Spring 2011

Efficient Contracting between Foreign Investors and Host States: Evidence from Stabilization Clauses

Sam F. Halabi
University of Missouri School of Law, halabis@missouri.edu

31 Nw. J. Int'l L. & Bus. 261

Northwestern Journal of International Law and Business
Spring 2011

Article

Sam Foster **Halabi** [a1]

EFFICIENT CONTRACTING BETWEEN FOREIGN INVESTORS AND HOST STATES: EVIDENCE FROM STABILIZATION CLAUSES

Bilateral investment treaties are agreements between sovereign states that give broad protections to investors and investments made within the jurisdiction of the other state. The prevailing view in the academy and practice is that developing countries sign bilateral investment treaties in order to reassure investors from developed states that their investments will be safe from changes in domestic law. Without these "credible commitments," investors would be deterred from making investments, depriving developing countries of foreign capital. This Article disputes that view by demonstrating that foreign investors and host states effectively contract around the risk of changes in the law. This Article applies transaction cost economic theory to the most comprehensive empirical study of stabilization clauses (provisions intended to manage post-investment changes in domestic law) recently conducted under the auspices of the World Bank's International Finance Corporation. The analysis shows that investors and states demonstrate principles of efficient contracting even without the protections of bilateral investment treaties (BITs). This finding adds to current research focusing on the "credible commitment" story. The Article concludes that (1) BITs can be explained as instruments developed and developing states use in their competition for markets and capital and (2) differences in the reasons states execute BITs raise significant doubts about conclusions drawn based on aggregate phenomena.

I. INTRODUCTION
II. HISTORY AND PROLIFERATION OF BITS
A. Political Risk
B. Diplomatic Protections for Investors
C. Contractual Protection for Investors
D. BITs: the Convergence of Diplomatic and Contractual Protections
E. Insurance Regimes
F. Joint Ventures
G. The Relative Importance of BITs in Securing Investments
III. COASE, WILLIAMSON AND INCOMPLETE CONTRACTING
A. Coase and the Nature of the Firm: the Spectrum between Markets and Hierarchy
B. Oliver Williamson: Bounded Rationality, Opportunism and Asset Specificity
1. Bounded Rationality
2. Opportunism
3. Asset Specificity

	C. The Coase-Williamson Framework and Foreign Investment
	1. Foreign Investment, Bounded Rationality and Opportunism
	2. Foreign Investment and Asset Specificity
	i. Apparel and Footwear
	ii. Owning or Leasing Land
	iii. Institutional Variations
IV.	STABILIZATION CLAUSES
	A. Freezing Clauses
	B. Economic Equilibrium Clauses
	C. Hybrid Stabilization Clauses
	D. Stabilization Clauses and Asset Specificity
	1. Regional Differences
	2. Freezing Clauses: Natural Resources
	3. Economic Equilibrium Clauses: Power and Infrastructure
	4. Hybrid Clauses
	E. Investors and States Use Diverse Institutional Governance Structures
	1. Sharing Benefits and Costs of Changes in the Law
	2. Renegotiation
	3. Stabilization Clause Mechanisms
	i. Included and Excluded Laws
	ii. Threshold Loss Limits
	iii. Foreseeability
	iv. Discriminatory Effect
V.	EFFICIENT CONTRACTING BETWEEN STATES AND INVESTORS
	A. The BIT as Barrier to Efficient Contracting
	B. Evidence from State Practice
VI.	CONCLUSION

***263 I. INTRODUCTION**

The proliferation of bilateral investment treaties (BITs) in the late 1980s and early 1990s generated robust debate on whether these treaties actually advance their presumed goal of increasing and protecting foreign direct investment in developing countries or whether they represent an economically unjustified benefit to business entities incorporated in capital exporting countries. BITs are treaties signed between two sovereign states that give private investors certain protections for investments made in the other state. The substantial majority of BITs are signed between one developed state and one developing state. The parties generally agree to refer disputes over their promises to international arbitration for resolution. Advocates and scholars criticize both the economic rationale behind BITs and their effects on developing countries. First, they question whether BITs increase investment in developing states; second, they argue BITs undermine the legitimate regulatory authority of the state; finally, they allege BITs feed an international arbitration industry that, at best, lacks transparency and, at worst, issues inconsistent decisions shaped by conflicting motives. [1] Recent scholarship has attempted to identify a pro-investment "mythology" of BITs, attacking that mythology as lacking empirical and logical coherence. [2]

This Article offers an efficiency rationale for the rejection of BITs in ***264** favor of direct negotiation between foreign investors and host states. In many cases, BITs are unnecessary; under some circumstances, they may undermine efficient contracting. My argument relies in significant part on the framework developed by Ronald Coase and Oliver Williamson on the "theory of the firm," [3] which argues that boundedly rational, opportunistic parties will adopt one of several alternative institutions that maximize transaction gains while minimizing transaction costs. [4] This Article applies these insights to a recent comprehensive study of contracting behavior between states and foreign investors. The study shows these parties ensure commitments to each other with a variety of contractual mechanisms that efficiently distribute the risks of changes in local law.

The principal purpose of this Article is to demonstrate that investors and host states, by and large, effectively construct conflict-resolving institutions without the "credible commitments" [5] BITs purportedly ***265** provide. [6] The article relies on a recent empirical study of "stabilization clauses" in agreements between foreign investors and host states. Stabilization clauses are provisions in individual investment contracts that govern how, if at all, laws enacted post-investment will apply to the investor or investment. This study, coordinated between the World Bank's International Finance Corporation (IFC) and the U.N. Special Representative of the Secretary-General for Business and Human Rights (UN Special Representative), obtained seventy-six current investment contracts and twelve model investment contracts. The data gleaned from these contracts support predictions generated under the Coase-Williamson framework: parties will adopt stronger institutional protections as the object of the contract increases in mutual importance.

A secondary argument is that, in some circumstances, BITs may undermine efficient contracting between foreign investors and host states. [7] Because the terms of BITs are broader and generally lopsided in favor of the investor, an investor may choose to rely on the provisions of the BIT instead of a stabilization clause. Even where a stabilization clause is negotiated between the parties, a foreign investor may (1) ex post, incorporate a holding company in a jurisdiction that will give it greater protections under a BIT than the stabilization clause, [8] or (2) if a dispute arises, use the most-favored-nation clauses in BITs to argue the most favorable BIT to which the host state is a party represents the applicable ***266** law. [9] BITs may, in fact, reduce or eliminate alternative institutional possibilities investors and host states might use in the event a host state changes its law in a manner affecting the value of the investment. [10]

This thesis adds an important dimension to the prevailing theory which asserts that capital importing or developing countries sign BITs as part of an effort to encourage or reassure investors. [11] While this explanation might account for some decisions to sign BITs, there is evidence to show that developed or capital exporting countries also compete--not only for access to new or emerging markets, but also to attract (or retain) domiciliary investors. [12] Foreign policy objectives also complicate the competition for global capital. It is often unclear whether the desire to promote and protect foreign investment drives political and diplomatic calculations or vice versa. [13]

***267** To the extent that principles of efficient contracting, as articulated by Coase and Williamson, might improve both the BIT negotiating process and the overall regime of BITs, it is worth providing a sustained treatment of the topic to do so. [14] Even if the proliferation of BITs displaces foreign investor-host state contracting, it may be possible to apply lessons learned from investor-state negotiations to BIT negotiations which are often one-sided and tend to allocate greater risk to the host state and its citizens. [15] While some scholars have explored the extent to which BITs duplicate protections provided in investment contracts, the literature is lacking (1) evidence to support the basic claim that contracting may provide a complete alternative to BITs and (2) a sustained analysis of whether foreign investment decisions closely approximate the same contracting principles that enjoy empirical support in the domestic context.

This paper is organized as follows: Part II of this Article provides a brief history of bilateral investment treaties. Part III explains the Coase-Williamson framework for analyzing efficient contracting and predicting the development of conflict-reducing institutions. Part IV comprehensively analyzes the study of investment agreement stabilization clauses conducted by Andrea Shemberg under the auspices of the IFC and the UN Special Representative. The analysis will support the views that (1) prior to the proliferation of BITs, investors contracted with host governments around political risks using a variety of conflict-reducing institutions, (2) the complexity of these institutions by and large reflected the probability that one or both parties would act opportunistically (low probability corresponding to relatively simple dispute resolution mechanisms), and (3) the proliferation of BITs may undermine investment-specific arrangements. In Part V, I argue the view of BITs as "credible commitments" from developing countries toward investors in developed countries is too narrow. BITs are one of many instruments available to states to accomplish interrelated economic and political objectives. The literature, therefore, is skewed in at least two directions: first, it over-emphasizes competition between developing, as opposed to developed, countries; second, it tends to assume uniformity in the objectives behind BITs.

II. HISTORY AND PROLIFERATION OF BILATERAL INVESTMENT TREATIES

A. Political Risk

A foreign investor will endeavor to minimize at least the following ***268** risks after making the decision to invest: commercial risk (prices for a commodity or good may drift above or below estimates), financial risk (interest rates may rise or fall beyond an anticipated range), natural disasters, and political risk--the risk a change in law will diminish the value of the investment. [16] Political risk in this context describes the incentives host governments have to pass laws or regulations that extract greater value from a project or investment after the investor has sunk significant costs building facilities, obtaining labor, and establishing requisite conditions. [17] Historically, foreign investors worried about nationalization per se; now, their concerns are focused on less sweeping but nevertheless costlyenvironmental, health, labor, and tax changes. To reduce this risk, investors might rely on the ability to petition their home governments to act on their behalf; to conclude agreements that give them expanded rights vis-à-vis host states; and to negotiate contractual provisions directly with host governments. An investor may also reduce political risk by procuring insurance or engaging in a joint venture, enabling it simultaneously to limit its exposure and increase the number of parties that can pressure a government that passes an unfavorable law or regulation.

B. Diplomatic Protection for Foreign Investors

In the event a host government violates customary international law, causing a breach of contract, or direct or indirect expropriation, an investor may have access to the diplomatic protections of its home government. [18] A state is liable under customary international law where (1) it breaches a contract with an alien investor and (2) that breach was caused by discriminatory or arbitrary conduct. [19] Furthermore, a state may take action against another state for direct or indirect expropriation where the host state "impairs the value of an investment through unilateral interference with a ***269** contract by legislative or administrative means" and fails to "properly compensate" the investor. [20] In either event, the home state acts when the customary and legitimate expectations its citizens enjoy when visiting a foreign but friendly territory have been violated, and it asserts those rights as a sovereign. [21] Practically, however, the process of this ex post effort at compensation is slow and deeply influenced by surrounding political considerations.

Before the modern regime of international investment arbitration, investors often were required to exhaust the domestic courts of the host country before receiving diplomatic assistance. [22] Although empirical studies are inconclusive on the issue, investors perceived these courts as inhospitable, and they sought other forums to resolve investor-state disputes. [23] As recently as 1998, states tried to address this problem with broad, multilateral investment agreements. [24] These attempts failed for several reasons, including intractable differences between developed and developing countries and, with the proposed Multilateral Agreement on Investment (MAI), the extraordinary mobilization of civil society groups arguing the MAI would disproportionately disadvantage developing countries. [25]

*270 C. Contractual Protection for Investors

Because of the unreliability of diplomatic protections, investors often used agreements with host governments to manage political risk.[26] In long-term contracts, investors included clauses that sought to render new laws affecting the investment's value inapplicable to the investment. Generally referred to as stabilization clauses, parties drafted these provisions to explicitly cover political risk. For example, a stabilization clause might provide that:

> the GOVERNMENT hereby undertakes and affirms that at no time shall the rights (and the full and peaceful enjoyment thereof) granted by it under this Agreement be derogated from or otherwise prejudiced by any Law or by the action or inaction of the GOVERNMENT, or any official thereof, or any other Person whose actions or inactions are subject to the control of the GOVERNMENT. In particular, any modifications that could be made in the future to the law as [i]n effect on the Effective Date shall not apply to the CONCESSIONAIRE and its Associates without their prior written consent, but the CONCESSIONAIRE and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date.[27]

While some legal scholars predicted the demise of these provisions during the wave of nationalizations in the 1950s and 1960s, foreign investors and states continued to use them.[28]

Stabilization clauses manage political risk through a wide range of strategies. They may freeze both fiscal and non-fiscal law with respect to an investment, specify a given set of issue areas that are frozen, require compensation in the event of any change in the law, require limited compensation or compensation over a given threshold after a change in the law, carve out exemptions from certain laws, or protect against financial loss on account of a limited set of changes in the law.[29] The complexity, ***271** diversity, and history of stabilization clauses play an important evidentiary role in the argument presented here.

