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Julian Arato

**The Logic of Contract in the World of
Investment Treaties**

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The Logic of Contract in the World of Investment Treaties

Julian Arato*

The relationship between treaty and contract remains undecided in international investment law. It is an open question which instrument takes priority when their terms diverge. While it is clear that investment treaties 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, creating significant problems of certainty, efficiency, and fairness – for states and foreign investors alike. I suggest that the problem arises out of a tendency to confuse the logics of property and contract in a context where the contracting parties have themselves chosen how to allocate risk and price.

This Article reappraises the treaty/contract issue from the perspective of contract theory, adopting the ex ante perspective of contracting states and foreign investors. From this point of view, I argue that investment treaties must be understood as having generated a rudimentary law of contracts, governing agreements between states and foreign investors on issues ranging from substantive rights and duties, to damages and forum selection. But, critically, it remains unclear whether parties are free to

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contract around these treaty rules, or whether treaty provisions should be understood as mandatory terms that constrain party choice – whether, in other words, treaty norms should be understood as defaults, sticky defaults, or mandatory terms vis-à-vis subsequent investment contracts. Though states and foreign investors may have different interests and values at stake, the treaty/contract problem is not zero-sum. I argue that the best approach for both states and foreign investors is usually to privilege their contractual arrangements over background treaty rules. And I explore when and how adjudicators (or treaty-makers) might justifiably insist that certain treaty norms exert a greater pull.

It is a maxim of classical international law that all contracts are 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 only create rights and obligations under the domestic law chosen by the parties. Today, however, this maxim is no longer entirely correct.² 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 field of contract law – a 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 forum selection and even damages. The problem is that the development of this new international law of contracts has been unpredictable and highly irregular – not just in terms of the content of the rules, but even on

¹ See, e.g., *Serbian Loans*, 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(2) HARV. INT’L. L.J. 301 (2015).

the basic question of the relationship between treaty rules and the contracts to which they apply.

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 of property law, oriented around fixed rules for particular assets. 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. 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,³ or to impute what they would have wanted had they considered an issue.⁴ 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.⁵ 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.⁶ One might think that, to the extent investment treaties apply to contracts at all, they would do so in a way

³ CHARLES FRIED, *CONTRACT AS PROMISE* (2d ed., 2015).

⁴ See, e.g., Jody S. Kraus, *The Correspondence of Contract and Promise*, 109 COLUM. L. REV. 1603, 1632–33 (2009). See also Ian Ayres & Robert Gertner, *Filing Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 90 (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 – e.g. to reveal information).

⁵ HANOCH DAGAN & MICHAEL HELLER, *THE CHOICE THEORY OF CONTRACTS* (CUP, forthcoming 2016).

⁶ See, e.g., HANOCH DAGAN, *PROPERTY: VALUES AND INSTITUTIONS* (OUP 2011).

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. This poses significant problems for states and investors alike.

The first problem is that the law is in a woefully unstable state of flux. The extent to which investment treaties augment contracts negotiated by states and foreign investors remains unclear, and awards by arbitral tribunals have been highly uneven and irregular on this issue. As a result, the meaning of state contracts in the world of investment treaties remains under a cloud of doubt. The second, deeper problem is that tribunals too often resolve this question in the wrong way. Even if regularized, the tendency of some tribunals to prioritize treaty provisions over duly negotiated contractual bargains 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, including: for the investor, risks associated with the viability and profitability of the project; and, for the state, the risk of future regulatory chill. 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. Indeed, the tendency to weaken the state's capacity to define the scope of its potential future liability under an investment treaty risks damaging the flow of foreign capital in the long run – the very goal that investment treaties are meant to achieve.

The root of the problem is that investment treaties tend to say nothing, or only very little, about how they relate to contracts.⁷ They often clearly apply to state contracts, either explicitly or by evident implication.⁸ Some treaties even incorporate provisions that equate breach of a state

⁷ James Crawford, *Treaty and Contract in Investment Arbitration*, 24 *ARB. INT'L* 351 (2008); Arato, *supra* note 2 at 249.

⁸ *Id.*

contract with breach of the treaty (the “umbrella clause”).⁹ But treaties generally 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.¹⁰ As a result, it remains unclear how investment treaties relate to the parties’ contractual choices. From the perspective of contract theory, crucial questions remain totally unaddressed: are treaty rules 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?

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 or not 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

⁹ DOLZER & SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 166–178 (2d ed., 2012)

¹⁰ The closest these treaties come to defining their relationship to covered contracts is by stating that in the context of investor-state disputes, tribunals shall apply both national law (contract) and international law (treaty) – and that in case of *conflict* the latter shall prevail. Crawford, *supra* note 7, at 353. But this conflicts rule applies only if we determine that treaty provisions are mandatory, as express contract terms would not properly “conflict” with diverging defaults. Richard Craswell, Freedom of Contract, Coase – Sandor Working Paper on Law and Economics No.33 (1995).

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: states and foreign investors.¹¹ 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. If anything, tribunals seem to 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 and fairness that are just beginning to come to light in practice.

My normative claim is that the prevailing interpretive tendency to subordinate contractual choice to treaty rules is usually bad policy. 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 (e.g. information sharing), or external values (like environmental protection). It is no longer true that contracts between states and foreign investors are purely instruments of national law. But a better international law of contracts is essential if we are to remain

¹¹ *Cf.*, *mutatis mutandis*, U.S.—Sections 301–310 of the Trade Act 1974, WT/DS152/R, Panel Report, 7.8–7.12 (1999).

sensitive to both the needs of foreign capital and the vitality of local and global public values.

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 suggest that thinking in terms of default rules, sticky defaults, and mandatory terms provides a useful 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 tendency seems to be to treat treaty rules as 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 by the treaty text. I argue that, in general, the principle ought to be that explicit contractual terms trump 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 as a matter of international law – 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 private law (e.g. efficiency and party autonomy) and public values (e.g. the state’s capacity to regulate and to control its liability for major privatization projects). Yet all this should only be taken 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 the forum selection clause makes a good candidate. 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. PUBLIC AND PRIVATE VALUES IN THE LAW OF CONTRACTS

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. *The Material Contract: Defaults, Sticky Defaults, and Mandatory Rules*

To paraphrase Robert Scott, the explicit terms of any contract reflect only the tip of the iceberg. In all national legal orders, contracts are formally (and sometimes informally) augmented by a manifold of legal rules, covering all kinds of potential price terms – from basic obligations like good faith, defenses, and damages to procedural rights like forum selection. 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.

