a sizeable benefit from these treaties, which generally put in place highly protective provisions on breach, defenses, damages, and forum selection by default. Thus, the State begins negotiation somewhat on the back foot. But at the same time, the State will still be able to manage its risk so long as the parties' contractual choices ultimately take precedence over the background treaty norms.

C. Justifying Constraints on Choice

Insofar as investment treaties apply to contracts, their provisions should be presumptively understood as doing so only by way of defaults. The general rule should be that the contracting parties' choices prevail over background treaty protections. Yet there may

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is a good example. The MIGA is an international institution connected to the World Bank. *See id.* It offers prospective investors an array of schemes to insure themselves against political and regulatory risks. *See id.* As importantly, it acts as an important go-between facilitating relationships between investors and states before disputes arise and in their early stages—often obviating the need for dispute resolution. *See generally Overview*, MULTILATERAL INV. GUARANTEE AGENCY, www.miga.org/who-we-are [https://perma.cc/JL4D-ZZWZ].

218. *See infra* notes 232-40 and accompanying text.

still be instances in which constraints on party choice might be justifiable.

Though they differ widely in extent, most national legal orders do incorporate some limits on contracting parties' capacity to choose how to structure their arrangements—partially (via sticky defaults) or completely (via mandatory rules).[219] Such constraints on party choice are usually justified in one of two broad ways: on grounds intrinsic to the logic of contract or on the basis of external values. The first type of justification considers sticky defaults and mandatory rules appropriate where they serve to *enhance* party autonomy, for example by putting the parties on equal footing or by correcting for certain market failures.[220] These kinds of constraints serve to ensure the rules of the game, protect basic fairness among contracting parties, and the like. A second type of justification for constraining choice relies on extrinsic values including, classically, mandatory rules invalidating contracts of enslavement or contracts to commit a crime.[221]

The same logic might apply to the treaty/contract issue in international investment law. Although in general there are strong reasons to allow parties to contract around treaty norms, there may be specific instances in which it makes sense to treat a particular treaty provision—or aspects of it—as sticky or mandatory. And as in national law, such reasons might be either intrinsic to the logic of contract, or extrinsic in the service of some other value.

Again, it must be borne in mind that the treaties do not clearly resolve the matter one way or the other, in general or vis-à-vis any of their norms. So interpreters are left to explore the issue on the basis of principles. Given the importance of the basic principle supporting party choice in investment contracts,[222] significant caution should be exercised here. A first corollary is that any such departure from the general rule favoring contractual choice must be justifiable and justified—not simply assumed, as several of the cases have been wont to do.[223] Ideally, we would also expect that, in

219. *See, e.g.*, Ayres & Gertner, *supra* note 15, at 87.

220. *See, e.g.*, Ayres, *supra* note 27, at 2095-96.

221. *See* Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 764-65 (1983).

222. *See supra* Part III.A.

223. *See, e.g.*, *Sempra*, ICSID Case No. ARB/02/16, Award (Sept. 28, 2007); *Enron*, ICSID

determining that a default is sticky, a tribunal would afford some explanation of *how* the parties could have contracted out—for the benefit of future contracting parties.[224] A second corollary is that there are strong reasons to limit the pool of such exceptions. The greater the number of sticky treaty defaults, the more complicated drafting becomes—which has an exponential effect on transaction costs.[225] There may be reasons to deviate from the general rule in some cases, but such sticky defaults should be based on especially compelling reasons and not be stricter than necessary.

Keeping these principles in mind, it is easier to start with the possibility of intrinsic justifications for constraints on contractual choice in investment treaties. The example of forum selection clauses provides a plausible example where stickiness might be justified—though I raise it only by hypothesis here, in full recognition that there may be countervailing reasons to limit investor-state dispute settlement to a default rule. As discussed above, the *SGS* cases reveal two distinct visions of interaction between contract and treaty on the issue of forum selection.[226] *SGS v. Philippines* privileges the contracting parties' choice to *exclusively* select national courts for the resolution of all disputes arising out of the contract—thereby displacing the treaty forum.[227] On this view, the treaty does not rewrite the contract.[228] *SGS v. Paraguay*, by contrast, privileges treaty over contract.[229] There, even an express

Case No. ARB/01/3, Award (May 22, 2007); *CMS Gas*, ICSID Case No. ARB/01/8, Award (May 12, 2005).