D. BITs: The Convergence of Diplomatic and Contractual Protections

Bilateral investment treaties combine aspects of diplomatic and contractual protections for investors.[30] Generally, BITs are negotiated between capital-exporting nations (developed or home states) and capital-importing nations (developing or host states), although BITs are increasingly executed between two developing countries.[31] BITs contain provisions guaranteeing investors from the home state protections for their "investments" in the host state. These guarantees may include fair and equitable or non-discriminatory treatment,[32] free transfer of profits and currency, and, in many cases, payment of compensation should a host state adopt measures having the effect of direct or indirect expropriation.[33] BITs do not, typically, include enumerated rights for host states outside their ability to prohibit certain economic activities altogether or to take normal regulatory action in the interest of public order, public health or public morality--so-called "non-precluded measures."[34] Host states are still potentially obligated to compensate investors for these "regulatory takings."[35] Most of these treaties provide investors access to one of the major international arbitral tribunals to vindicate rights under a BIT. BITs often provide for arbitration at the International Centre for the Settlement of Investment Disputes (ICSID) because it is perceived to move quickly[36] and to issue decisions less prone to appeal or unenforceability than those issued by domestic courts or other arbitration forums.[37] Although the position ***272** staked out by Argentina as a result of its economic crisis of 2002 is changing these perceptions, states generally pay awards issued by ICSID tribunals voluntarily. [38]

The origin and number of BITs in existence is well-documented, although the reasons for their proliferation remain in dispute. [39] After the first BIT--generally agreed to be the treaty concluded between Germany and Pakistan in 1959--the number of BITs increased steadily. [40] At the end of the 1980s, records at the U.N. Conference on Trade and Development (UNCTAD) showed 385 BITs; a decade later, the number reached 1,857; [41] current estimates show approximately 3,000 BITs in force. [42]

The most parroted theory about BITs is that developing countries sign them as a way to "credibly commit" to investors so as to encourage foreign direct investment. [43] Under one elaboration of this theory, scholars explain the rise of BITs as a response to the decolonization and nationalization movements of the 1950s and 1960s:

> The nationalization of British oil assets by Iran in 1951, the expropriation of Liamco's concessions in Libya in 1955, and the nationalization of the Suez Canal by Egypt a year later served notice of a new militancy on the part of investment hosts. The nationalization of sugar interests by Cuba in the 1960s further undercut assumptions about the security of international ***273** investments. [44]

Simultaneously, developing countries used the U.N. General Assembly to pass resolutions that purportedly upended customary international norms for determining compensation in the event of nationalization. Those norms had been advanced by capital exporting states to argue that customary international law required the payment of "prompt, adequate, and effective" compensation for the taking of property whether through direct or indirect expropriation. [45]

Certain scholars of international law and international political economy have challenged important aspects of this theory. Jose Alvarez, for example, argues the collective activity of developing countries at the U.N. had a relatively small effect on what were understood to be the customary international norms at the time, [46] so there was no need to "reassure" investors through BITs. [47] He offers several alternative explanations: after the decline of the Soviet Union in the late 1980s, developing countries signed BITs (1) in order to signal--both internally and externally--their acceptance that command economy norms were dead or dying; (2) to signal that they would work toward fulfilling the expectations of international lenders; (3) as part of a broader effort to build market-based domestic institutions; and (4) to satisfy the pressures exerted by certain domestic constituencies. [48] Joseph Stiglitz views the proliferation of BITs as a response to NGOs' extraordinarily strong resistance to the OECD's proposed Multilateral Agreement on Investment which would have created ***274** a multilateral instrument--like the laws under which the WTO operates--giving the protections now obtained through BITs. [49] Almost all scholars, however, at least impliedly accept that the driving force behind BITs is developing countries competition for investments from companies based in developed countries.

The economic effect of these treaties is also disputed. [50] Some studies conclude developing countries that sign BITs experience increases in foreign direct investment and growth while others see no impact or even a negative effect, considering the regulatory restraints placed upon the host state. [51] Moreover, as awards from ICSID increase in size, the overall effect on host state development and global investment flows is largely unknown. [52]

E. Insurance Regimes

Foreign investors may also protect their investments through an increasing number of national, private or international insurance regimes, as long as they meet certain conditions. [53] U.S. investors, for example, can obtain insurance through the Overseas Private Investment Corporation (OPIC), as long as the investment is predominately owned by Americans, is made in certain countries, and is intended to promote the economic ***275** development of the host country, among other requirements. [54] OPIC also requires investors to invest in host countries that have subrogation treaties with the United States, allowing OPIC to attempt to reclaim its expenditure from the host country, usually through a fiduciary agent located in the host country (thereby avoiding direct political controversy). [55] Other common conditions imposed by home countries offering insurance to their investors include the requirement that the investment be in a host country with which the home country already has a BIT, [56] or that the investment be new or an expansion of an existing investment. [57]

Private investment insurance programs have advantages and disadvantages compared to national programs. While they cover nationals of any country and can operate independently of policy objectives, [58] they also must run a profit and are limited in the types of coverage they can provide (such as long-term investment guarantees). [59] The private insurance market is growing and now accounts for approximately half the market previously dominated by national insurance schemes and the World Bank's Multilateral Investment Guarantee Agency (MIGA). [60]

Since its creation, MIGA has been joined by 175 countries [61] and has issued over $21 billion of guarantees for over 600 projects. [62] MIGA will insure any investment made by a national or company of a member state within another member state. [63] MIGA insurance covers the risks associated with currency transfer, expropriation, breach of contract, and war and civil disturbance. Disputes are submitted to the Permanent Court of Arbitration at The Hague. [64] To date, MIGA has only paid out three claims: two claims in response to host government intervention to control economic crises [65] ***276** and one claim for a project damaged by a Maoist rebel attack in Nepal. [66] However, MIGA has also resolved over fifty disputes over its guaranteed investments to prevent claims filings. [67]

F. Joint Ventures

Investors may also reduce political risk by engaging in joint ventures. Doing so can simultaneously limit an investor's exposure and increase the number of parties that might eventually pressure a government that passes an unfavorable law or regulation. [68] In a joint venture with a state-owned enterprise, the state might theoretically be deterred from passing laws or regulations that would diminish the value of the state enterprise. The stability of such arrangements, however, depends on the business relationship between state and investor. [69] Failure to agree on the terms of an investment during a renegotiation, for example, might lead to expropriation of the private portion of the joint venture. [70] However, assuming profits are high for the host state or the host state derives a benefit from the private investor's expertise, foreign investors may use joint ventures as part of an effective political risk management strategy. [71]

G. The Relative Importance of BITs in Securing Investments

Despite the alternatives available and used for investment protection, scholars, practitioners, and international arbitrators focus on BITs as the key security against host states' cheating on the original investment bargain. Recently, however, Jason Webb Yackee has argued that the original theoretical premise--that without BITs, cheating would be inevitable--is specious. First, he notes, any host government seeking subsequent investment would not cheat on an original investment out of reputational concern. [72] Second, it remains empirically unanswered whether BITs encourage or deter investors from negotiating specific political or legal risks. Signing BITs may deter such negotiation because "[m]odern investment treaties . . . include methods of property and contract protection which individual investors, in an often more difficult negotiating context, ***277** might not have been able to negotiate on their own." [73] Yackee suggests a BIT regime may be appropriate for small or medium-sized enterprise but, as applied to large investors, undermines the legitimacy of the international arbitration system and inefficiently distributes investment risk.

This Article provides theoretical and empirical support that investors and host states are, and have been, capable of negotiating institutional arrangements of varying complexity based on the asset specificity of the investment. [74] Using the framework developed by Ronald Coase and Oliver Williamson, the thesis presented here is that investments which require a shorter time commitment and fewer resources--like manufacturing, for example, because the presence of many competitors drives down costs--will demonstrate simpler contracts with easy exit as a primary remedy for investors. Investments that require a significant commitment of time and resources--like those in the extractive sector--will demonstrate more complex arrangements addressing specific risks. These contracts will be more likely to include contractual provisions governing a host states' ability to change the law in a way that raises the investors' costs, accompanied by specific arrangements for monitoring the extracted resource and resolving any disputes.

III. COASE, WILLIAMSON AND INCOMPLETE CONTRACTING

A. Coase and The Nature of the Firm

In 1937, Ronald Coase suggested that firms presented a special problem for the field of economics as it was then understood. [75] If it were true, as Adam Smith had theorized, that the economic system worked itself autonomously with supply effortlessly drifting to meet demand, there would be no reason for firms to exist. [76] All economic activity would occur through arms-length contracts. [77] Firms existed, Coase theorized, because ***278** arms-length contracts themselves involved some cost. [78]

Rather than continually negotiating with parties on the market, an owner would bring the transaction under his or her control and reduce the costs of making contracts. [79] Whether or not an owner would use the market, conclude longer-term contracts, or bring an activity under his or her control became known generally as the "make-or-buy" question.

In The Nature of the Firm, Coase implicitly established a spectrum of institutional arrangements between markets--the price mechanism--and hierarchy--the firm--where command and control displaces the spot market. [80] Scholars following Coase sought to articulate the conditions under which parties used firms instead of markets and to explore the institutional arrangements that might economize on transaction costs as initially explored by Coase. [81] In between markets and firms, they identified numerous contractual mechanisms that promoted efficient long-term arrangements.

B. Oliver Williamson: Bounded Rationality, Opportunism and Asset Specificity

Scholars [82] did not elaborate extensively on Coase's 1937 essay until ***279** after the publication of the arguably more influential The Problem of Social Cost. [83] Drawing on the intellectual contributions of John R. Commons, Herbert

Spencer, [84] and Karl Llewelyn, [85] Oliver Williamson approached the problem outlined by Coase by analyzing (1) the characteristics of contracting parties and (2) the relative importance of the object of the contract. [86] With respect to contracting parties, Williamson assumed two characteristics: (1) bounded rationality and (2) opportunism. [87] With respect to the object of the negotiation, Williamson argued institutional arrangements move toward hierarchy as the good or service negotiated for increases in mutual importance. [88]

1. Bounded Rationality

Bounded rationality is a function of the contract formation process. Future events, contingencies, and needs suffer from what might otherwise be termed a lack of imagination. [89] It refers to the limitations and costs humans face in acquiring and processing the full range of information ***280** required for optimal decision-making. Contracting parties face an inability to negotiate future plans because parties "have to find a common language to describe states of the world and actions with respect to which prior experience may not provide much of a guide." [90] This condition of human frailty means contracts will always be "incomplete," and will require, when entering an exchange relationship, a contracting party to assume the other party's behavior will be opportunistic in the future. [91] Some scholars have extensively elaborated on humans' cognitive limitations, while others have used the phrase to simply denote the impossibility of predicting the future. [92]

2. Opportunism

Opportunism is the tendency of economic agents to disclose information "in a selective and distorted manner . . . [including] effects to mislead, disguise, obfuscate, and confuse . . . ." [93] The essence of opportunism is an individual's aspiration to realize his or her own egoistic ***281** interests, accompanied by cunning and deceit. [94] Opportunism is closely related with asset specificity or "hold up" in the theory-of-the-firm literature. [95] Because humans are limited in their cognitive capacities, and because others will provide distorted information, parties demand institutions to protect themselves. [96] Opportunism can be both ex ante (parties must assume information provided to them is distorted or imprecise to the advantage of the other party) and ex post (upon an unforeseen change in circumstances, a party will attempt to manipulate that change in its favor). [97]

3. Asset Specificity

Asset specificity refers to the idea that an investment made for purposes of a particular transaction has more value for that transaction than any alternative purpose. [98] Because bounded rationality and opportunistic behavior may cause the expropriation of gains, parties demand institutional arrangements of varying strength to govern their contracts. [99] These institutions gain strength as the level of uncertainty and the value of the asset within the relationship increase. [100] Where parties meet on the open market and conclude simple arms-length exchanges, the traditional economic forces of supply and demand operate without significant cost. [101] ***282** When parties contract for assets uniquely valuable to the parties' use and not readily available for alternative use or users, greater opportunities for exploitation emerge. [102] Examples of transactions involving highly specific assets include:

> location of an electricity generating plant next door to a coal mine that is going to supply it, a firm's expansion of capacity to satisfy the demands of a particular customer, the training a worker undertakes

> to operate a particular set of machines or to work with a particular group of individuals, or a worker's relocation to a town where he has a new job. [103]

These factors influence transactions differently, giving rise to manifold arrangements (contracting regimes) that economize on incentives to exploit. [104] Contract-cost economizing regimes vary depending on the perceived need of the exchanged good or service provided and the limiting effects of bounded rationality and opportunism. [105] Within the literature on BITs, [106] asset specificity passes under the name of the "obsolescing bargain" or the problem of "holdup":

> ***283** Holdup occurs when one contracting party [with an asset specific investment] threatens another with economic harm unless concessions are granted by the threatened party. The potential for holdup exists only within contractual relationships, not in initial contract negotiations, and it results from the investment of relationship-specific assets by one of the parties. Anticipation of holdup is said to motivate the structure of contractual relationships. [107]