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.¹² 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. As it happens, in many domestic systems, including the U.S., the law of *public* contracts subjects states only to reliance damages by default – not expectation damages.¹³ Such background rules on damages are price terms like any other, that 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, or mandatory rules.¹⁴ Classically, default rules supplement contracts and fill gaps, and parties are free to contract around them. Mandatory rules, by contrast, cannot be contracted around. Sticky defaults lie somewhere in between. 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.

¹²See Christopher Serkin, *Public Entrenchment Through Private Law: Binding Local Governments*, 78 U. CHI. L. REV. 879, 895 (2011).

¹³ *Id.*, at 916.

¹⁴ Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 Yale L.J. 2032, 2048, 2084 (2012).

Mandatory rules are only justifiable where they protect some value, which might be intrinsic to the logic of contract (like equality of information, or the protection of unsophisticated parties)¹⁵ or extrinsic public goods (like the prohibition on slavery).¹⁶ Like mandatory rules, sticky defaults are meant to protect certain values – though to a weaker degree. Typically, the values concerned here are relational, and would not be undercut if informed and sophisticated parties were to opt out. Moreover, sticky defaults may be more or less difficult to contract around. Some may be subject only to clear statement rules. Others might be stickier, requiring parties to use special language. 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 contract out must use language that discloses the necessary information.¹⁷ In general, however, mandatory rules and sticky defaults are the exception.¹⁸ 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.¹⁹

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. 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

¹⁵ DAGAN & HELLER, *supra* note 5, at ch. 10.

¹⁶ Craswell, *supra* note 10, at 1-2.

¹⁷ Ayres, *supra* note 14, at 2037.

¹⁸ *Id.*, 87–89.

¹⁹ DAGAN & HELLER, *supra* note 5.

defaults and mandatory terms. Still, so far, the situation is still basically similar to the above.

Investment treaties provide a more vexing wrinkle. Insofar as an investment treaty applies to contracts between the state and a foreign investor, it becomes an additional source of background rules. Now any such contract may be augmented by defaults and mandatory provisions arising out of two legal orders – the chosen domestic law of the contract, and the international investment treaty. The problem is that it is not at all clear how the treaty, national contract law, and express contract terms are supposed to interact. But 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 a material part of the deal.

B. *Property and Contract in International Investment Law*

Investment treaties are agreements between two or more states, governing interactions between each state and foreign private parties hailing from the other(s). Their twin purposes are to protect foreign investors' assets and promote foreign direct investment (*FDI*). They codify a number of basic protections, framed largely in the style of property rules – in particular guarantees against expropriation and standards like “fair and equitable treatment” (*FET*). These protections are generally explicitly or implicitly linked to rules on damages. 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. Put another way, investment treaties seek to promote foreign direct investment 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 a judicial claim, a state will simply refuse to pay up.

Though framed as treaties establishing rules for the protection of foreign property – i.e. regimes of property law – these treaties apply to a surprisingly broad range of assets, including not only real and personal property, but also IP, going concerns, and a vast range of contracts with the state (state contracts).²⁰ There has been some debate about the extent of these treaties’ scope.²¹ But, there has been precious little discussion about whether they apply to all covered assets in precisely the same way.²²

Here we are concerned with contracts specifically, and it is enough to contrast the basic orientation of contract law with the law of real property. Here I put to the side the normative question of how far these treaties ought to protect foreign property rights.²³ 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

²⁰ Dolzer & Schreuer, *supra* note 9, at 62.

²¹ See *Poštová Banka v. Hellenic Republic*, ICSID Case No. ARB/13/18, Award (2015) (sovereign debt did not qualify as a covered asset); and *SGS v. Republic of Paraguay*, ICSID Case No. ARB/07/29, Jurisdiction (2010) (hereinafter *SGS v. Paraguay* (Jurisdiction) (noting that a one-off contract for the sale of goods might not qualify as investments).

²² 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 also Rochelle Dreyfuss & Susy Frankel, *From Incentive to Commodity to Asset: How International Law is Reconceptualizing Intellectual Property*, 36 MICH. J. INT’L L. 557 (2015) (exploring how investment treaties unthinkingly “propertize” IP); and Arato, *supra* note 2 at 247, 292 (regarding contract); Zachary Douglas, *Property, Investment, and the Scope of Investment Protection Obligations*, in THE FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW: BRINGING THEORY INTO PRACTICE, Zachary Douglas, Joost Pauwelyn, and Jorge Viñuales, eds., 363 (2014).

²³ 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.

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. The law of property affords only limited space for investors to choose how the law will apply to their holdings. Investors may have options, but property law places little emphasis on choice. 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. True, as explained above, they do so against a complex background of norms – which fills gaps, and occasionally nudges parties to contract in certain ways (sticky defaults) or even forces them to do so (mandatory rules). 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.²⁴

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

²⁴ For one of the few authorities to recognize the problem, see Crawford, *supra* note 7, at 352–353.

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. In other words, there is a tendency in investor-state jurisprudence to treat contracts as assets subject to a fixed set of treaty rules.²⁵ As I argue in Part III, this confusion creates significant inefficiencies that harm both states and investors.

C. How Might Treaty and Contract Relate?

The 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 thin and rudimentary. This much international investment law has already done. What remains to determine 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 extremely 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 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. But provisions guaranteeing investors fair and equitable treatment (FET), or protecting their assets from regulatory takings (“indirect expropriation”)

²⁵ Arato, *supra* note 2 at 271.

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. 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 affect on any contractual provision. The latter 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 treaty text, which clearly indicates that the treaty applies to contracts in *some* way – as covered investments.