224. Ayres, *supra* note 27, at 2055 ("[I]n deciding any contractual issue concerning defaults, judges should presumptively provide ... contractual language that would allow future contractors to achieve the results desired by the losing party." (emphasis omitted)); *see, e.g.*, *Crystallex*, ICSID Case No. ARB(AF)/11/2, Award, ¶ 482 (Apr. 4, 2016) (suggesting that a contractual exclusive forum selection clause will only be effective to waive treaty arbitration if it mentions the investment treaty by name).

225. *See* Ayres, *supra* note 27, at 2055.

226. *See SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, ¶¶ 128-129 (Feb. 12, 2010); *SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶¶ 139-143 (Jan. 29, 2004).

227. *See SGS v. Philippines*, ICSID Case No. ARB/02/6, ¶ 143; *accord BIVAC v. Paraguay*, ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, ¶ 152 (May 29, 2009).

228. Crawford, *supra* note 4, at 374. Crawford, incidentally, chaired the *SGS v. Philippines* tribunal. *See ConocoPhillips*, ICSID Case No. ARB/07/30, Dissenting Opinion of Georges Abi-Saab to Decision on Jurisdiction and Merits (Feb. 19, 2015).

229. *See SGS v. Paraguay*, ICSID Case No. ARB/07/29, ¶¶ 128-129.

clause exclusively selecting national courts does not waive the investor's right to international arbitration under the treaty.[230] On this view, from the ex ante perspective, the treaty provisions must be understood as effectively mandatory. As argued above, the *SGS v. Paraguay* interpretation rests on a faulty premise that treaty and contract are radically separate, which should be discarded.[231] There is no good reason why fully informed and sophisticated investors and sovereign states should not be *able* to structure their investments around treaty jurisdiction. Indeed, investors may well want to disclaim such rights if doing so can fetch them a better price—especially if they are sufficiently confident in the national courts. But that does not mean such a provision should be easy to contract around.

Though treaty provisions on international dispute resolution should certainly be understood as defaults, there may be reason to treat them as relatively sticky. The argument would start by recalling that investment treaties are international agreements between states to reciprocally protect one another's nationals.[232] Yet there is real concern about whether investors are fully aware of their treaty rights in making the decision to invest abroad—indeed, the empirical evidence shows that, with the exception of repeat players in certain fields, like oil and gas, investors are often not aware that they might be empowered to compel a host state into international arbitration.[233] Arguably, states have an interest in preserving their nationals' access to treaty fora when they invest abroad *whether they know it or not*. The argument would stress that the goal of protecting and promoting foreign direct investment is not just to induce private actors to invest, but also to de-escalate disputes between sovereigns over their treatment of one another's nationals. By letting investors press their own claims directly, investment treaties free home states from the responsibility of espousing their aggrieved nationals' claims against foreign host states, and further free them from resolving such disputes through self-help countermeasures. But at the same time, these interests may not be absolute. States may be perfectly happy for their

230. *See id.* ¶¶ 125, 128-129.
231. *See supra* Part II.D.
232. *See* Yackee, *supra* note 12, at 398.
233. *See id.* at 400.

nationals to *intentionally* negotiate over access to investor-state dispute settlement, in hopes of securing a better price. The states' interest in preserving their nationals' access to arbitration may thus be outweighed by an interest in efficiency where states can be sure their investors are negotiating in full knowledge of their treaty rights. It might be that the real issue is thus ensuring that investors have access to adequate information in negotiating over dispute settlement fora. If so, then there may be cause to push states to convey information to putative investors about their default rights to treaty fora, where they may not otherwise be aware of what they are giving up.

If such concerns about information asymmetries were sufficiently compelling, treaty provisions on dispute resolution might justifiably act as a sticky default. The function of constraining choice, here, would be to force states to convey information about treaty rights to foreign investors—as apparently envisioned by the Tribunal in *Crystallex*.[234] Fully informed contracting parties could still get around such a clause, but only by including language evidencing that all sides were sufficiently informed. On this view, even the following clause might not suffice: "*all disputes shall be resolved exclusively before the courts of [x country].*" Though expressly exclusive, such a clause would not guarantee against the relevant information asymmetries. On this view, to contract around the treaty, states would have to ensure that the contractual clause put the investor on sufficient notice, for example by stating "notwithstanding the [BIT]," or "notwithstanding the existence of any international fora."[235] Such clauses would ensure that the investor had been aware of her rights and was thus satisfied with the contract's reallocation of risks.