The 1926 merger between GM and Fisher Body classically illustrates the process by which parties move from contract to hierarchy as asset specificity increases. [108] In 1919, GM and Fisher Body concluded a ten-year agreement in which GM agreed to an exclusive dealing clause as an incentive for Fisher Body to invest in highly specialized manufacturing equipment (stamping machines and dies). [109] To prevent opportunistic behavior by Fisher Body (by charging monopoly prices for the bodies), the contract stipulated prices could not exceed those of similarly manufactured bodies by companies other than Fisher Body; disputes were to be settled by compulsory arbitration. [110] Soon after 1919, demand for GM automobiles increased significantly, producing general dissatisfaction on GM's part with the price it was paying for Fisher bodies;GM pressed Fisher Body to move its manufacturing plants nearer to GM plants, reducing transportation and inventory costs. [111] Fisher Body refused and in 1924, GM began purchasing Fisher Body stock and concluded a merger agreement in 1926. [112] The GM-Fisher Body relationship moved from market exchange to vertical integration where asset specificity was very high. [113] The ten-year agreement provided many of the features--e.g., arbitration and price ceilings--that scholars like Coase and Williamson suggested be part of hybrid institutions to promote efficient exchange. [114] The GM-Fisher Body example is one of several narratives used to show the empirical support the theory enjoys. [115]

*284 C. The Coase-Williamson Framework and Foreign Investment

Williamson predicts asset specificity, transaction frequency, and uncertainty are the primary factors which guide an activity toward vertical integration, or the choice to bring a transaction within the firm. Between arms-length transactions and command-and-control hierarchy are hybrid institutions that deepen the contracting parties' relationship and commitment: hostages, arbitration, take-or-pay procurement clauses, tied sales, reciprocity, regulation, and threat of reputational loss, among others. [116] In the investment context, an investor may include within the contract a demand that a host state provide some service before releasing a royalty payment (a form of hostage exchange); [117] an investor and a host state may appoint a neutral monitor to ensure the investor's accounting practices are fair; or, the host state may grant an investor freedom from changes in the law, with an exception for changes in environmental laws or regulations instituted in order to keep pace with technological changes and duties to minimize environmental damage. [118]

***285** Investment decisions are driven by many factors. Under liberal economic theory, the fundamental drive is to deploy capital where it will generate the highest returns. [119] Foreign direct investment may result in higher returns where, for example, a manufacturer can economize on transportation costs and there is a local demand for its products. [120] The decision to invest may also reflect a fear of losing ground to competitors. [121] Finally, an enterprise might alternatively gain access to a foreign market by licensing local producers, but the importance of controlling the quality of a valuable trademark, for example, may encourage direct ownership. [122] Many of these factors shape the agenda investors use during negotiations with host states.

1. Foreign Investment, Bounded Rationality and Opportunism

Both host states and investors are subject to the limitations (bounded rationality and opportunism) all contracting parties face. Complex contracts governing long-term relationships, like investment contracts, are necessarily incomplete. "They contain gaps and do not cover every possible aspect of the parties' relation, because the future state of the world is not fully predictable . . ." [123] Investors and states may, for example, poorly predict what the price of an extracted resource might be in the near term.

In addition to the risks of bounded rationality, both parties may impose opportunistic risks as well. Foreign investors, for example, may present host state negotiators with marginal cases to institute a tax regime. [124] They may also manipulate accounting practices or structure internal transactions to avoid taxes or other costs imposed by the host government. [125] In ***286** infrastructure, investors may sell themselves goods and services from affiliated companies at inflated prices knowing "[g]overnment policing of conflict-of-interest issues of this sort [is] generally lax or absent in most developing countries." [126] Manufacturing plants importing components from a parent investor company may manipulate transfer prices. Investors may underestimate the environmental costs manufacturing or extractive investments may impose. Host states may pass laws or issue regulations after an investment agreement is in place which raises the cost of the investment. [127] Successor governments may renege on promises made by previous governments. [128] Host states or their affiliated state-owned enterprises may provide faulty advice as to the cost of a project. [129]

2. Foreign Investment and Asset Specificity

In the domestic context, evidence for the Coase-Williamson theory is often limited to case studies due to the difficulty of obtaining consistent data on the cost of contracting, the complexity of a transaction, and, especially, asset specificity. [130] Similarly, applying the Coase-Williamson theory to foreign investment contracting can be done only with at least three important qualifications. [131] First, economic exchange across international boundaries is subject to distortion from national, regional and international trade and tax regimes. Second, jurisdictional idiosyncrasies affect the study ***287** of individual and aggregate economic phenomena. [132] Third, foreign direct investment can involve complicated evaluations of currency exchange risk, local or regional market potential, and other industry-specific considerations. Despite these distortions and analytical difficulties, predictions based on the theory find support in the case studies used here.

The Coase-Williamson theory predicts increasingly complex hybrid institutions as assets become more specific to the relationship. When an investor has many options and competition is robust, simple exchange contracts will prevail.

Where an investment requires significant capital outlays, ten or more years of exploration, and physical specificity, the theory predicts a more complex institution will govern the relationship:

> Firms in industries characterized by large sunk costs, asset specificity and immobility of assets, for example, necessarily make more long-term commitments to host countries than firms in other industries . . In contrast, small service or retail establishments generally have lower sunk costs and higher mobility, making exit strategies less problematic. [133]

i. Apparel and Footwear

As expected, in industries where retailers can choose from manufacturers in many states, such as the sportswear and apparel industries, simple-to-administer-contracts are common. [134] Consider the example of Nike. Although known primarily as a footwear retailer, Nike is also a significant retailer of sportswear apparel. The two product lines reflect the fundamentals of Nike's contracting relationships. Footwear factories are "usually large, capital-intensive facilities," whereas garment factories are usually smaller and easy to establish. [135] According to Richard Locke, et al., ***288** "[t]hese industry differences have a significant impact on the kinds of relationships that Nike can develop with its various suppliers." [136] In footwear:

> Nike has been able to develop long-term relationships with several large Korean and Taiwanese firms. With some of these firms, Nike designers create and then relay via satellite new footwear designs and styles for upcoming seasons to suppliers, who in turn, develop the prototypes. Once these prototypes are approved, these lead suppliers fax the product specifications to their various plants throughout Southeast Asia, where production can take place almost immediately. This level of trust and coordination facilitates both production and (presumably) compliance activities for Nike. [137]

In apparel, on the other hand:

> [G]iven short production cycles and volatile fashion trends, the situation is completely different. Nike works with numerous suppliers, most of whom are also producing apparel in the same factories for other (often competitor) companies. Given that different apparel suppliers specialize in particular market segments, shifts in consumer preferences or fashion trends could translate into very short-term contracts with and/or limited orders from Nike. This alters both the level of influence which Nike has with these suppliers as well as its ability to monitor on a regular basis the production processes and working conditions of these factories. [138]

The complexities of Nike's contracts vary accordingly. While a handful of Korean and Taiwanese firms enjoy sharing intellectual property and securer footwear orders (including an exclusive production relationship and guaranteed monthly minimum orders), [139] generally a regime of short term contracts prevails in apparel. [140]

ii. Owning or Leasing Land

For foreign investments requiring land, the decision to purchase freehold rights or obtain long-term leases similarly varies with the asset ***289** specificity of the investment. Foreign investors entering garment, retail, hospitality, agribusiness, and service sectors typically prefer to lease land so they can quickly exit should the investment take a downward turn. [141] Conversely, investors in capital-intensive and/or physical infrastructure projects like machinery, electronics and pharmaceuticals will tend to purchase land in freehold. [142]

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

[143]

The likelihood of owning land is also correlated to the size of the investment. For larger investments, land purchase is more likely than obtaining long-term leases.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

[144]

The lease or purchase of land to serve investment needs is often accompanied by negotiations with the host government. For example, investors must contract with host states in the manufacturing sector in order to receive special treatment, such as free trade zones, or certain tax ***290** incentives. [145] As Yackee notes, "Intel's practice when deciding whether to construct new semi-conductor manufacturing facilities, for example, is to enter into intensive haggling with potential host states over a variety of fine-grained matters, and to insist that any resulting deal be committed to a written contract before the investment will be sunk." [146]

iii. Institutional Variation

Investors and host states have traditionally devised numerous contractual arrangements to address problems of bounded rationality, opportunism, and holdup. Dalia Marin and Monika Schnitzer have documented the use of barter in international trade where host states are reluctant to give access to foreign ownership in their markets. [147] In the extractive industry, investors have mitigated political risk through early termination rights, open-ended exploration and development commitments, and balancing of clarity and vagueness with respect to obligations and duties. [148] Indeed "hostage-taking" is a method commonly used by foreign investors to reduce political risk--requiring the state to provide some service and/or having the contractual right to withhold some payment until that service is provided or a condition is met. [149]

IV. STABILIZATION CLAUSES

Stabilization clauses are one mechanism by which investors and host states have ensured the credibility of their commitments. [150] Not all investment contracts include stabilization clauses, but they are common in contracts for a wide range of industries in most regions of the world. [151] Stabilization clauses are often coupled with renegotiation clauses in investment agreements to provide for changes in circumstances affecting the interests of the investor and the host state. [152] Investors and states use stabilization clauses to form part of the ground rules upon which the investors operate the project; guide informal dealings and formal negotiations between the parties to the agreement; and serve as a formal ***291** protection of rights if a dispute should arise. [153] The clause may also provide the investor a legal basis to resist compliance with new laws even if host government authorities are unable or unwilling to monitor the investor's compliance and no formal dispute arises. The international case law largely supports the propositions that (1) stabilization clauses are lawful and legally binding under international law and (2) parties treat stabilization clauses as binding. [154]

In "likely the first empirical study on modern stabilization practice covering a wide range of industries and regions of the world," Andrea Shemberg, in cooperation with the IFC and the UN Special Representative, obtained seventy-six current investment contracts and twelve model contracts from various sources including international law firms (the "Shemberg Study"). [155] The data gleaned from these contracts support predictions generated by the Coase-Williamson theory: for highly asset specific investments like mining and petroleum, parties are inclined to agree that changes in the law will be inapplicable to the investment. For sectors in which investments demonstrate lower asset specificity like telecommunications or light manufacturing, stabilization clauses either do not exist or they are weaker, allowing for compensation to an investor for complying with new laws only after reaching a certain threshold or exempting areas of new laws like human rights codes altogether.

There are both acknowledged and unacknowledged limitations noted in the Shemberg Study. Evidence of the use and function of stabilization clauses remains limited. [156] Agreements between investors and host governments are generally confidential--details about them discovered only through legal proceedings or confidential interviews. Given the hundreds or thousands of investment agreements in existence, the sample may provide a skewed glimpse into the broader world of contracting between investors and states. Participating law firms extracted only specific information requested for the study and did not make the entire contracts available nor did they disclose the identity of the investment project. The lawyers who provided redacted investment agreements and ***292** were interviewed about stabilization clauses may, consciously or unconsciously, shape their redactions and statements in a way favoring existing or potential clients. [157] Indeed, independent interviews with practitioners indicated that international arbitration litigation practices at large private international law firms are heavily involved in pre-investment advising. [158] Participants in the Shemberg Study did concede that the links between bilateral and regional investment treaties and stabilization clauses are not well understood. [159] Investments made through project finance from regional or international lenders, secured through political risk insurance or through a joint venture with a state-owned enterprise may face varying pressures as to the type and strength of stabilization clauses. [160] The contracts used in the study were in English or had English translations readily available. [161]

Nevertheless, an empirical study of stabilization clauses of this breadth and scope is unlikely without financial and logistical support from major funders like the IFC; therefore, the Shemberg Study provides a unique opportunity to study investor-state contracting behavior. What follows is an elaboration of the findings of the study, including the kinds of stabilization clauses used, the sectors in which they are prevalent, and how they demonstrate or refute principles of efficient contracting according to the theories developed by Coase and Williamson.