The *second* possibility is that a treaty rule does not trump any express choice by the parties, but may augment background rules in the relations between the parties. By this view, the treaty rule supplants any conflicting background rules set by the domestic law of the contract, but still only fills gaps in any particular contract.²⁶ The parties can contract out of the treaty rule with no added difficulty. I suggest, below, that most of the time this represents the better approach – most resonant with both the goals of investment treaties and the logic of contract.

²⁶ See *SGS v. Philippines*, Jurisdiction, ICSID Case No. ARB/02/06, (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. Crawford, *supra* note 7, 363; Douglas, *supra* note 22.

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. For example if a treaty makes international arbitration available as a forum for resolving disputes, it might be held that the contracting parties can only waive the treaty rule if they do so in a certain way. The rule might require an exceptionally clear waiver. An even stickier rule would require specific language to validate a waiver – e.g. by only recognizing waivers of BIT jurisdiction that mention the treaty by name.

Fourth, a treaty term might impose a mandatory rule that cannot be waived under any circumstances. Few argue explicitly that investment treaty terms are fully mandatory, though occasionally commentators have explored whether it might not be possible to waive treaty protection by contract *in toto*.²⁷ However, this kind of thinking 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*.

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

²⁷ See. S.I. Strong, *Contractual Waivers of Investment Arbitration: Wa(i)ve of the Future?*, 29 ICSID REV–FILJ (2014); Bart Smit Duijzenkunst, “Of Rights and Powers: Waiving Investment Treaty Protection,” EJILTalk!, available at <http://www.ejiltalk.org/of-rights-and-powers-waiving-investment-treaty-protection/>.

must be nuanced and flexible, and explore the possibility that in limited cases sticky defaults and mandatory rules may be appropriate – where justifiable in light of compelling intrinsic or extrinsic values.

II. IRREGULARITIES AND ASSUMPTIONS 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 price terms addressed by most treaties: the contents of the FET standard, damages, and forum selection. 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 – 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 head on in Part III.

A. Legitimate Expectations and Stabilization

The content of substantive investment treaty standards remains one of the most fraught issues in international investment law – and none more so than the vague catch-all standard guaranteeing investors fair and equitable treatment. 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 (i.e. a duty of “stabilization”).²⁸

Tribunals have disagreed fiercely on just how far FET entails a guarantee of regulatory stabilization – if at all. To be clear, there is no need here to take a position on this issue of the substantive content of FET. 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 put the issue in context from the contracts perspective, absent any investment treaty, stabilization is something that parties often can and do contract for. Most national legal orders have special rules for public contracts – i.e. contracts with the government, or sub-units of the government, and in some cases with state-owned enterprises. Usually the defaults are government-friendly. 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, by default, guaranteed against general legislative changes that diminish the value of her contract with the government. But to the extent parties are sufficiently concerned about the risk of regulatory change, they can negotiate for a stabilization clause.²⁹ 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 so too with 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 at all, vis-à-vis any kind of asset.³⁰ Our question is related, but conceptually

²⁸ Dolzer & Schreuer, *supra* note 9.

²⁹ See Serkin, *supra* note 12, 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. *Id.*, at n. 57; Mann, *Stabilization in Investment Contracts*.

³⁰ Rudolf Dolzer, *Fair and Equitable Treatment: Today’s Contours*, 12 SANTA CLARA J. INT’L L. 7, 20–29 (2013); Moshe Hirsch, *Between Fair and Equitable Treatment and*

independent from the issue of content. The question for us is about 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 – whether the treaty grafts an obligation of stabilization on to such contracts, and to what extent the parties can contract around the treaty standard.

Notice that no such issue arises with pure property cases, where 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. 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, of how much to respect the parties own efforts to allocate risk. Investor-state cases involving contracts have 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 Dolzer notes, jurisprudence on legitimate expectations is in a state of flux.³¹ 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 division serves to illustrate the extent to which tribunals tend to assume that the treaty standard materially adds *something* to state contracts within its ambit.

The broad approach to legitimate expectations in contracts cases is typified by a series gas disputes against Argentina arising out of the 2001-2002 financial crisis, including *CMS Gas v. Argentina*, *Sempra v.*

Stabilization Clause: Stable Legal Environment and Regulatory Change in International Law, 12 J. World Trade & Invest., 783 (2011).

³¹ Dolzer generally supports the view that, under the legitimate expectations component of FET, contracts should establish *some* stabilization duty. Dolzer, *supra* note 30, at 25. *But see* Crawford, *supra* note 7, at 373 (“the relevance of legitimate expectations is not a licence to arbitral tribunals to rewrite the freely negotiated terms of investment contracts.”).

Argentina, and *Enron v. Argentina (Argentine Gas Cases)*.³² Each of these disputes arose out of regulatory changes that severely devalued long-term gas distribution contracts between the private investors and the Argentine state. In the early 1990's Argentina embarked on a comprehensive privatization program – part of which involved designing a regulatory framework covering the gas sector designed to attract foreign direct investment. 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. At the time, the peso was also pegged to the dollar. As Argentina slipped into financial crisis in the 1990's, 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 (“pessification”), and subsequently devaluing the peso.³³ Needless to say, these measures severely depreciated the value of the underlying contracts and completely undermined their value as investments.³⁴

CMS, Sempra, and Enron each sued Argentina under the U.S.–Argentina BIT. 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.³⁵

³² *CMS Gas v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, (2005) (hereinafter *CMS Gas*); *Sempra v. Argentine Republic*, ICSID Case No. ARB/02/16, Award (2007) (hereinafter *Sempra*); *Enron v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (2007) (hereinafter *Enron*). See José Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors*, 2008/2009 Ybk. Int'l Invest. L. & Policy, 379 (2009).

³³ See *CMS Gas*; *Sempra*; *Enron*.

³⁴ *Id.*

³⁵ 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. The implicit issue, here, is whether the treaty clauses would afford investors greater protection than that available under the contracts.