234. *See Crystallex*, ICSID Case No. ARB(AF)/11/2, Award, ¶ 482 (Apr. 4, 2016).

235. *See, e.g.*, *id.* In another instance, Colombia contemplated this sort of reasoning in a 2014 draft concession contract, which sought to waive "investment arbitration contemplated in any [BIT] or other international treaty." Contrato de Concesión Bajo el Esquema de App No. [*] de [*]" [Model Agreement] (Colom.), *translated in* Strong, *supra* note 69, at 692. As an aside, it would be wiser for the *state* to opt for a more general waiver clause, rather than mentioning any particular BIT by name, because arbitral jurisprudence generally allows corporate investors to change their nationality to access myriad treaties with relative ease—even *after* executing the contract. *See* Arato, *supra* note 2, at 275-76.

Notice that this account is also similar to the Claimants' argument in *Kardassopoulos*, on the question of liquidated damages.[236] In my view, however, stickiness makes less sense in that context. Sophisticated commercial parties can be presumed to be sufficiently well versed in the different measures of damages available, and how to negotiate over damages, reducing concerns about information asymmetries considerably. For example, there is little reason to worry about whether foreign investors would not be aware of the precise meaning of a damages cap—whether or not they knew of the existence of the treaty. And there is good reason to limit stickiness in investment treaties. Though forum-selection might be a special case, there is generally not sufficient reason to question the substantive deal between the parties. Conversely, going too far with insisting that particular treaty provisions ought to be sticky would have the perverse effect of ballooning drafting costs unnecessarily, by forcing the parties to disclaim the treaty by name any time they expect a contractual provision to deviate from its terms.

There may indeed be compelling reasons for viewing treaty provisions on forum selection as sticky defaults. International dispute resolution by nonnational arbitrators is, after all, the central structural innovation of the investment treaty regime—on which all confidence in the application of other treaty standards is based and on which the key enforcement mechanisms rely.[237] Given its structural and institutional functions, there are arguably special reasons to ensure that parties are sufficiently aware of what they are giving up—which may justify stickiness in this limited context. But this rationale should not be taken too far vis-à-vis other treaty standards.

And what of extrinsic values? It is possible that some treaty rules might be justifiably considered sticky, or made sticky, for reasons wholly external to the logic of contract—for example, in the service of protecting the state's capacity to engage in environmental or public health regulation. A rationale for stickiness, in such contexts,

236. *See Kardassopoulos*, ICSID Case Nos. ARB/05/18 & ARB/07/15, Award, ¶ 481 (Mar. 3, 2010).

237. The status of investor-state judgments as *international arbitral* awards links them to extremely powerful mechanisms for the enforcement like the New York Convention on foreign arbitral awards—allowing investors to effectively pursue delinquent states' assets across the globe. DOLZER & SCHREUER, *supra* note 6, at 310.

would involve a classic concern about agency costs. The point is best expressed through a hypothetical. The state's capacity to regulate in the public interest is an omnipresent controversy in international investment law. Investment treaties tend not to include general exceptions provisions granting states carve-outs for bona fide regulation in the public interest.[238] But occasionally, such clauses appear, typically modelled on the WTO General Agreement on Tariffs and Trade (GATT).[239] For example, the 2012 Canada—China BIT provides a long list of carve-outs on the model of GATT Article XX, covering, inter alia, regulation in the interest of protecting public health, the environment, public morals, and more.[240]

Imagine a hypothetical investment treaty on this model, which includes a typical FET protection, along with a clause modeled on GATT Article XX, exempting the state from liability for any measures necessary to secure public health, environmental protection, and public morals. An investor negotiates and executes a contract to explore dolomite in the state with a relatively low-level official in the ministry of finance (or even a representative of a state-owned entity). Assume the contract includes a robust stabilization clause, guaranteeing the investor full compensation for any subsequent regulation that undermines the value of the contract. A year later, the legislature passes sweeping environmental reforms that reduce the investor's future profitability by 60 percent, and the investor brings suit under the Treaty. Can the State take advantage of the exceptions clause, or does the contract's stabilization clause prevail over the State's treaty protection? In other words, is the exceptions clause a mere default, a sticky default, or is it mandatory?