A. Freezing Clauses

"Freezing clauses" render new laws completely inapplicable to the investment over the entire life of the project. These clauses often secure a specific fiscal regime for an investment. For example,

> The . . . Laws and Decrees which may in the future impose higher tax rates or more progressive rates of [tax] or would otherwise impose a greater . . . tax liability than anticipated under Section . . . ***293** of the Upstream Project Agreement shall not apply to the Company." [162]

"Limited freezing clauses" render only a narrow class of laws or regulations inapplicable to an investment. For example, a partial freezing clause might give a specific exemption to an investment for any new labor laws. [163]

B. Economic Equilibrium Clauses

"Economic equilibrium clauses" protect against the financial effects of changes in the law as opposed to freezing the law's applicability. An investor must comply with a new law, but the host state must compensate the investor for compliance or allow adjustments to the agreement providing for a lower level of, or delayed compliance with, the new law. [164] Economic equilibrium clauses may impose a materiality threshold below which compensation is not permitted or may require the host state to restore the investor to its original state "to the extent reasonably possible." [165] A "limited economic equilibrium clause" will provide for compensation for complying with new laws, but will only do so after a certain threshold is reached. A limited economic equilibrium clause may also provide an exemption from the otherwise applicable standards for applying economic equilibrium:

> Notwithstanding the generality of the foregoing or anything to the contrary, the Parties acknowledge that the provisions of [the economic equilibrium clause] shall not apply if . . . the new law or decree has been enacted by the Government [state] with the intent of protecting health, safety, the environment or security, and is generally applicable to all ventures having the same general purpose as does the Project. [166]

C. Hybrid Stabilization Clauses

"Hybrid clauses generally give the investor an opportunity to demand adjustments to the contract, including exemption from the law, to compensate the investor." [167] Hybrid clauses explicitly provide that ***294** exemptions from a law are one way of restoring an investor to the position it held before the new law was passed. [168] An example:

> if any existing Laws of [the host country] or any other applicable or existing law of any other Government, is changed or repealed, or if new laws are introduced, or if there occurs a rise in the tax rate or the introduction of a new tax, which bears unfavourably on the financial status of the Joint Venture or the Parties, then the Parties will apply all efforts that are necessary to completely or partially release the Joint Venture or the Parties from the above-mentioned changes, or the Parties will undertake all other necessary steps to alleviate the unfavourable impact of these changes. [169]

D. Stabilization Clauses and Asset Specificity

Based on the theory elaborated by Coase and Williamson, highly asset-specific investments such as petroleum extractions--where high fixed costs "require large capital injections in the early stages of the project and where long time frames are needed for the economic viability of the project"--are more likely to enjoy a full freezing of the law, so as to reduce to the greatest extent possible the uncertainty posed by local law. [170] For smaller infrastructure projects such as road construction, involving less uncertainty but where changes in local law can still affect the expected value of the investment, either general or limited economic equilibrium clauses will prevail. Factors important to determining the likelihood of opportunism by a host government include its overall reputation for stability, the existence of transparent and legitimate administrative processes, and an independent judiciary.

The table below presents a simplified view of the study's findings:

Sector	Full Freezing	Partial Freezing	Hybrid	Full Economic Equilibrium	Partial Economic Equilibrium	None	Total
Extractives	5	4	5	2	2	0	18
Other Transport	0	1	0	3	2	1	7
Infrastructure	1	0	1	1	1	0	4
Power	0	1	0	15	15	1	32
Road	0	0	0	2	4	0	6
Rail	0	0	0	2	3	0	5
Water	0	0	0	1	1	0	2
Telecom	0	0	0	1	0	1	2
Total Contracts	6	6	6	27	28	3	76

***295** 1. Regional Differences

Stabilization clauses were featured with greater frequency and force in investment contracts with developing countries. [171] Countries in sub-Saharan Africa, which are likely to have low or no ratings from risk rating agencies, were far more likely to have full freezing clauses in their contracts. [172] Moreover, those stabilization clauses are notable for their breadth. [173] Full freezing clauses are less likely to be found in agreements in the Middle East and North Africa, South Asia, Europe and Central Asia, East Asia, and Latin America. [174] The study found limited freezing clauses in the Middle East and North Africa; Latin America and the Caribbean; Eastern Europe, Southern Europe and Central Asia; South Asia; and Sub-Saharan Africa. [175] Stabilization clauses in investment agreements with developed countries are likely to have only the narrowest limited economic equilibrium clauses. [176]

Although generally regional differences correspond with country credit risk ratings, the ratings for OECD countries and Sub-Saharan African countries appear to be influenced by other factors. The study found that the OECD countries with limited stabilization clauses in their investment agreements also possess low risk ratings. For sub-Saharan Africa, Moody's had only rated one country. As expected, the Shemberg Study found a high percentage of freezing clauses as well as a high percentage of full economic equilibrium clauses in investment agreements with sub-Saharan African countries. The perception of political risk appears to drive these extreme differences. [177]

***296** 2. Freezing Clauses

Stabilization clauses were also more prominent in investment agreements governing highly capital-intensive industries where large initial outlays made investors "hostage" to host governments. [178] Every investment agreement in the extractive sector, for example, contained some form of stabilization clause. In the telecommunications sector stabilization clauses were present in only one of two agreements. The difference corresponds with the greater political risk associated with a natural resource project than with a private sector public service project. [179]

Five of the six full freezing clauses in the study governed investment agreements in the mining sector, where asset specificity is very high. [180] Full and limited freezing clauses appeared in nine of eighteen of the extractive contracts. In contrast, in sectors with significantly less physical (or other) asset specificity, freezing clauses were far less frequent. Only one of thirty-two power projects, one of seven transportation contracts, and one of four infrastructure projects included freezing clauses. Freezing clauses did not appear in the railroad, road, water, telecom, or health care contracts or models. [181]

These sectors do not require the same level of commitment by an investor or a host state; therefore, the contractual mechanism is more flexible.

3. Economic Equilibrium Clauses

The most common form of stabilization clause identified in the study is the full or partial economic equilibrium clause. Instead of targeting the sovereign legislative power of the state, they govern the effects of legislative changes on investments. [182]

***297** As with freezing clauses, economic equilibrium clauses are more likely in contracts involving non-OECD states than in contracts involving OECD states. In Western Europe, only one rail project and one road project included a full economic equilibrium clause; the remaining twenty-five investment agreements and model contracts provide for limited economic equilibrium. [183]

In non-OECD states, economic equilibrium clauses of both kinds were more common. In the electricity and water industries, public authorities often can set prices and bar investors from passing regulatory cost increases on to end-users. Economic equilibrium clauses provide a mechanism by which investors can guard against the risk of these legislatively-imposed higher costs. [184] In the Shemberg Study, approximately half of the water, telecommunications, and power industry contracts contain full economic equilibrium clauses. Similarly, of five transportation contracts, three contained full economic equilibrium clauses. [185] Of the seventy-six contracts in the study, twenty-eight of them limit the scope of the coverage of the clause, permitting adjustments to the contract or compensation only under designated circumstances. [186]

Infrastructure and power agreements demonstrated the most diverse set of arrangements. This might be explained in part because those agreements cover a wide range of asset-specific investments:

> Infrastructure deals cover the range of possible government/private sector relationships, including simple construction contracts; build, operate, and transfer (BOT) projects; purchases of public firms; and build, operate, and own investments operating under state regulatory authority. Behind many of these deals are power purchase agreements which are long-term agreements with the buyers of a project's service--such as a commercial purchaser of electricity-- that provide funds for payment of project expenses, repayment of the project's debts, and dividends or distributions to those who hold equity in the project. [187]

***298** 4. Hybrid Clauses

Hybrid clauses obligate the state party to attempt to provide exemptions from new laws, or explicitly contemplate exemptions as a means to compensate the investor for changes in the law. In the Shemberg Study, hybrid clauses appeared in only six of the seventy-six agreements, and appeared to govern oil and gas projects in the Eastern Europe, Southern Europe, Middle East and Central Asian regions. [188] One project provides an explicit recognition of the host state's obligation to implement international standards or to adapt to scientific and technological progress through domestic legislation. It does not make stabilization applicable to those laws. [189]

A second contract in the study was designed to specifically stabilize foreseeable changes in labor law. The stabilization clause required the government to compensate the investor for all changes to labor and employment laws, even if consistent with EU standards, until the latter of either 2016 or when the host state becomes a candidate for EU membership. [190]

E. Investors and States Use Diverse Institutional Governance Structures

The stabilization clauses reviewed in the Shemberg Study both support the thesis that states and investors demonstrate efficient contracting behavior, considering ex ante and ex post probabilities of opportunism and showng significant diversity in institutional design. The following are short descriptions of different ways parties limit or redistribute risk.

1. Sharing Benefits and Costs of Changes in the Law

In his 2008 article on the deficiencies in bilateral investment treaties ***299** and the need for an international commercial court, Joseph Stiglitz argued that a principal deficiency in modern investment treaties is their asymmetry:

> While companies demand compensation when a government-initiated change lowers the value of their assets, they do not offer to return to the government the increase in value from positive changes. Indeed, attempts by a government to capture an increase in value resulting from government actions might themselves be subject to investor suits, unless such recapture is guaranteed in the treaty itself. [191]

That may be true for investment treaties, but investor-state agreements appear to demonstrate a higher degree of sensitivity to the allocation of costs and benefits for changes in the law. Many stabilization clauses are drafted with the intent of limiting the application of the stabilization clause in some ways, ensuring fairness in its application, and preserving the long-term mutual interests of the parties, including the distribution of gains (as opposed to losses) from changes in the law to both parties. [192]

Approximately one-third of the limited economic equilibrium contracts and models narrow the scope of coverage (exempting some laws) and contain a "threshold loss requirement under which no compensation or contract adjustment is due the investor for changes in law." [193] A similar percentage of economic equilibrium contracts and models require the investor to mitigate the costs imposed by change in the law. These provisions make sense for the sectors in which they are most common: power and road projects.

2. Renegotiation

Nearly all of the economic equilibrium clauses in the contracts and models in the Shemberg Study provide for an informal process or contractual duty to negotiate adjustments or compensation before resorting to formal dispute resolution procedures. [194] Approximately one-third of those clauses identify an independent expert or regulatory body to verify the costs claimed and to determine which party should bear them. [195] Freezing ***300** clauses do not provide for renegotiation or verification, but instead either prohibit changes in law or require exemption for the investment. Four of six of the hybrid clauses require the host state to remedy the impacts on the economic equilibrium of the investment. The other two sample hybrid clauses provide for renegotiation or amendments in good faith when exemptions or compensation is not possible. Neither the freezing nor hybrid clauses provide for an independent expert or third party to verify costs or to allocate risk among the parties from the change in law. [196]

These clauses provide a rough sketch of how parties are good at minimizing transaction costs. [197] For example, when Venezuela unilaterally changed the legal structure under which extraction in the Orinoco Belt operated, foreign investors, relying on the procedures included in the stabilization clause, decided to renegotiate the terms of the concessions. [198] As a result of its abrupt reordering of its investment law (analysts generally agree it was done to expropriate the value available from the spike in global oil prices), Venezuela has subsequently encountered a reputational loss and difficulty finding partners for more recent projects. [199]

***301** 3. Specification of Applicable Laws, Threshold Loss Limits, Foreseeability and Discriminatory Effect

The limited economic equilibrium contracts from developing countries generally limit stabilization coverage through three mechanisms: (1) designated issue areas for inclusion or exclusion (e.g. tax and environmental laws); (2) stabilization of laws but limits on coverage by providing a threshold loss requirement (i.e. the investor must suffer a loss of a given magnitude for the clause to apply); or (3) stabilization of "not foreseeable" changes in law. [200]

i. Included and Excluded Laws

Investors and states will negotiate areas of the law that balance state obligations with investor expectations. Two Latin American and Caribbean power projects provide a detailed list of what is included in the stabilization clause: fiscal and customs issues, environmental, labor or work safety laws, regulatory laws dealing with electrical power, and discriminatory laws. [201]

Three investment agreements limit stabilization to fiscal issues: a water privatization project, a power project, and an extractive industry project. [202] Other variations on these kinds of equilibrium clauses include "a road contract that stabilizes economic status for all laws except inflationary tax law changes," and a "power contract that explicitly covers only changes in environmental law and tax and fiscal issues." [203] Many stabilization clauses cover laws with general applicability like minimum wage, employment and labor laws, and health and safety laws. [204] "None of the non-OECD contracts offers an explicit risk-sharing approach for specific changes in law (targeting the industry) that change project requirements, where the risk cannot be passed on to third parties." [205]

ii. Threshold Loss Limits

Of the twenty-two limited economic equilibrium clauses in place between investors and non-OECD states, seven (six power projects and one road project) stabilized all laws but imposed a threshold economic loss requirement on the project before triggering adjustments or ***302** compensation.[206] These threshold requirements limit the applicability of the stabilization clause, but operate without regard to the nature of the issue-area in which the change in law occurs.[207] "In these contracts it doesn't matter whether the change in law is foreseeable, or whether it is a law of general applicability, specific applicability, or for a public policy purpose."[208]

Investment agreements may also impose thresholds of materiality before compensation or adjustment is required or may leave the standard for compensation to the customary international law norm for a regulatory taking.[209]

iii. Foreseeability

Some limited economic equilibrium clauses in contracts between investors and host states stabilize "foreseeable" changes in laws.[210] Two sample contracts provide stabilization coverage for foreseeable laws that are already passed, but yet to be in force.[211] Other contracts are more encompassing, stabilizing all unforeseeable changes in law except for tax changes.[212] In one instance, the parties stabilized laws in force as of years before the contract date.[213]

iv. Discriminatory Effect

Of the limited economic equilibrium clauses in the study between foreign investors and a non-OECD state, only two limit stabilization ***303** coverage based strictly on discriminatory or arbitrary actions by the government, the standard under customary international law discussed above.[214] For example, one Latin American transportation project contract permits stabilization protection only where the law: (1) is onerous and highly unusual in the industry internationally; (2) affects the costs of the foreign investor so as to "substantially prevent it from carrying on a significant part of its business"; and (3) prevents the foreign investor from meeting its senior debt requirements.[215] Even then, "adjustments can be made to the contract only as needed to make the senior debt payments."[216]

V. EFFICIENT CONTRACTING BETWEEN STATES AND INVESTORS

As the analysis above reveals, host states and foreign investors appear to demonstrate the contracting efficiencies predicted under generally accepted economic theory. The analysis also answers one of the puzzles arising in one prominent study conducted by Zach Elkins, Andrew Guzman and Beth Simmons. They predicted followers of the "obsolescing bargain" school would expect investors in the extractive industries to demand BITs, but they found that "dependence on extractive industries reduced the probability that a host would make such a commitment."[217] The analysis above suggests that investors in the extractive industries are more likely to demand detailed contracts to govern their investments, not BITs. This is not inconsistent with Elkins', Guzman's, and Simmons' finding that a high number of "manufacturing" host states signed BITs. The wish to signal openness to garment retailers, for example, may play a role in why a developing country signs a BIT, but the Coase-Williamson theory would predict investors in light manufacturing would probably not "demand" BITs, as the sheer competition between manufacturers in several states would make supplier-shopping relatively inexpensive. BITs would have a marginal or negligible effect.