First, each case defined FET broadly to include a duty of stabilization.³⁶ The Tribunal in *CMS Gas* held that “there can be no doubt ... that a stable legal and business environment is an essential element of fair and equitable treatment.”³⁷ 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].”³⁸ 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. 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.³⁹ Each tribunal found that Argentina had violated its obligation to provide FET. As the *Enron* Tribunal put it, “the measures in question ... have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented.”⁴⁰

What is hardly discussed in any of the cases is the relationship between FET and the underlying contracts, and the extent to which the tribunals’ interpretations of the standard affects the contractual arrangement. *Sempra* merely waves the question away formalistically. According to that Tribunal, treaty claims and contract claims can be neatly separated – here, the FET claim arises out of the treaty, not the contract, because it arises out of the state’s legislative action – not literally a commercial dispute about the contract.⁴¹ On this view, FET protects investors’ expectations to the same degree no matter how they choose to invest – and if the investment is structured through a contract, the treaty

³⁶ Each Tribunal was careful to note that the State might not be under a total stabilization requirement, without clarifying how far it goes. See *CMS Gas*, ¶ 277; see also *Enron*, ¶ 261

³⁷ *CMS Gas*, ¶ 274.

³⁸ *Enron*, ¶ 262

³⁹ *CMS Gas*, ¶ 280; *Sempra*, ¶ 304; *Enron*, ¶ 268.

⁴⁰ *Enron*, ¶ 264.

⁴¹ *Sempra*, ¶¶ 99–101.

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 just as if they were forms of real property.

If we change our perspective, however, 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 materially part of the deal. Where stabilization is permissible at all, in national law, 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 minimum, on this interpretation of FET, stabilization becomes a default rule applying in contractual relations between states and foreign investors – whether or not the law of the contract includes any such principle. Left unclear is whether this treaty-based default is something the parties could have explicitly contracted around – although the tribunals’ strict separation of treaty and contract seems to imply that FET may be effectively mandatory.

Another line of cases – typified by *Parkerings v. Lithuania* – presents a far narrower approach to FET in contract cases.⁴² It 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.⁴³ The company was to retain the rights to collect parking fees, and to enforce the system through clamping delinquent cars and imposing fines for a period of thirteen years.⁴⁴ Less than a year into the contract, however, the national government began taking measures that undercut Parkerings’ rights under the contract –

⁴² *Parkerings-Compagniet v. Republic of Lithuania*, ICSID Case No. ARB/05/08, Award (2007) (hereinafter *Parkerings*); see also *EDF v. Romania*, ICSID Case No. ARB/05/13, Award, ¶ 217 (2009) (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”).

⁴³ *Parkerings*, ¶ 82.

⁴⁴ *Id.*, ¶ 84.

including the passage of national legislation that prohibited private companies from collecting parking fees and enforcing violations.⁴⁵ Lithuania eventually terminated the contract, and Parkerings sued the State under the Norway—Lithuania BIT.

Parkerings claimed that Lithuania violated FET by frustrating the company's legitimate expectations. 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. 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.”⁴⁶ 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 stabilization. To the contrary, the Tribunal points out that “any businessman or investor knows that laws will evolve over time.”⁴⁷

Importantly, the Tribunal focused on the deal as actually negotiated by the parties – particularly emphasizing the absence of a stabilization clause in the underlying contract. As the Tribunal pointed out, in contract it is up to the parties themselves to allocate risk as they see fit. 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.”⁴⁸ 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 stabilization clause ... protecting it against unexpected and unwelcome changes.”⁴⁹ Of course it would have had to pay for such a right, with a less

⁴⁵ *Id.*, ¶ 328.

⁴⁶ *Id.*, ¶ 332.

⁴⁷ *Id.*, ¶ 332.

⁴⁸ *Id.*, ¶ 333.

⁴⁹ *Id.*, ¶ 336.

attractive deal – if the State would have agreed at all. “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.”⁵⁰

Nevertheless, the Tribunal did not entirely limit the effect of FET in contract cases. The Tribunal 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.⁵¹ But it viewed this condition minimally, and found no evidence that Lithuania ran afoul of its obligations under the BIT.⁵²

These two lines of cases diverge sharply as to the *content* of legitimate expectations in FET. *CMS Gas*, *Enron*, and *Sempra* contemplate an objective test with strong stabilization effects. *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. However, in principle, they seem to address the separate question of the relationship between treaty and contract in similar ways. Abstracting from the substantive content of FET, both lines of cases seem to assume that the treaty standard represents a background default against which all contracting takes place.

Some tribunals, like *Sempra*, try to frame FET as a treaty obligation totally distinct from the contract. But 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

⁵⁰ *Id.*, ¶ 336 (emphasis in original). See also *EDF v. Romania*, ¶ 217 (“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.”).

⁵¹ *Parkerings*, ¶ 332.

⁵² *Id.*, ¶ 336.

of the contract. If known and understood, it would be viewed as an implied price term – and one that obviously affects the allocation of risk.

In each of these cases, however, it remains unclear what kind of background norm FET creates – whether it can be contracted around, and if so how sticky it might be. Notice that in all of these cases the rule is at least somewhat sticky. All of the above contracts adopt the law of the host state as the “law of the contract” for purposes of filling gaps – laws which presumably bear on the question of the state’s liability for using its legislative power to the detriment of its private contracting partners. But in applying FET in contract cases – in either its thick or thin versions – tribunals have tended to assume that the treaty norm sets a new background rule. By saying that FET applies on top of the contract, tribunals are saying that FET *displaces* the law of the contract on this issue. At a minimum, the parties would have to affirmatively disclaim the protections of FET, or redefine its contours in their agreement, in order to reallocate risks. And even still, the language of strict separation between contract and treaty claims seems to imply something stronger – that, implicitly, contracting parties are in effect unable to contract out of FET at all.

The question of the content of FET is thus crucially separate from the question of whether and to what extent FET grafts obligations on to covered state contracts. Though the two lines of cases considered above vary dramatically on the content of FET, they both assume that – whatever its content – legitimate expectations adds *something* to the contract.⁵³

⁵³ It bears noting that the content of the standard will turn out to matter, from the perspective of contract theory, when we turn to the normative question of how adjudicators *ought* to resolve the treaty/contract question. If FET is an extremely robust standard of protection, incorporating a stabilization requirement, then it will be critical to the state to be able to contract around it. However, the sting of the problem dissipates the narrower the interpretation of FET becomes. If, in contract cases, FET is limited to something like a guarantee that sovereign powers will be used in good faith, then, yes, it would still augment the contract – but the consequences of its so doing would not be as problematic.