Since the hypothetical is speculative, we can skip the technical question of proper treaty interpretation and start with the normative question: What would be the rationale for making such an

238. *See* Céline Lévesque & Andrew Newcombe, *Canada*, *in* COMMENTARIES ON SELECTED MODEL INVESTMENT TREATIES 53, 88 (Chester Brown ed., 2013). Increasingly treaties have incorporated more specific clauses to that effect with regard to indirect expropriation claims, but generally not in the context of FET. *See* Arato, *supra* note 2, at 263-64.

239. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A11, 55 U.N.T.S. 194 [hereinafter GATT].

240. Agreement for the Promotion and Reciprocal Protection of Investments, Can.-China, art. 13, Sept. 9, 2012 [hereinafter China-Canada BIT], http://unctad.org/Sections/dite_tobe deleted/iia/docs/bits/canada_china.pdf [https://perma.cc/3Q3F-BMME]. Several of Canada's BIT's include clauses of this kind. *See* Lévesque & Newcombe, *supra* note 238, at 88.

exceptions clause difficult to contract around? In my view, there is a compelling argument about agency costs here. The reality of foreign direct investment is that major investment projects are often executed by relatively low-ranking state actors—and often employees of state-owned enterprises. Many states lack the resources (or expertise) to rigorously vet these contracts across all government agencies for whom they might be relevant. If a hypothetical treaty exceptions clause were a mere default, a contractual stabilization clause like the above would seem to have the effect of abrogating the exception completely. States might thus be justifiably worried about the possibility of lower-level officials without all relevant expertise waiving the state's regulatory exemptions under the treaty. Making the treaty exceptions sticky or mandatory would go a long way toward addressing these agency costs. A mandatory rule would eliminate such costs completely, though at the expense of some of the State's bargaining power should it affirmatively want to offer such a stabilization clause in full knowledge of the consequences. A sticky default rule, dependent on a "notwithstanding international law" clause, would at least help ensure that the state officials were contracting on behalf of the state with adequate information.

Agency costs might provide a good justification for making a general exceptions provision resistant to contractual opt-out. If states were to contemplate enacting such a clause, they might take pains to make it sticky or even mandatory. Of course, if they were so inclined, it would be safest to do so explicitly in the treaty text—in the mode of the CISG, or in national contract law—by indicating whether the clause could be waived at all, and if so, through which magic words. We need not speculate about how an interpreter should address this question absent any affirmative treaty language. Suffice it to say that extreme caution would be appropriate.

Framed in formal international legal terms, treating a *limited* set of treaty norms as sticky defaults could—in principle—resonate with the object and purpose of investment treaties. But such instances would have to be strictly justified. The treaties' twin goals are, again, to protect and promote foreign direct investment.[241] In the context of contractual investments, this means respecting the parties' bargains. In most cases, this will mean privileging the parties'

241. *See* Yackee, *supra* note 12, at 398.

choices. However, partially constraining choice may occasionally be necessary to ensure that the law is protecting real bargains— ensuring that they are arms-length deals between sufficiently sophisticated parties. And treaty parties may well seek to constrain party choice in the service of values wholly extrinsic to the logic of contract. This may mean that some treaty norms are properly understood as stickier than others.

CONCLUSION: TOWARD REFORMING THE INTERNATIONAL LAW OF INVESTMENT CONTRACTS

Investment treaties are creating a new international law of contracts, governing arrangements between states and foreign investors. But they are largely silent about what kind of law they create, and in particular how their norms relate to the express choices made by states and foreign investors in their covered contracts.[242] I have argued that the jurisprudence on this issue is remarkably inconsistent and unclear, creating significant uncertainty for states and investors alike.[243] Moreover, uncertainty is not the only problem. Though tribunals have resolved the issue in all kinds of ways, the tendency appears to favor privileging treaty norms over the parties' duly negotiated contractual arrangements— often based on the assumption that treaty and contract can be neatly separated. As mere domestic law, the assumption goes, a contract can never vitiate a treaty right. The tendency toward interpreting investment treaties rigidly vis-à-vis investment contracts benefits neither states nor investors ex ante. Rigidity unnecessarily constrains the state's capacity to safeguard its future regulatory autonomy,[244] and inefficiently constrains each party's negotiating power. An international law of investment contracts is indeed emerging, in fits and spurts, but it has a long way to go toward achieving the nuance and systematicity appropriate to a global regime of private law.