So, if investors and states generally construct effective mechanisms like stabilization clauses to economize on bounded rationality and opportunism, what explains BITs? It might be argued, first, that it is the proliferation of BITs that has facilitated the entry of foreign investors into new markets. Therefore, stabilization clauses represent marginal benefits arising from BITs which, in any case, are better at promoting foreign direct investment. [218] A related argument might be that an underlying BIT operated as a default regime for negotiating the contract. The parties contracted in the shadow of the BIT just as parties might contract in the ***304** shadow of local law.

First, the Shemberg Study does not give us insight as to whether any given contracting relationship was also supported by a BIT, so it is not possible to investigate that assertion, at least with respect to analyzing the influence of a BIT on an investment agreement negotiation. [219] Second, it is reasonable to assume an investor is far more aware of a contract it is directly negotiating than the presence of a BIT (or even a regional investment treaty). [220] The limited evidence shows investors, from small to very large, are often unaware, ex ante, of BITs or the protections they might provide. Third, stabilization clauses pre-date the modern explosion of BITs and, in the case of freezing clauses, appear to have moved through the 1990s and 2000s in more-or-less the same form as they read before. [221] Furthermore, a great deal of evidence suggests the primary consideration influencing a decision to invest is the size of the target market. [222] If it is true that companies are anxious to be "first-movers" in sectors of promising economies like Argentina, Mexico, Thailand, or Egypt, it is probably not true as a general matter that "the rational and risk-adverse investor will choose not to invest at all or only invest at a higher premium that takes into account the potential risk of the host State reneging on its original promise." [223]

Lastly, evidence that BITs displace or undermine contracting is limited and mixed. While Exxon invested in the Orinoco Belt beginning in the 1990s, it did not house its investment in a Dutch holding company until February 2006, after the Chavez administration declared thirty-two investment agreements illegal under a revised 2001 hydrocarbons law. [224] ConocoPhillips also established a Dutch holding company for its operations in the Orinoco Belt and both are resorting to ICSID arbitration instead of renegotiating pursuant to their international investment agreements. Italian energy company ENI, on the other hand, also invests in Venezuela through ***305** a Dutch holding company, but renegotiated its investment as contemplated by the stabilization clause. At the very least, these factors suggest BITs are not facilitating efficient stabilization clauses.

It might also be argued economic equilibrium clauses are newer than freezing clauses, which are a relic of pre-nationalization, post-colonial dominance by large investors. [225] According to the Shemberg Study, however, it appears freezing clauses are still widely used in recent agreements, which surprised many of the lawyers who participated in the study. [226] Even for those agreements where "path dependence" leads large law firms in the United States and Europe to include stabilization clauses because they have been inherited from form contracts, the diversity of institutional design suggests parties engage in bargaining over multiple aspects of the stabilization clause.

A. BITs as a Barrier to Efficient Contracting

In some circumstances, an investor who is aware of BITs may view stabilization clauses, even economic equilibrium clauses, as threats to the more generous terms offered by BITs; in other circumstances, an investor may reorganize its corporate structure to avail itself of a BIT that undermines the purpose of the stabilization clause. If the terms of a BIT provide for compensating an investor for changes in the law resulting in indirect expropriation, but do not conversely provide for sharing of windfalls with the government, the incentive is to rely on the vaguer and broader promises contained within the BIT. As one practitioner noted, while his law firm may inherit a freezing clause from a model contract, this inherited clause may not best secure the client's interest with respect to future changes in a host state's law. This is instead accomplished by identifying and availing itself of the most favorable terms under a BIT, often using the Netherlands or Switzerland (the determination of which is affected by tax and other regulatory implications). [227] While there is some precedent to suggest a tribunal may require authorizing language from a stabilization clause before issuing an award,[228] substantial inconsistency in ***306** existing decisions and unpredictability for future decisions casts doubt on whether the existence of a stabilization clause alone can guard against challenges based on one or more BITs.[229] As one practitioner noted with respect to clients in the petroleum sector: "[t]his mechanism [launching an investor-state claim under a BIT] is available regardless of whether the investor already has a contractual or arbitration arrangement with the host state or with one of its governmental entities."[230]

Even lengthier BITs, those covering a greater number of investors and investments with greater specificity, are unlikely to obtain the same level of risk distribution as investment agreements. First, investors shop for the home state whose BITs offer the greatest benefits for a single transaction or broader operations.[231] Exxon Mobil and ConocoPhillips are currently ***307** engaged in arbitration with Venezuela through Dutch holding companies.[232] Philip Morris International moved its operations from the U.S. to Switzerland in 2008, organizing its ownership structure to favor Swiss corporate vehicles and permitting it to take advantage of Switzerland's vast network of short, pro-investor BITs. Second, investors argue the "most favored nation" provisions in many BITs allow them to use the most favorable procedural and substantive provisions of other BITs with that host state.[233] As Kenneth Vandevelde concluded:

> In effect, BITs allow host states complete discretion either to exclude foreign investment or to admit it only conditionally, but then they place major restrictions on the ability of the host state to regulate foreign investment once established . . . . To the extent that they require reliance upon exclusion rather than regulation of foreign investments, BITs appear to adopt the least economically desirable means of addressing macroeconomic concerns; just as they choose the least economically desirable means of addressing the microeconomic concerns.[234]

Whether BITs actually deter the formation of more complete contracts is unclear.[235] One measure might be whether the proliferation of BITs has had a deterrent effect on the use of stabilization clauses, a proposition for which there is, at best, anecdotal support.[236] It is impossible to definitively conclude stabilization clauses are declining in use; it is likewise impossible to conclude they are increasing.[237]

***308** A second measure may be how investors or their lawyers weigh BITs and investment agreements. One international arbitrator argued investor-state contracts are only available to "investors with sufficient negotiating power," although it is unclear from the available evidence if this is so.[238] A survey of large Swiss enterprises concluded that investment decisions are made regardless of whether a BIT is in place or not (Switzerland has signed at least 113 BITs).[239] Small and medium enterprises--constituencies for which international arbitrators, practitioners, scholars and even critics agree should be the beneficiaries of BITs--showed marginally greater reliance on BITs, but also confirmed they invested in countries without a BIT.[240] Investment decisions are based on factors including political stability, the availability of inexpensive labor or natural resources, and the size of the domestic market. There is little (and disputed) evidence BITs result in increased investment.[241] The size of the target market is apparently the factor that best explains decisions to invest.[242]

B. BITs as Instruments of State Power

If it is true (1) investors and states demonstrate efficient contracting behavior and (2) BITs may, under some circumstances, diminish the incentives to negotiate appropriate political risk between parties, then the explanation for the proliferation of BITs may lie in the origins of BITs themselves: competition between developed countries to achieve both political and economic objectives. [243] There are good reasons to believe this is so.

First, the web of BITs appears to reflect the overall distribution of power in the international system. In the vast majority of cases, industrialized countries initiate the formation of investment treaties with developing countries. [244] As one prominent scholar of BITs observed, "If [host governments'] collaboration is required--as it is for public (national ***309** and international) risk insurance or for bilateral investment treaties--it is usually given reluctantly, under pressure, and with the promise of major investment forthcoming." [245] Stiglitz notes, "[i]n practice, [BITs] are part of the demands developed countries impose on developing countries, often as part of trade agreements, acceded to by developing countries . . . " [246] Once a country like the Netherlands or Switzerland has decided it wants to formalize protection for its companies and nationals, it develops a model treaty which will serve as a starting point for all negotiations. In forming a model treaty, a government will consult all interested governmental and private sector parties to form a national position. [247] The model determines the agenda and sets the framework for negotiations, and therefore gives the creator an advantage in the negotiations. [248] The developing countries that do best in negotiations are unsurprisingly the larger and more powerful ones. For example, India and China both have model BITs that make BIT provisions "subject to or in accordance with national laws"--a feature not shared by other, arguably less influential, host states. [249] Brazil tends not to enter into BITs at all. [250] Evidently it is not the case that "developing states almost rush to conclude [BITs] . . . " [251]

Second, the history of BITs appears to reflect global competition between developed countries. The United States initiated its BIT program after "repeated calls from Congress and the U.S. business community for a U.S. investment treaty program similar to European programs," calls reflecting their fears that U.S. investors were losing the global race to open new markets. [252] The United States entered negotiations for an FTA (with an investment chapter) with South Korea, manifesting a desire to keep pace with the European Union, which has already concluded a trade treaty with South Korea. [253] Switzerland competes with other European countries to ***310** host the international operations of multiple industries; an extensive network of BITs is one of many factors that might tip the balance in its favor. [254]

Third, BITs are negotiated in close connection with foreign policy objectives. As Alvarez notes, "states have a multitude of reasons for entering into international obligations--from the political to the highly legalistic." [255] After the fall of the Soviet Union, the United States viewed BITs as a way to support its objectives in Eastern Europe where it focused most of its early attention. [256] Similar diplomatic and political influences drove U.S. overtures toward Colombia and Rwanda. [257] While the United States uses BITs and the investment chapters of FTAs in close connection with foreign policy objectives, [258] Switzerland's objective appears driven by the principle of opening up developing world economies to its investors. As the Swiss Secretariat for Economic Affairs stated in an interview, the goal of the ministry is to sign a BIT with every non-OECD country. [259]

VI. CONCLUSION

This Article has argued the presence of stabilization clauses in contracts between investors and host states provides some evidence that these parties demonstrate efficient contracting behavior. While more research is required in order to fully understand the relationship between stabilization clauses and investment treaties, certain factors, including investor awareness of BITs, suggest investment treaties are often unnecessary and may erode the efficiencies achieved through stabilization clauses. [260] If BITs are not efficiency-enhancing mechanisms promoting investment, they may be, as critics argue, economically unjustified subsidies imposed upon developing countries as part of a global ***311** competition for new markets and new capital. That developing countries sign BITs in order to compete in sectors like light manufacturing may be only a small part of the story. [261]

The future of BITs is uncertain. Many commentators suggest that, as developing countries like the BRICs become great powers, the number will increase. [262] However, Pakistan, South Africa, and Venezuela have reecntly exhibited an interest in terminating or renegotiating BITs. [263] Even if investors ultimately demand BITs as their primary investment protection, this Article may lay the groundwork for better negotiations at the BIT level. [264] States may, for example, include historically excluded constituencies at negotiations, like representatives from Ministries of Health or Environment, as investors frequently target their administrative measures. [265] Principles from economic equilibrium clauses including exemptions for environment, health, and labor laws also may be incorporated into the broader language of BITs with more specificity than "non-precluded measures" clauses now provide. Currently, many BITs place health and safety provisions in ambiguous preamble statements or ***312** couch them in non-binding terms. [266]

More certain is that the current literature on BITs does not sufficiently discuss the full range of issues on which existing evidence might provide insight, including how the mobility of capital shapes competition between states and basic aspects of domestic corporate law; the nuances lurking behind and within BITs not reflected by their aggregate numbers; and the complicated interactions between politics, diplomacy, and investment. Further consideration is therefore necessary to understand more fully the role BITs play in growth and development.

Footnotes

a1 Assistant Professor, University of Tulsa College of Law. J.D. Harvard, 2005; M.Phil. Oxford, 2001; B.A. B.S. Kansas State University, 1999. The author would like to thank Bill Bratton, Don Langevoort, Bob Thompson and Kathy Zeiler for helpful reflections on the theory-of-the-firm literature and Zach Perez for excellent research assistance. The author would also like to thank Jenelle Beavers, Andrew Halaby and two anonymous reviewers for helpful comments as well as participants at the Washington University School of Law's Junior Faculty Workshop. This Article was made possible through a University of Tulsa College of Law Summer Research Grant.