B. Contractual Damages

As noted above, the realm of potential interactions between treaty and contract does not begin and end with substantive treaty rights and duties. Indeed, investment treaties create fulsome regimes of background rules which, if applicable, would cover all 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 entitled to some lesser measure – like recuperation of reasonable reliance damages.⁵⁴ 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.⁵⁵ By contrast, the usual measure of damages in international investment law is, today, fair market value (*FMV*).⁵⁶ 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. 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 explicit discussion of the issue.

It should be noted that investment treaties do not themselves usually include express provisions on damages applicable to each and

⁵⁴ See Serkin, *supra* note 12; Daniel Fischel & Alan Sykes, *Government Liability for Breach of Contract*, 1 AM. L. & ECON. REV. 313, 316 (1999).

⁵⁵ Serkin, *supra* note 12; Arato, *supra* note 2 at 273.

⁵⁶ *Case Concerning the Factory at Chorzów*, PCIJ, Series A, No. 7, 47 (1928).

every treaty standard. Typically provisions on expropriation do include language on compensation – usually invoking FMV. But standards like FET tend to be laconic on the issue, leaving much up to the adjudicator’s discretion. Suffice it to note, for present purposes, 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.⁵⁷

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. 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.⁵⁸ Under that rubric, the tribunals measured each private party’s losses in light of its expected future earning potential over the thirty-five year life of the contract, via discounted cash flow (DCF) analysis – which amounts to a sophisticated approach to expectation damages in the context of long term investment contracts.⁵⁹

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 by default. Under this rule,

⁵⁷ P. Y. Tschanz and J. E. Vinuales, *Compensation for Non-Expropriatory Breaches of International Investment Law*, J. INT’L ARB., Vol. 26 (5), p. 735.

⁵⁸ *Sempra*, ¶¶ 400–403; *CMS Gas*, ¶ 410; *Enron*, ¶¶ 359–363.

⁵⁹ *Sempra*, ¶ 417; *CMS Gas*, ¶ 411; *Enron*, ¶¶ 384–385.

contracting parties would have to 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, again, it is unclear how sticky such a rule would be. From the way these tribunals formalistically sever treaty and contract, it is not clear that they would have been swayed by even express contractual provisions on damages.

Other cases take a more nuanced approach to damages in disputes arising out of investment contracts, more mindful of the parties' underlying contractual arrangements. *Kardassopoulos & Fuchs v. Georgia* addressed the issue in particularly clear dicta. Echoing the *Argentine Gas Cases*, the Tribunal noted that the claims were treaty based – grounded in violations of FET and Expropriation. 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”⁶⁰ – which, for both claims turned out to be FMV.⁶¹ 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.”⁶² The Tribunal added that it would be “loathe to accept the categorical denial of such an arrangement ... as a matter of law.”⁶³ 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

⁶⁰ *Kardassopoulos & Fuchs v. Republic of Georgia*, ICSID Case Nos. ARB/05/18 & ARB/07/15, Award, ¶ 480 (2010) (hereinafter *Kardassopoulos*).

⁶¹ *Id.*, ¶¶ 501–504, 533–534.

⁶² *Id.*, ¶ 481.

⁶³ *Id.*

around an investment treaty through a clear liquidated damages clause or other cap on damages.⁶⁴ One of the arbitrators (Vaughn Lowe) pressed the Claimant on this point, asking the crucial question of what such a clause would look like if the parties intended to contract around the treaty. The Claimant 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...’”⁶⁵ The Claimant’s point was that contracting out would be possible if the contractual language indicated an awareness of both parties of the existence of the relevant treaty standards – an awareness, in other words, of what exactly was being given up. Put in contract theoretical terms, on the Claimant’s understanding the treaty rules on damages would thus represent a fairly sticky default, whose stickiness would be justified on an information-sharing rationale.⁶⁶

Ultimately, however, *Kardassopoulos* did not decide the issue. In the event it did not inquire into whether the contract or treaty took precedence in this case, because it determined that that no material difference would arise. 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.”⁶⁷ 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* seem to offer two competing answers to the treaty/contract issue. Each of these cases accept that FMV reflects the correct approach to damages under FET (meaning expectation damages in

⁶⁴ *Id.*, ¶ 480.

⁶⁵ *Id.*, ¶ 481.

⁶⁶ The *Kardassopoulos* discussion is exceptionally helpful analytically, as it begins to consider 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 14. I do not want to suggest that the Claimant’s approach makes sense with regard to damages. But in Part III, below, I suggest that a similar rationale might make sense in other contexts – like forum selection.

⁶⁷ *Kardassopoulos*, ¶ 482–483.

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. *Kardassopoulos*, by contrast, acknowledges that the contracting parties can control damages in their own arrangements if they do so expressly. 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.⁶⁸

C. *Exclusive Forum Selection Clauses*

Forum selection provides a final example, useful because on this issue tribunals have given closer attention to the relationship between treaty and contract than in any other context. What accounts for the difference is that the leading cases did not primarily turn on FET or expropriation provisions. They rather turn on a more uncommon provision known as the “umbrella clause,” which has the effect of elevating contract claims to the level of treaty claims.⁶⁹ I discuss these controversial provisions in further detail elsewhere.⁷⁰ Here it is enough to note that, as generally understood, umbrella clauses transform at least some kinds of promises made by the state to the investor in the contract into obligations actionable under the treaty. 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 contracts, and similar facts. Each of the contracts was executed under the law of the host

⁶⁸ *Id.*, ¶¶ 481–482.

⁶⁹ *Noble Ventures v. Romania*, ICSID Case No. ARB/01/11, Award, ¶ 54 (2005). 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.

⁷⁰ Arato, *supra* note 2 at 251–258.

state, and each contract provided that the local courts would have exclusive jurisdiction over any disputes over the contracts. 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.