The key to resolving the treaty/contract issue lies in appreciating the function of choice in the logic of contract.[245] As a matter of

242. *See* Arato, *supra* note 2, at 546.
243. *See supra* Part II.
244. *See supra* Part III.B.
245. *See supra* Part III.

formal treaty interpretation, the investment treaty's object and purpose of protecting and promoting investment is generally best served by prioritizing the choices made by states and foreign investors in their contracts. Protecting an investment contract generally means respecting the terms of the bargain actually struck by the contracting parties, rather than invoking the treaty to rewrite it.

At the same time, prioritizing party choice has tangible policy benefits for both states and foreign investors. As a policy matter, prioritizing choice is optimal from the ex ante perspective of both states and investors. Privileging contractual choice in investment law is, unsurprisingly, the best way to enable investors to secure efficient contracts with foreign sovereigns. But it is equally the best way to empower states, without giving up on all security for investors. Contractual freedom here *enables* states to manage risk to their regulatory capacities. Privileging choice recognizes that the contracting parties are best positioned to regulate their interactions themselves and empowers them to do so. This means understanding treaty norms as mere defaults, which can be overturned by any explicit contract language (if not choice of law).

Insofar as they relate to contracts, investment treaties should be presumptively interpreted in such a way as to prioritize party choice. As a corollary to that principle, however, a degree of constraint on party liberty can be autonomy-enhancing in some instances.[246] Privileging the treaty over terms in the contract may make sense under certain limited circumstances—as, for example, a sticky default in cases when informational asymmetries seem likely to create a market failure or otherwise undermine the goals of the investment treaty. Given their centrality in the investment treaty system, forum selection provisions might be a plausible candidate.[247] Constraints on choice might also be justified on the basis of values completely extrinsic to contract—as might be the case with general exceptions clauses in certain BITs modelled on GATT Article XX.[248] But in any case, adjudicators ought to view

246. *See* Ayres & Gertner, *supra* note 15, at 97.
247. *See supra* Part II.A.
248. *See supra* notes 238-39 and accompanying text.

such situations as exceptional, and carefully justify deviation from the norm of privileging party choice.

Investment treaties have given rise to an international law of investment contracts, if only in fits and spurts. To constitute a fully coherent and legitimate system of contract law, the regime must better appreciate the function of choice in the logic of contract. In other words, I am arguing that the regulatory ideal of an international law of investment contracts would presumptively prioritize the choices of contracting parties against a system of mostly default background rules. Needless to say, this discussion cannot be complete without acknowledging the significant institutional difficulties with moving toward that ideal in a systematic way.

As should by now be clear, international investment law is frustratingly fragmented—comprised of thousands of treaties, which are interpreted with semiprecedential effect on an ad hoc basis, by one-off arbitral panels.[249] As a result, there is little hope for a quick global fix to the treaty/contract question—short of the seemingly remote possibilities of erecting a single multilateral investment agreement or a coherent judicial system for investor-state dispute settlement. Absent major institutional change, these problems are not likely to be resolved by a single legislative action or a single authoritative interpretation.

The real prospects for reform are piecemeal. Arbitral interpretation provides one limited path, even under the constraint of our current fragmented institutions. Arbitrators can certainly do better to consider and respect the choices made by states and investors as contracting parties. And, as importantly, they can generally do better to justify their reasoning in resolving the relationship between treaty and contract, one way or the other. Though it might not do much to resolve the problem of uncertainty, tribunals should still err on the side of giving effect to the parties' contractual bargain absent strong reasons for restricting party choice in some way.[250]

But by far the most legitimate pathway for reform lies with the treaty-making power. States themselves can best resolve the treaty/contract problem by reworking their treaties to specify how

249. *See supra* Part II.
250. *See supra* Part III.

their provisions relate to contracts. This might be as simple as CISG Article 6, which sets out a general rule prioritizing contractual choice over treaty terms with a few exceptions.[251] Or it might be done in a more involved way by enumerating which treaty provisions can be contracted around as mere defaults, which provisions require specific language to waive, and which provisions, if any, should be understood as mandatory.

Though by no means an easy path, treaty reform represents the only reasonably realistic way to overcome both the problems of uncertainty and rigidity at once. Only formally deciding the relationship between treaty and contract in investment treaties themselves can signal to contracting parties ex ante that their carefully negotiated choices will ultimately be given effect. Such certainty and flexibilty are essential toward redeeming the purposes of investment treaties, without unduly burdening the states parties' regulatory capacities of our emergent international law of investment contracts.

251. *See* CISG, *supra* note 3, art. 6.