1 See, e.g., Joseph E. Stiglitz, Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights with Responsibilities, 23 Am. U. Int'l L. Rev. 451 (2008); William W. Burke-White & Andreas von Staden, Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties, 48 Va. J. Int'l L. 307 (2008); Gus Van Harten, Five Justifications for Investment Treaties: A Critical Discussion, 2(1) Trade L. & Dev. (Special Issue) 19 (2010). For an example of the final critique, see Luke Eric Peterson, Philip Morris Files First-Known Investment Treaty Claim Against Tobacco Regulations, Inv. Arb. Rep. (Mar. 3, 2010), http://www.iareporter.com/articles/20100303 (describing how two Swiss-incorporated entities of Philip Morris International used the 1991 Swiss-Uruguay Bilateral Investment Treaty to initiate arbitration against Uruguay for implementing regulations that were (1) consistent with obligations under the World Health Organization's Framework Convention on Tobacco Control and (2) anchored in the interest of protecting the health of its citizens. See also Agreement on the Reciprocal Promotion and Protection of Investments, Switz.-Uru., Oct. 7, 1988, 1976 U.N.T.S. 389. See also Tamara R. Piety, Citizens United and the Threat to the Regulatory State, 109 Mich. L. Rev. First Impressions 16 (2010), http://www.michiganlawreview.org/assets/fi/109/piety.pdf (reviewing the bases for regulation of tobacco packaging and labeling). PMI's challenge is particularly brazen since the Framework Convention on Tobacco Control is an evidence-based treaty and the vagaries that often accompany determination of optimal regulation regimes are minimal. See Hannah Wiseman,

Regulatory Adaptation in Fractured Appalachia, 21 Vill. Envtl. L.J. 229, 252 (2010) (listing the various factors than can complicate calculations of optimal regulatory regimes).

2 See Van Harten, supra note 1; Jason Webb Yackee, Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties, 33 Brook. J. Int'l L. 405, 408 (2008) [hereinafter Empirical Study of Bilateral Investment Treaties].

3 The permutations, classifications and categorizations of "theories of the firm" reveal very little consistency in the literature, but most credit Coase and Williamson with the key historical development. See Oliver Hart, An Economist's Perspective on the Theory of the Firm, in Organization Theory 154 (Oliver E. Williamson ed., 1990) (identifying the "neoclassical theory," "principal-agent theory," "transaction cost economic theory," "nexus of contracts theory," and "property rights theory"). Many scholars argue that the view that firms are mostly one of many institutions governing transaction costs is too narrow. See Richard Langlois, The Boundaries of the Firm, in The Elgar Companion to Austrian Economics 175 (Peter J. Boettke ed., 1994) (classifying the "transaction cost theory" and the "nexus of contracts theory" both as "transaction cost theories" focusing on different transactions); Reza Dibadj, Reconceiving the Firm, 26 Cardozo L. Rev. 1459, 1464-65 (2005) (suggesting that all of the authors otherwise distinguished above present no positive theory of the firm, in its internal workings, but varying themes of resource allocation); Jack High, The Market Process: An Austrian View, in The Market Process 20 (Peter J. Boettke & David L. Prychitko eds., 1994).

4 While Coase and Williamson focused on the business entity, the principles of efficient contracting they articulated are applied widely. See Donald C. Langevoort, Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms), 146 U. Pa. L. Rev. 101 (1997) (explaining how, in its most advanced form, a firm demonstrates many characteristics typical of a social (as opposed to a contracting) institution)); see also Jon Hanson & David Yosifon, The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics and Deep Capture, 153 U. Pa. L. Rev. 129, 198 (2004). The critical literature is similarly large, targeting in particular asymmetries in information. The growing body of literature on information asymmetries pioneered by Akerlof, Stiglitz and Spence, among others, has made significant gains in addressing some of the problems arising from assigning mutually uniform characteristics to contracting parties. There remains robust debate about the extent these insights play versus the corrective functioning of the market. Joseph E. Stiglitz, The Contributions of the Economics of Information to Twentieth Century Economics, 115 Q. J. Econ. 1441, 1441-78 (2000); George A. Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q. J. Econ. 488 (1970); Frederick C. v. N. Fourie, In the Beginning There Were Markets?, in Transaction Costs, Markets and Hierarchies 46 (Christos Pitelis ed., 1993).

5 See, e.g., Andrew T. Guzman, Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties, 38 Va. J. Int'l L. 639, 659 (1998) ("The central problem is that a sovereign state is not able, absent a BIT, to credibly bind itself to a particular set of legal rules when it negotiates with a potential investor.").

6 This would be true even if developing countries did not bargain collectively. See id. at 643. See also Charles N. Brower & Stephan W. Schill, Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?, 9 Chi. J. Int'l L. 471, 477 (2009) ("Conversely, from the host state's perspective, the investor's right to initiate arbitration enables the host state to make credible the commitments it made under its investment treaties. This, in turn, reduces the political risk of foreign investment, lowers the risk premium connected to it, and therefore makes investment projects more cost-efficient."); Kenneth J. Vandevelde, U.S. Bilateral Investment Treaties: The Second Wave, 14 Mich. J. Int'l L. 621, 638 (1993) [hereinafter U.S. Bilateral Investment Treaties].

7 See Derek S. Pugh, Does Context Determine Form?, in Organization Theory 16 (Derek S. Pugh ed., 1997).

8 See Robert T. Greig, Claudia Annacker & Roland Ziade, How Bilateral Investment Treaties Can Protect Foreign Investors in the Arab World or Arab Investors Abroad, 25 J. Int'l Arb. 257, 272 (2008); Prabhash Ranjan, Definition of Investment in Bilateral Investment Treaties of South Asian Countries and Regulatory Discretion, 26 J. Int'l Arb. 217, 221 (2009) (citing Fedax v. Venezuela, July 11, 1997, 37 I.L.M. 1378 (1998) in which holders of promissory notes who were not entitled to investment protection transferred the notes to a Dutch company which then availed itself of treaty protection). When Philip Morris International became a Swiss company in 2007, it did so for "regulatory, overseas" operations but it has also made

extensive use of Switzerland's vast network of BITs. Altria to Spin Off Philip Morris International, MSNBC.com, Aug. 29, 2007, http://www.msnbc.msn.com/ id/20494757/ ("The spin-off would clear the international tobacco business from the legal and regulatory constraints facing its domestic counterpart, Philip Morris USA.").

9 This possibility, in effect, adds a second layer of contracting inefficiency. The stabilization clause is undermined by the BIT governing the relationship between the foreign investor's home state and the host state. The BIT is undermined by the most-favored-nation clause which renders any given provision of the BIT subject to the most favorable procedural or substantive treatment in any other BIT the host state has with any other home state. See Yannick Radi, The Application of the Most-Favoured-Nation Clause to the Dispute Settlement Provisions of Bilateral Investment Treaties: Domesticating the 'Trojan Horse', 18 Eur. J. Int'l L. 757 (2007).

10 This calculation would be shaped by analysis of how international arbitration tribunals use stabilization clauses. Certainly it is possible, indeed it is probable, that a tribunal would use some aspect of the BIT to obtain jurisdiction and then apply the terms of the stabilization clause in calculating damages. The stabilization clause would, in effect, provide specificity where the BIT does not. Indeed, at least one tribunal has required a stabilization clause as a precondition of issuing an award for an indirect expropriation. Parkerings-Compagneit AS v. Republic of Lith., ICSID Case No. ARB/05/8, Award, (Sept. 11, 2007), 2007 WL 5366481 P 332 (2007) ("Save for the existence of an agreement in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time the investor made its investment."). Nevertheless, it is asserted that under some conditions, an investor may determine that the broader terms of the BIT may provide a better chance of obtaining a larger award for an "indirect expropriation."

11 Zachary Elkins, Andrew T. Guzman & Beth A. Simmons, Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000, 60 Int'l Org. 811, 813 (2006).

12 Stiglitz, supra note 1, at 509 n.130 ("One of the often cited examples is Aguas del Tunari, S.A. v. Bolivia. Bechtel the U.S. parent company of Aguas del Tunari, S.A., established a post office in the Netherlands, so that the International Centre for Settlement of Investment Disputes (ICSID) could have jurisdiction. See Sarah Anderson & Sara Grusky, Challenging Corporate Investor Rule 18 (Inst. for Pol'y Studies & Food & Water Watch 2007). More telling, two of the three arbitrators at ICSID seemingly were enthusiastic about Bechtel's strategy describing BITs as "portals" through which investors from a multitude of countries might choose to make onward investments into the developing world, and thereby enjoy the treaty protections. See IISD, Tribunal Split in Bechtel-Bolivia Case Over Corporate Nationality of Investor, Inv. Treaty News (Dec. 20, 2006), http:// www.iisd.org/pdf/2005/itn_dec20_2005.pdf (summarizing the tribunal's two-to-one ruling dismissing all of Bolivia's jurisdictional objections).

13 Hedley Bull, the Anarchical Society (1977); Kenneth N. Waltz, Theory of International Politics (1979).

14 See David D. Friedman, Law's Order: What Economics Has to do with Law and Why It Matters 112-70, 189-244 (2000).

15 Jeffrey L. Dunoff & Joel P. Trachtman, Economic Analysis of International Law, 24 Yale J. Int'l L. 1, 4 (1999).

16 Margarita T.B. Coale, Stabilization Clauses in International Petroleum Transactions, 30 Denv. J. Int'l L. & Pol'y 217, 220 (2002). Here, "political risk" means primarily legal risks like regulatory change, although it might mean more catastrophic events like a civil war.

17 Thomas Wäelde & Abba Kolo, Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law, 50 Int'l & Comp. L.Q. 811, 819 (2001).

18 See Steven R. Ratner, Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law, 102 Am. J. Int'l L. 475, 478-81 (2008) ("Under customary international law, governmental and private actors are free to agree upon the point at which government regulation will constitute indirect expropriation, as well as the consequences of that determination for compensation."). The standard for indirect expropriation under customary international law is high. Michael G. Parisi, Comment, Moving Toward Transparency? An Examination of Regulatory Takings in International Law, 19 Emory Int'l L. Rev. 383, 394 (2005) ("International courts and tribunals have stressed that the 'obligation to compensate

does not extend to regulations imposed pursuant to the exercise of legitimate government police powers, such as taxation and protection of human health and welfare.").

19 Id.

20 Laura Henry, Investment Agreement Claims under the 2004 Model U.S. BIT: A Challenge for State Police Powers?, 31 U. Pa. J. Int'l L. 935, 955 (2010) (citing Ian Brownlie, Principles of Public International Law 553 (5th ed. 1998)).

21 Jeswald W. Salacuse, The Law of Investment Treaties 109-11, 373 (2010).

22 See Brower & Schill, supra note 6, at 480-81; Valentin Jentsch, The Role of Bilateral Investment Treaties (BITs) in Switzerland: Importance and Alternatives from an Entrepreneurial Perspective 5 (Univ. of St. Gallen Law & Econ., Working Paper No. 2009-02, 2009).

23 Lucy Reed et al., Guide to ICSID arbitration 3 (2d ed. 2006); Van Harten, supra note 1, at 33-34.

24 Aron Broches, The Experience of the International Centre for Settlement of Investment Disputes, in International Investment Disputes: Avoidance and Settlement 75, 76 (Seymour J. Rubin & Richard W. Nelson eds., 1985); Anthony C. Sinclair, The Origins of the Umbrella Clause in the International Law of Investment Protection, 20 Arb. Int'l 411, 427 (2004) (discussing the 1962 OECD Draft Convention on the Protection of Foreign Property).

25 These differences included the appropriate standard of compensation and the types of property eligible for protection. See Katia Tielemann, Global Public Policy Institute, The Failure of the Multilateral Agreement on Investment (MAI) and the Absence of a Global Public Policy Network (1999), http://www.gppi.net/fileadmin/gppi/Tieleman_MAI_GPP_Network.pdf. For an interesting look at a smaller, more focused, example of a multilateral investment agreement, see Andrei Konoplyanik & Thomas Wäelde, Energy Charter Treaty and its Role in International Energy, 24 J. of Energy & Nat. Resources L. 523 (2006) (describing the Energy Charter Treaty (ECT), which protects foreign investments in energy projects and facilitates transit of energy resources). The ECT served as the basis for one claim challenging Kyoto-related regulations on coal-energy production. Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/6.

26 Frederick Alexander Mann, The Aminoil Arbitration, in Further Studies in International Law 252, 252-54 (Frederick Alexander Mann ed., 1990).

27 Andrea Shemberg, Stabilization Clauses and Human Rights (Mar. 11, 2008), http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_ StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf.

28 Id. See also Thomas W. Wäelde & George Ndi, Stabilizing International Investment Commitments: International Law Versus Contract Interpretation, 31 Tex. Int'l L.J. 215, 224 (1996); Lorenzo Cotula, Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses, 1 J. World Energy L. & Bus. 158 (2008). Both Wäelde and Ndi and Cotula refer to a perception that the use of stabilization clauses declined in the 1970s and 1980s, but those claims appear to have more to do with their relative prominence in the academic literature as opposed to actual use by investors and states.