Both tribunals faced the same tension. 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:

. . . 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.⁷¹

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 – i.e. municipal law. And where the contract provides for an exclusive forum to resolve all contractual disputes, the existence of a breach and the amount of damage

⁷¹ *SGS v. Philippines*, ¶ 128.

thereby caused can only be authoritatively determined by the contractually provided forum.⁷² Forum selection is, after all, part of the deal – a price term that could have been negotiated non-exclusively, but here was not. Noting that the contract provided exclusively for local court jurisdiction, the Tribunal issued a stay. 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. Only then would the state's compliance become a matter of international law.⁷³

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. The approach in *SGS v. Paraguay* resonates more closely with the approaches in the *Argentine Gas Cases*.⁷⁴ Here, the Tribunal held that a covered state contract would simultaneously create both domestic legal rights and international legal rights under the treaty. In the Tribunal's view it had no jurisdiction over the former, but it asserted full jurisdiction over the latter. And unlike *SGS v. Philippines*, it viewed the contract's exclusive forum selection clause as no bar to adjudicating the treaty claims.⁷⁵ 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. In its view, even an 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.⁷⁶

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *SGS v. Paraguay*, (Jurisdiction).

⁷⁵ *Id.*, ¶ 174.

⁷⁶ *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 assigned damages totaling \$39 million, plus over ten years of interest accruing from

From the *ex ante* perspective of the parties to an investment contract, these cases again 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.⁷⁷ 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 contract parties.⁷⁸ On this reading, dispute resolution provisions represent only a default, which can be contracted around via clear express language in the contract.⁷⁹

D. A Disordered Status Quo

The jurisprudence on the treaty/contract issue lies in a state of disarray. The question is handled with significant irregularity within and across all treaty issues, from substantive rights and duties to damages and forum selection. Such uncertainty is a real problem in private law. From the *ex ante* perspective, states and foreign investors cannot be confident about

the date of termination. *SGS v. Republic of Paraguay*, ICSID Case No. ARB/07/29, Award, ¶¶ 182–184, 188 (2012).

⁷⁷ For an example outside the context of the umbrella clause, see *Parkerings* (asserting a similar argument in a case turning on FET).

⁷⁸ See also *BIVAC v. Republic of Paraguay*, ICSID Case No. ARB/07/9, Jurisdiction, ¶ 142 (2009) (“Assuming that [the umbrella clause] does import the obligations under the Contract into the BIT ... this would 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 able to resolve any ‘conflict, controversy, or claim which arises from’ ... the Contract.”)

⁷⁹ See further, Crawford, *supra* note 7, at 363; GUS VAN HARTEN, SOVEREIGN CHOICES AND SOVEREIGN CONSTRAINTS 122 (2013).

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, in other words, the parties opt out of treaty arrangements if they prefer to allocate risks 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.⁸⁰ 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.”⁸¹ Taking the *ex ante* perspective of states and foreign investors – as contracting parties – helps clarify how to begin resolving their messy interactions.

Under most interpretations, where a treaty claim arises out of a contract dispute it 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. But this is overly

⁸⁰ Only a handful of cases address the treaty/contract issue directly. See, e.g., *SGS v. Philippines*; *Kardassopoulos*.

⁸¹ Crawford, *supra* note 7, at 373.

formalistic – focused too much on the formal 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.

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 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* or *SGS v. Philippines*, the parties may then dicker over them in their negotiations as they would with any other price term. On the latter reading the treaty may change the baseline for negotiations from 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.

On the specific question of how contract and treaty provisions interact, the cases are irregular, inconsistent, and often markedly unclear. Most simply make assumptions about how treaties and contracts interact – and their assumptions are not always the same. Still, there do seem to be trends. The tendency seems to be to treat investment treaty provisions as

effectively mandatory. Most others tend to assume treaty provisions are something like highly sticky default rules, which apply unless the parties explicitly contract around them.⁸² In other words they act to fill gaps, and also effectively supervene any contrary defaults or mandatory provisions in the domestic “law-of-the-contract” – and they are not easily contracted around. Only a few cases consider the issue explicitly, like *Kardassopoulos* – for most it is a matter of reading between the lines to excavate their underlying assumptions. And only a handful of cases explicitly buck the trend – such as *SGS v. Philippines*, which implicitly views treaty norms as something much closer to standard default rules.⁸³

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 confidently plan on the material meaning of any contractual arrangements under the shadow of an investment treaty. It 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 consistency of any kind would already be a boon. 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.

⁸² *Kardassopoulos*, ¶ 481.

⁸³ *SGS v. Philippines*; *BIVAC v. Paraguay*.

III. EFFICIENCY, AUTONOMY, AND CHOICE

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 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 only compounded 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 the prevailing tendencies, I suggest that it should generally be presumed that explicit contractual provisions trump treaty provisions, as the authentic expression of the contracting parties' division of risk. In the first place, a general presumption that treaties create mere defaults is essential to the object and purpose of these treaties as a matter of international law – to protect and promote foreign direct investment. There are also strong policy reasons for understanding treaty rules as mere defaults, grounded in both the logic of private law and in concern for public regulatory values. But, crucially, 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 the forum selection clause makes a good candidate. It may even be that some treaty provisions ought to be understood as mandatory. But 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.

Since the nature of the treaty/contract relationship undecided in treaty text, the first touchstone for treaty interpretation must always be the investment treaty's object and purpose. This entails, in most cases, the twin overarching goals of protecting 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 – states rather 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. If states did not want to induce investment, they would not sign modern investment treaties.

Yet different provisions may well serve the treaty's 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 Crawford notes, the customary conflicts rule applies in investor-state arbitration – whereby international law prevails over domestic law in case of conflict.⁸⁴ But a conflict would only arise if we assume the treaty creates mandatory rules. As 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.⁸⁵ In the absence of any other general rules, the issue of how contract relates to treaty must be asked anew *vis-à-vis* each particular treaty, and each particular treaty provision, bearing in mind its 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.

⁸⁴ Crawford, *supra* note 7, at 353

⁸⁵ Craswell, *supra* note 10, at 1.

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.⁸⁶

A. *The Value of Choice in the Logic of Contract*

It is useful to consider again 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

⁸⁶ Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 L. & SOC. REV. 239, 254–256 (1983); DAGAN & HELLER, *supra* note 5.