29 These represent only a few of the alternatives negotiated by parties. Shemberg, supra note 27, at 18 tbl. 6.1.

30 Sinclair, supra note 24, at 415; Ole Spiermann, Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties, 20 Arb. Int'l 179, 183 (2004).

31 Salacuse, supra note 21, at 1, 96.

32 Graham Mayeda, Playing Fair: The Meaning of Fair and Equitable Treatment in Bilateral Investment Treaties, 41 J. World Trade 273, 274 (2007).

33 See, e.g., Agreement between the Swiss Confederation and the Oriental Republic of Uruguay concerning the reciprocal promotion and protection of investments, art. 5, Oct. 7, 1988.

34 Bill Burke-White & Andreas von Staden, Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties, 48 Va. J. Int'l L. 307 (2008).

35 See Stiglitz, supra note 1. See also Marla Mansfield, Tahoe-Sierra Returns Penn Central to the Center Track, 38 Tulsa L. Rev. 263 (2002) (describing doctrines of regulatory takings in the context of U.S. jurisprudence).

36 Michael Trebilcock & Jing Leng, The Role of Formal Contract Law and Enforcement in Economic Development, 92 Va. L. Rev. 1517, 1541 (2006).

37 Jason Webb Yackee, Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality, 32 Fordham Int'l L.J. 1550, 1555 (2009). Contra Christophe Dugue, Dispute Resolution in International Project Finance Transactions, 24 Fordham Int'l L.J. 1064, 1072 (2001) (noting that international financiers often prefer English or New York courts).

38 Mélida N. Hodgson, Panel Presentation at Young Arbitrator's Forum (July 20, 2010).

39 See Kojo Yelpaala, Fundamentalism in Public Health and Safety in Bilateral Investment Treaties [Part I], 3 Asian J. WTO & Int'l Health L. & Pol'y 235, 236, 239 (2008).

40 Id. at 236.

41 U.N. Conf. on Trade and Dev. (UNCTAD), Bilateral Investment Treaties 1959-1999, at 1, U.N. Doc. UNCTAD/ITE/IIA/2 (2000).

42 See, e.g., Jose E. Alvarez, A Bit on Custom, 42 N.Y.U. J. Int'l L. & Pol. 17, 23 (2009); Robert E. Greig, Claudia Annacker & Roland Ziade, How Bilateral Investment Treaties Can Protect Foreign Investors in the Arab World or Arab Investors Abroad, 25 J. Int'l Arb. 257, 259 (2008).

43 See, e.g., Elkins, Guzman & Simmons, supra note 11, at 826 ("Obsolescing bargaining suggests that investors are more likely to demand treaties to protect their extractive and primary production investments, at least relative to easier-to-relocate light manufactures."); Brower & Schill, supra note 6; see Stephan W. Schill, Enabling Private Ordering: Function, Scope and Effect of Umbrella Clauses in International Investment Treaties, 18 Minn. J. Int'l L. 1 (2009); Wäelde & Ndi, supra note 28, at 224 (noting that although politically controversial, governments enter into agreements with investors to offset investor concerns by guaranteeing a favorable tax regime addressing items such as accelerated depreciation and amortization or providing a long loss carry-forward period; facilitation of foreign exchange repatriation and offshore account facilities; and preferential treatment on import duty and expatriate income tax exonerations).

44 Elkins, Guzman & Simmons, supra note 11, at 813.

45 The Hull Rule required prompt, adequate, and effective compensation upon expropriation. See Alvarez, supra note 42, at 19.

46 Indeed, even after pressure from developing countries, the Resolution on Permanent Sovereignty over Natural Resources required "appropriate" compensation. G.A.Res. 1803 (XVII), P 4, U.N.GAOR, 17th Sess., Supp. No.17,U.N.Doc. A/5217 (Dec. 14, 1962). See also Charter of Economic Rights and Duties of States, Art. 2(2)(c), G.A. Res. 29/3281 (XXIX), U.N. Doc. A/RES/29/3281 (Dec. 12, 1974) (emphasizing each State has a right "[t]o nationalize, expropriate or transfer ownership of foreign property" provided compensation is paid to the State pursuant to the State's laws, and disputes regarding compensation will be resolved under domestic law unless another agreement has been reached) available at http://daccess-dds-ny.un.org/doc/RESOLUTION/GEN/NR0/738/83/IMG/NR073883.pdf?OpenElement; Yelpaala, supra note 39, at 246 (reviewing that the Charter of Economic Rights and Duties when read in its entirety "constituted a significant departure from what was considered by capital exporting countries to be the customary international law standard expressed in the U.N.

General Assembly Resolution on Permanent Sovereignty over Natural Resources, Resolution 1803 adopted in 1963," giving States free reign to adopt policies over their resources).

47 Alvarez, supra note 42, at 49-50. He notes that 27% of BITs are executed between developing countries but (1) it is not clear how many of those are generated by BRICS and (2) 90% of arbitration disputes are between Western investors and developing world governments. See Van Harten, supra note 1, at 26.

48 Alvarez, supra note 42, at 41-42 (citations omitted).

49 Stiglitz, supra note 1, at 482. The WTO itself is viewed as a multilateral agreement that succeeded where a patchwork of bilateral or regional treaties could not. After its formation, countries have still used bilateral treaties to obtain benefits they could not get through the WTO. See Judith Goldstein & Richard Steinberg, Regulatory Shift: the Rise of Judicial Liberalization at the WTO, in The Politics of Global Regulation 211 (Ngaire Woods & Walter Mattli, eds. 2009).

50 See Susan Franck, Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law, 19 Pac. McGeorge Global Bus. & Dev. L.J. 337, 348-49 (2007) (citing Salacuse and Sullivan's findings that when developing countries sign BITs with OECD countries, FDI increases and that increase is likely to be larger if the country is the U.S.); See Eric Neumayer & Laura Spess, Do Bilateral Investment Treaties Increase Foreign Direct Investment in Developing Countries?, 33 World Dev. 1567 (2005).

51 Franck, supra note 50, at 349 ("Analysts from the United Nations Conference on Trade and Development (UNCTAD), the World Bank, and elsewhere have conducted research suggesting that investment treaties have a minimal impact on foreign investment."); Mayeda, supra note 32, at 274 (noting that there have been large awards in cases involving BITs placing a substantial burden on countries such as Argentina and the Slovak Republic, but more problematically "[t]he legal and macroeconomic consequences of broad investment rights are largely unknown") (change in original); Mary Hallward-Drimeier, Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite (June 2003), http://econ.worldbnank.org/files/29143_ wps3121.pdf; Vahe Lskavyan & Mariana Spatareanu, Host Country's Governance and the Size of Foreign Investors, 100 Econ. Letters 258 (2008).

52 Bernard Hoekman & Richard Newfarmer, Preferential Trade Agreements, Investment Disciplines and Investment Flows, 39 J. World Trade 949, 966 (2005).

53 Broches, supra note 24, at 76; Wolfgang Peter, Arbitration and Renegotiation of International Investment Agreements 343, 360 (2nd ed. 1995).

54 Id. at 343.

55 Id. at 344.

56 Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties 12-13 (1995); see Lauge Skovgaard Poulsen, Vale Columbia Center on Sustainable International Investment, Political Risk Insurance and Bilateral Investment Treaties: A View from Below, 27 Colum. FDI Perspectives (Aug. 2, 2010), http:// www.vcc.columbia.edu/content/political-risk-insurance-and-bilateral-investment-treaties-view-below (examining the overlap between political risk insurance and BITs in government provided agencies, the Multilateral Investment Guarantee Agency and through private companies).

57 Peter, supra note 53, at 345.

58 Id. at 359.

59 Id.

60 Of Coups and Coverage, The Economist (Apr. 4, 2007), http:// www.economist.com/node/8967224.

61 MIGA Member Countries, Multilateral Investment Guarantee Agency, http://www.miga.org/about/index_sv.cfm?stid=1695 (last visited Mar. 1, 2011).

62 Overview, Multilateral Investment Guarantee Agency, http:// www.miga.org/about/index_sv.cfm?stid=1736 (last visited Mar. 1, 2011).

63 Peter, supra note 53, at 363.

64 Id. at 364-65.

65 Frequently Asked Questions, Multilateral Investment Guarantee Agency, http://www.miga.org/quickref/index_sv.cfm?stid=1587&pv=s#con9 (last visited Mar. 1, 2011). These interventions occurred in Argentina and Indonesia.

66 Id.

67 Id.

68 Ingrid Detter De Lupis, Finance and Protection of Investments in Developing Countries 156 (2nd ed. 1987).

69 Susan Rose-Ackerman & Jim Rossi, Disentangling Deregulatory Takings, 86 Va. L. Rev. 1435, 1473 (2000).

70 Id.; Detter De Lupis, supra note 68, at 172-73.

71 Rose-Ackerman & Rossi, supra note 69.

72 Jason Webb Yackee, Do We Really Need BITs? Toward a Return to Contract in International Investment Law, 3 Asian J. WTO & Int'l Health L. & Pol'y 121, 125 (2008) [hereinafter International Investment Law].

73 Id. at 131.

74 See infra notes 90-134.

75 See, e.g., Paul Milgrom & John Roberts, Economics, Organization & Management (1992); Michael D. Whinston, Assessing the Property Rights and Transaction-Cost Theories of Firm Scope, 91 Am. Econ. Rev. 184, 184 (2001); Armen A. Alchian & Harold Demsetz, Production, Information Costs, and Economic Organization, 62 Am. Econ. Rev. 777, 783 (1972); Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 312 (1976).

76 Ronald Coase, The Nature of the Firm, 4 Economica 386, 386-405 (1937); Oliver Hart & John Moore, Property Rights and the Nature of the Firm, 98 J. Pol. Econ. 1119, 1121 (1990); See David M. Driesen & Shubha Ghosh, The Functions of Transaction Costs: Rethinking Transaction Cost Minimization in a World of Friction, 47 Ariz. L. Rev. 61, 80 (2005).

77 Harold Demsetz, The Theory of the Firm Revisited, in The Nature of the Firm: Origins, Evolution and Development 160 (Oliver Williamson & Sidney G. Winter eds. 1991) [hereinafter Nature of the Firm].

78 Ronald Coase, The Firm, the Market, and the Law 6 (1988). Coase did not actually coin the term "transaction costs" which is generally attributed to Kenneth Arrow, The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Nonmarket Allocation, in The Analysis and Evaluation of Public Expenditure: The PPB System 59-73 (1969).

79 See, e.g., Oliver Williamson, The Vertical Integration of Production: Market Failure Considerations, 61 Am. Econ. Rev. 112, 114 (1971).

80 See Scott Masten, A Legal Basis for the Firm, 4 J. L., Econ., and Org. 181 (1988).

81 For example, Oliver Hart and John Moore argued that the firm's ownership of assets (e.g., access to a certain machine or access to client lists) allowed it to establish incentives for workers to act in the firm's interest vis-à-vis the opportunity to

specialize skills. Because workers need access to these assets to improve the value of their skills to the firm and thus their bargaining position relative to the owner, the owner can indirectly encourage them to act in his or her interest relative to an arms-length contract where the owner negotiated with a second owner who directly employed the workers. Oliver Hart & John Moore, Property Rights and the Nature of the Firm, 98 J. Pol. Econ. 1119, 1121 (1990). Raghuram Rajan and Luigi Zingales modified this thesis to emphasize the access component of the Hart-Moore theory. They argued that access, not ownership, is key to encouraging optimal specific investment by workers. By carefully structuring access to key assets (broadly defined), firms may not only encourage specific investment by workers through the bilateral relationship with the owner, but may also create a "rat race" between workers to specialize. Raghuram Rajan & Luigi Zingales, Power in a Theory of the Firm, 113 Q. J. Econ. 387, 388 (1998).

82 See, e.g., Oliver Williamson, The Economic Institutions of Capitalism 365-84 (1985) (tracing the shift in American antitrust enforcement against mergers) [hereinafter EIC]; Armen Alchian & Harold Demsetz, Production, Information Costs and Economic Organization, 62 Am. Econ. Rev. 777 (1972); Victor Goldberg, Regulation and Administered Contracts, 7 Bell J. Econ. 426 (1976); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, Vertical Integration, Appropriable Rents, and the Competitive Contracting Process, 21 J. L. & Econ. 297, 297-98 (1978); Richard Posner, Problematics of Moral and Legal Theory 239 (1999); Ian Ayres & Eric Talley, Solomonic Bargaining: Dividing a Legal Entitlement To Facilitate Coasean Trade, 104 Yale L.J. 1027, 1030-32 (1995).

83 Ronald Coase, The Problem of Social Cost, 3 J. L. & Econ. 1, 1-44 (1960); Coase, The Nature of the Firm: Influence, in Nature of the Firm, supra note 77, at 63 ("Although the attention given to my argument in 'The Nature of the Firm' in the 1970s and 1980s derived in part from the interest in my views generated by the 'Social Cost' article and the greater appreciation of the importance of transaction costs which it brought about, the writings of Williamson must have had the same effect.").