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 trump contract provisions negotiated by the parties.⁸⁷ 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 cases of 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,⁸⁸ or a more utilitarian vision of efficiency.⁸⁹ This is not the place to wade deep into that discourse. Suffice it to say that across all these visions of contract *choice* ultimately gets pride of place. In one recent and compelling account, choice is made the centerpiece. Dagan and Heller’s liberal “choice theory

⁸⁷ *CMS Gas; Sempra; Enron; SGS v. Paraguay* (Jurisdiction).

⁸⁸ FRIED, *supra* note 3; Krauss, *supra* note 4; Seana Valentine Shiffrin, *Promising, Intimate Relationships, and Conventionalism*, 117 PHIL. REV. 481, 520 (2008), Andrei Marmor, ed. (2012); DAGAN & HELLER, *supra* note 5.

⁸⁹ See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003).

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). 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.⁹⁰ But choice plays just as big a role in utilitarian theories of contract. In the law and economics approach of scholars like Scott, efficiency is the central value – not autonomy – but, critically, efficiency is left up to the market. 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.⁹¹ Whether we emphasize autonomy or efficiency, it should be clear that choice lies at contract’s heart.

The logic of contract is fundamentally oriented around respect for party choice – choices about what kinds of contract to adopt, and choices about the terms within any particular contract.⁹² To the extent that investment treaties apply to contracts, they create contract law – and this law should resonate with contract’s basic 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 and other assets like real property. Treaties, in other words, should not normally be used to rewrite contractual arrangements.⁹³ Whatever their content, the basic presumption should be that investment treaty norms

⁹⁰ In other kinds of contracts, values like community might be emphasized – as with marriage contracts or non-profit charters. DAGAN & HELLER, *supra* note 5, at ch. 6.

⁹¹ Scott & Schwartz, *supra* note 89.

⁹² DAGAN & HELLER, *supra* note 5.

⁹³ Crawford, *supra* note 7, at 373.

apply to contracts as no more than defaults, which the parties are free to contract around.

B. *The Value of Choice in International Investment Law and Policy*

Beyond bringing the burgeoning treaty law on contracts into greater coherence with contract theory, the choice-oriented approach advocated here offers real 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 impinge on the state's policy space,⁹⁴ or how much they undercut its sovereign authority.⁹⁵ Too often this debate is portrayed as a conflict between commercial lawyers who tend to be “investor-friendly,” and “state-friendly” public lawyers – as if private law is intrinsically insensitive to public regulatory values.⁹⁶ 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

⁹⁴ Markus Wagner, *Regulatory Space in International Trade and Investment Law*, 36 U. Penn. Int'l L.J. 1 (2015).

⁹⁵ Critics have tried to reconceive international investment law in terms of public law in hopes of rebalancing the regime toward states. Alec Stone Sweet, *Investor-State Arbitration: Proportionality's New Frontier*, 4 L. & ETHICS H.R. 47, 76 (2010) (invoking proportionality); William 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 (2010) (invoking the “margin of appreciation”); Mattias Kumm, *An Empire of Capital? Transatlantic Investment Protection as the Institutionalization of Unjustified Privilege*, 4(3) ESIL REFLECTIONS (2015) (invoking proportionality and subsidiarity); see also Stephan W. Schill, *Deference in Investment Treaty Arbitration: Re-conceptualizing the Standard of Review*, 3 J. INT'L DISP. SETTLEMENT 577, 579 (2012). I am sympathetic to the public law school's concerns 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. Julian Arato, *The Margin of Appreciation in International Investment Law*, 54 VA. J. INT'L L. 545 (2014).

⁹⁶ 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 – and particularly in the transnational context, the power of contract can be highly liberating for states concerned to protect their public values. See, e.g., Dagan, *supra* note 6.

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.

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. Take, for example, a typical damages rule. It is usually understood that the proper measure of damages for a violation of FET is fair-market value (FMV), which amounts to expectation damages in contract cases.⁹⁷ What if, however, the contract was negotiated under a national legal order that provides only reliance damages by default for contracts with the state? Or what if the parties explicitly selected a liquidated damages provision?

From the state's perspective, the stickier the FMV rule is, the more difficult it becomes for states to manage risks to their capacity to 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, of course, be felt all the more acutely by emerging economies. A rational state will have to price such risks into their contracts.

And herein lies the problem for the investors – who may well want to shoulder more risk in the hopes of greater reward. In the context of foreign direct investment, some degree of risk in the hopes of greater rewards is, after all, the point. 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 imposes too great protections on a contract, the state may be pushed into offering investors less attractive investment

⁹⁷ Tschanz & Vinuales, *supra* note 57.

opportunities in order to insure itself, or 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 (i.e. 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 law of the contract might entail a lesser measure (like reliance damages) by default. But, much more importantly, the power would still lie with the contracting parties to allocate the risks among themselves.

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, 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 consequence of such a rule is not just regulatory chill, but *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. Except in special cases – discussed further below – the basic rule that contractual choices ought to be given priority over treaty norms *enhances* the autonomy of the state.

The approach here 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. Particular investors may simply not value certain provisions – where, for example, they trust the state's national courts. To the extent that the state party values avoiding international arbitration, such investors should be able to offer opting out. In other cases, investors may *want* to take on some risk – no business venture is risk free, and often the appeal of foreign investment is the possibility of taking on elevated risks in the hopes of high rewards. Investors surely want some measure of security in engaging with foreign sovereigns, but not necessarily at the expense of all rewards. Certainly, at the least, they want states to be *able* to negotiate over risk. If, however, treaties create rigid rules that mandate certain allocations of risk, investors may not be able to secure the risk profile they want. If, for example, states are forced to anticipate paying expectation damages where changes in regulation vitiate the value of a contract, they may not be willing to negotiate with foreign investors at all – and even if so, a rational state will have to price in such risks. If the investor wants to shoulder some of the risk, say by agreeing to a liquidated damages provision, she should be able to do so.

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

The point is that investors and states alike should prefer an arrangement where the treaty enables them to allocate risk as they see fit, at least *ex ante*. The investor still gets a sizeable benefit from the treaty, 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 take precedence over the background treaty norms.

C. Autonomy Enhancing Constraints

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 should prevail over background treaty protections. Yet there may 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). 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, by, for example, putting the parties on equal footing or correcting for certain market failures.⁹⁸ A second type of justification for constraints relies on extrinsic values – including, classically, mandatory rules invalidating contracts of enslavement or contracts to commit a crime.⁹⁹

⁹⁸ See, e.g., Ayres, *supra* note 14.

⁹⁹ Craswell, *supra* note 10.

The same logic might apply to the treaty/contract issue in international investment law. While 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. While it is possible that treaties could incorporate rules of the latter type, I put extrinsically justified rules to the side for purposes of this piece – since their relevance is less immediately apparent.¹⁰⁰

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, 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. Ideally, we would also expect that, in 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.¹⁰¹ 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.¹⁰² There might be reason to deviate from the general rule in some cases, but such sticky

¹⁰⁰ At any rate, the relevant extrinsic values would be values shared by the states parties to the *treaty*. We should expect any such rule to be expressed in the treaty itself – and not lightly assume that the determination of the states parties’ non-commercial values is left to arbitral discretion.

¹⁰¹ Ayres, *supra* note 14, at 2055 (“in 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.”).

¹⁰² Ayres, *supra* note 14, at 2054–2055.

defaults should be based on especially compelling reasons and not be stricter than necessary.

Given these principles, 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 it to a default. The *SGS* cases reveal two distinct visions of interaction between contract and treaty on the issue of forum selection. *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.¹⁰³ On this view, the treaty does not rewrite the contract.¹⁰⁴ *SGS v. Paraguay*, by contrast, privileges treaty over contract. There, even an express clause exclusively selecting national courts does not waive the investor's right to international arbitration under the treaty. 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. There is no reason, here, 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 it 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. Recall that investment treaties are international agreements between states to protect their nationals, and most states are subject to numerous such instruments. Investment treaties are meant to afford protection to all covered nationals, whether they know it or not. And

¹⁰³ *SGS v. Philippines; BIVAC v. Paraguay*.

¹⁰⁴ Crawford, *supra* note 7, at 373 (Crawford incidentally, chaired the *SGS v. Philippines* tribunal).

there is real concern about whether or not 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 sue host states before an international tribunal.¹⁰⁵ Arguably, there may thus be reason 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, there would be reason to conceive of treaty provisions on dispute resolution as a particular kind of sticky default – meant to force states to convey information about treaty rights to foreign investors. 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 ...”.¹⁰⁶ Such clauses would ensure that the investor had been aware of her rights, and was thus satisfied with the contract’s reallocation of risks.

Notice that this account is similar to the Claimants’ argument in *Kardassopoulos*, on the question of liquidated damages.¹⁰⁷ In my view,

¹⁰⁵ Jason Yackee, Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence, 51 VA J. INT’L L., 397 (2010).

¹⁰⁶ This is what Colombia contemplated in a 2014 draft concession contract, which sought to waive “investment arbitration contemplated in any [BIT] or other international treaty ...” *translated in Strong, supra note 27, 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. Arato, *supra note 2 at 275–276*.

¹⁰⁷ *Kardassopoulos*, ¶ 481.

however, stickiness makes less sense in that context. It would be going much too far to insist that all treaty provisions should be similarly sticky – forcing the parties to disclaim the treaty by name any time they expect a contractual provision to deviate from its terms. Even aside from the transaction costs such drafting would involve, there is generally not sufficient reason to question the substantive deal between the parties. If there is reason to treat forum selection as a special case, it would have to derive from the structural importance of that particular provision.

There may indeed be compelling reasons for viewing treaty provisions on forum selection as sticky defaults. International dispute resolution by non-national 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.¹⁰⁸ Given its structural and institutional weight, 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. In the context of damages, for example, there is much less reason to worry about whether parties would not be aware of the precise meaning of a damages cap – whether or not they knew of the existence of the treaty.

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. In the context of contractual investments, this means respecting the parties' bargains. In most cases this will mean privileging the parties' choices. However, it must be recognized that it is occasionally necessary to partially constrain choice, to

¹⁰⁸ 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 9, at 310.

ensure that the law is protecting real bargains – arms-length deals, between sufficiently sophisticated parties. This may mean that some treaty norms are properly understood as stickier than others.

IV. INTERNATIONAL INVESTMENT LAW AS REFLEXIVE LAW

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. I have argued that the jurisprudence lies in disarray, creating unbearable uncertainty. The case law's unjustified divergences make investing through contract insecure and highly inefficient, and pose a real threat to the state's regulatory autonomy. I have proposed, here, a principled way of grappling with the problem, grounded – perhaps counterintuitively – in private law.

Though it implicates critical areas of public policy, international investment law is best conceived in private law terms – as a system of *reflexive law*, oriented toward self-regulation. In Teubner's conception, the idea of reflexive law is to give parties the tools to structure and govern their interactions for themselves.¹⁰⁹ Where the parties are themselves best positioned to achieve optimal regulations themselves, through negotiation, the law should not mechanically impose categories on their choice (formal law); nor should it leave all matters up to the value judgments of adjudicators (substantive law). Reflexive law rather privileges the arrangements of the parties. It does not interfere with choice except in order to enhance autonomy, either through equalizing basic conditions (like information) or by providing security that subjects will follow through with their commitments.

¹⁰⁹ Teubner, *supra* note 86, at 254–256.

Drawing from the reflexive logic of contract, the basic organizing principle should be the choice of the parties. 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). To the extent that they apply to contracts, treaties should serve the logic of contract – as systems of reflexive private law oriented toward self-regulation by private parties.

As a corollary to that principle, however, a degree of constraint on party liberty can be autonomy enhancing in some instances. It may make sense to privilege the treaty over terms in the contract under certain limited circumstances – as, for example, a sticky default in cases where informational asymmetries seem likely to create a market failure, or otherwise undermine the goals of the investment treaty. Given their centrality in the treaty system, forum selection provisions might be a plausible candidate. But adjudicators ought to view such situations as exceptional, and carefully justify deviation from the norm by appeal to the logic of contract itself – rather than by simply insisting on the formal difference between treaty and contract claims, or by appealing to the general conflicts rule governing international law and national law.