84 See, e.g., G. March & Herbert A. Simon, Organizations 140-41 (1958).

85 See, e.g., Karl Llewelyn, A Realistic Jurisprudence--The Next Stop, 30 Colum. L. Rev. 431 (1930).

86 Oliver Williamson, Markets and Hierarchies: Analysis and Antitrust Implications (1983) [hereinafter Markets]. For an exposition of a competing view of the firm, see Kathleen R. Connor & C.K. Prahalad, A Resource-based Theory of the Firm: Knowledge Versus Opportunism, 7 Org. Sci. 477 (1996); Kathleen Connor, A Historical Comparison of Resource-Based Theory and Five Schools of Thought Within Industrial Organization Economics: Do We Have a New Theory of the Firm?" 17 J. Mgmt. 121, 121-54 (1991).

87 Roy Radner argues that "bounded rationality" is comprised of two "costs"--those associated with observation, communication and computation and "indeterminacy" like "not knowing the implications of everything that one knows. Radner concludes that "economists will not make further progress on the theory of the organization of the firm until we can deal more effectively with both of these phenomena." Roy Radner, Bounded Rationality, Indeterminacy and the Theory of the Firm, 106 Econ. J. 1360, 1360-61 (1996).

88 See generally Williamson, Markets, supra note 86.

89 Oliver E. Williamson, Internal Economic Organization, in Perspectives on the Economics of organization 9, 15 (Oliver E. Williamson, Sven-Erik Sjöstrand & Jan Johanson eds., 1989) (citing Herbert Simon, Models of Man 199 (1957)); see also Mark Casson, The Firm and the Market 41 (1987) (criticizing Williamson's "tortuous terminology").

90 See D. Gordon Smith & Brayden King, Contracts as Organizations, 51 Ariz. L. Rev. 1, 17 (2009) (citing Oliver Hart, Firms, Contracts and Financial Structure 23 (1995)) ("The degree to which contracts are incomplete is not completely foreordained, but depends in part on the tradeoff between the anticipated hazards of ex post opportunism and the costs of ex ante design."); see also Keith J. Crocker & Kenneth J. Reynolds, The Efficiency of Incomplete Contracts: An Empirical Analysis of Air Force Engine Procurement, 24 Rand J. Econ. 126, 127 (1993) ("Were contracting costless, it would be possible in principle to design arrangements complete enough to circumscribe all surplus-eroding redistributive tactics and intricate enough to mitigate investment distortions. In practice, however, the costs of identifying contingencies and devising responses increase rapidly in complex or uncertain environments, placing economic limits on the ability of agents to draft and implement elaborate

contractual agreements. When designing a contract, the parties may mitigate ex post opportunism and investment distortions by the use of more complete agreements, but at the cost of increased resources dedicated to crafting the document a priori. As a consequence, environmental characteristics that generate increased contracting costs should result in efficient contracts being less complete, whereas conditions that exacerbate the potential for ex post inefficiencies should lead to more exhaustive agreements.").

91 Oliver E. Williamson, The Law of Economic Organization, in Nature of the Firm, supra note 77, at 92-93; but see Peter J. Boettke, The Elgar Companion to Austrian Economics 175 (1998) ("[T]he transaction cost literature shows its neoclassical legacy in posing the problem of the firm in terms of a maximization problem perceived ex visu of a point in time. In present-day transaction cost economics, one explains particular business institutions we observe in the world as having arisen to minimize the sum of production costs and transaction costs. Those costs are normally understood implicitly to have arisen from the environment in existence at the moment under analysis. Seldom does the theory give thought to the possibility that organizational forms may be influenced as much by environments that exist only as future possibilities, imagined or feared.").

92 Christine Jolls, Cass R. Sunstein & Richard Thaler, A Behavioral Approach to Law and Economics, 50 Stan. L. Rev. 1471, 1477 (1998); David J. Teece, Vertical Integration & Vertical Divestiture in the U.S. Oil Industry **31** (1976).

93 Williamson, Internal Economic Organization, supra note 89, at 15.

94 Evgeny V. Popov & Victoria L. Simonova, Forms of Opportunism Between Principals and Agents, 12 **Int'l** Advances in Econ. Research 115, 115 (2006).

95 See D. Gordon Smith, The Branding Effects of Contracts, 12 Harv. Negot. L. Rev. 189, n.20 (2007) (citing Conrad S. Ciccotello et al., Research and Development Alliances: Evidence from a Federal Contracts Repository, 47 J.L. & Econ. 123, 127 (2004) (citing Scott E. Masten et al., The Costs of Organization, 7 J.L. Econ. & Org. 1, 9 (1991))) ("Masten et al. suggest the possibility of holdup in the absence of asset specificity. They use the term 'temporal specificity' to describe a situation in which 'timely performance is critical, [and] delay becomes a potentially effective strategy for exacting price concessions.").

96 Henry Hansmann, The Ownership of Enterprise 40; Gregory Jackson, Comparative Corporate Governance: Sociological Perspectives, in The Political Economy of the Company 265, 268-69 (John Parkinson, Andrew Gamble & Gavin Kelly eds., 2000).

97 Bruce Kogut & Udo Zander, Knowledge of the Firm and the Evolutionary Theory of the Multinational Corporation, 24 J. **Int'l** Bus. Stud. 625, 639 (1993).

98 Tony McGuinness, Markets and Managerial Hierarchies, in Markets, Hierarchies & Networks 66, 69 (G. Thompson, et al. eds., 1994).

99 Williamson, EIC, supra note 82, at 47. Williamson adopts concepts of ex ante and ex post opportunism from insurance literature. Parties are unable to "distinguish between risks and the unwillingness of poor risks candidly to disclose their true risk condition." Failure of parties to take "appropriate risk-mitigating actions" gives rise to ex post execution problems. Id. Contra Andreas A. Papandreou, Externality and Institutions 253 (1994) (explaining the tendency for this analysis to produce the unsatisfactory conclusion that "any institution that exists must be optimal otherwise wealth-maximizing agents would have exploited any 'attainable' improvements").

100 Williamson, Internal Economic Organization, supra note 89, at 16.

101 Louis Kaplow & Steven Shavell, Microeconomics 2 (2004).

102 But see Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 Am. Soc. Rev. 55 (1963); Robert C. Ellickson, Order without law: how Neighbors Settle Disputes (1991) for empirical studies that show that both formal and informal contracts play mediating and expectation-converging roles.

103 Oliver Hart, An Economist's Perspective on the Theory of the Firm, in Organization Theory: From Chester Barnard to the Present and Beyond 154, 158 (Oliver E. Williamson ed., 1995). Contra D. Bruce Johnsen, The Quasi-Rent Structure of Private Enterprise: A Transaction Cost Theory, 44 Emory L.J. 1277, 1316 (1995) ("Although this example adequately served the authors' purpose in explaining the choice between vertical integration and long-term contracting, the distinction between the specialized quasi-rent and the appropriable specialized quasi-rent is somewhat misleading. In theory, there are many possible dimensions of asset specificity and therefore many alternative measures of an asset's specialized quasi-rent. At the time the investment is made, an asset can be specific to a given user, to a given function, to a given location, et cetera. Which measure is appropriate depends on which alternative states of the world are being examined.").

104 See generally Jennifer Gerarda Brown & Ian Ayers, Economic Rationales for Mediation, 80 Va. L. Rev. 323 (1994); Scott R. Peppet, Contract Formation in Imperfect Markets: Should We Use Mediators in Deals?, 19 Ohio St. J. on Disp. Resol. 283 (2004). But see Mark Klock, Financial Options, Real Options, and Legal Options: Opting to Exploit Ourselves and What We Can Do About It, 55 Ala. L. Rev. 63, 102 (2003) (arguing that ADR may be more expensive than litigation in varying circumstances); Oliver Williamson, Credible Commitments: Using Hostages to Support Exchange, 73 Am. Econ. Rev. 519, 526 (1983). Cf. Masten, supra note 80, at 207 (arguing that common law doctrines recognize multiple "modes" of transactions, which "may also warrant the establishment of alternative sets of norms and conventions (namely, institutions) to govern disparate clusters of transactions").

105 Oliver E. Williamson, Comparative Economic Organization: The Analysis of Discrete Structural Alternatives, 36 Admin. Sci. Q. 269, 271 (1991) [hereinafter Comparative Economic Organization].

106 Brower & Schill, supra note 6, at 478.

107 Smith & King, supra note 90, at 17-18.

108 Klein, Crawford & Alchain, supra note 82, at 308; see also Williamson, EIC, supra note 82, at 114.

109 Klein, Crawford & Alchain, supra note 82, at 308-09.

110 Id. at 309.

111 Williamson, EIC, supra note 82, at 115.

112 Klein, Crawford & Alchain, supra note 82, at 310.

113 But see Oliver D. Hart, Incomplete Contracts and the Theory of the Firm, 4 J. L. Econ. & Org. 119, 125-35 (1988) (arguing that the GM-Fisher Body example proves more about transfer of property rights than other components of Williamson's theory like resolving disputes by fiat and correcting asymmetries of information.).

114 See Barak Richman, Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering, 104 Colum. L. Rev. 2328, 2329 (2004).

115 See The Bigger Picture, Economist (Oct. 17, 2009), http:// www.economist.com/node/14632614 (reporting on Williamson's receiving the Nobel Prize for Economic Sciences). But see Andreas A. Papandreou, Externality and Institutions 253 (Oxford University Press 1994). While the critique of the traditional notion of efficiency has been well taken, the ramifications of incorporating organizational costs in the notion of optimality remain far from clear. A particularly discouraging feature of such models, when combined with the behavioral assumption made, seems to be that they lead to the "'unpalatable conclusion'... that any institution that exists must be optimal, otherwise 'wealth-maximizing agents would have exploited any 'attainable' improvements."' Malcolm Rutherford, Andreas Papandreou's Externality and Institutions, 33 J. Econ. Literature 1981, 1983 (1995) (book review) (quoting Papandreou, supra).

116 Williamson, Comparative Economic Organization, supra note 105, at 269; Douglass North, Institutions, Institutional Change and Economic Performance 55 (1990); see also Carol Rose, Trust in the Mirror of Betrayal, 75 B.U. L. Rev. 531, 537 (1995); Michael J. Meurer, Law, Economics, and the Theory of the Firm, 52 Buff. L. Rev. 727, 734 (2004).

117 See Joy Mining Machinery, Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/03/11, Award on Jurisdiction, P 15 (Aug. 6, 2004). In Joy Mining, a company incorporated under the laws of England and Wales agreed to supply mining systems and supporting equipment to an agency of the Egyptian government. Joy Mining provided letters of guarantee for contractual obligations at the Bank of Alexandria. The contract provided for the schedule and conditions for release of these guarantees linked to the performance of the equipment and production levels. Although the ICSID panel determined that those guarantees did not constitute an "investment" for purposes of jurisdiction (under more recent decisions, it is questionable whether a current ICSID panel would refuse jurisdiction), the episode is one of many that shows how foreign investors and host states exchange "hostages" to promote exchange (in this case, the hostages were the letters of guarantee held at a bank in the host state). Markus W. Gehring & Marie-Claire Cordonier Segger, Sustainable Development in World Trade Law 405 (2005).

118 Rajeev J. Sawant, The Economics of Large-Scale Infrastructure FDI: The Case of Project Finance, 41 J Int'l Bus. Stud. 1036, 1036-56 (2009); see Judgment the Gabcikovo-Nagymaros Project (Hungary v. Slovakia) 1997 I.C.J. 92 (Sept. 25) ("In the field of environmental protection, vigilance and prevention are required on account of the often irreversible character of damage to the environment and of the limitation inherent in the very mechanism of reparation of this type of damage.") (quoted in Philippe Sands, Principles of International Environmental Law 247 n.65 (2003)); Anoop Madhok, Reassessing the Fundamentals and Beyond: Ronald Coase, the Transaction Cost and Resource-Based Theories of the Firm and the Institutional Structure of Production, 23 Strategic Mgmt. J. 535, 535-50 (2002); Nicolai J. Foss, Bounded Rationality and Tacit Knowledge in the Organizational Capabilities Approach: An Assessment and a Re-evaluation, 12 Indus. & Corp. Change 185 (2003).

119 Kenneth Vandevelde, The Economics of Bilateral Investment Treaties, 41 Harv. Int'l L.J. 469, 473 (2000).

120 John Dunning, Multinational Enterprise and the Global Economy (1993) (arguing that corporations located in a foreign location must possess an ownership (O) advantage (e.g. superior technology), a locational (L) advantage (e.g. available skills) and have reasons to internalize (I) operations rather than outsource and license foreign firms).

121 Ravi Ramamurti & Jonathan Doh, Rethinking Foreign Infrastructure Investment in Developing Countries, 39 J. World Bus. 151, 162 (2004).

122 Vandevelde, The Economics of Bilateral Investment Treaties, supra note 119, at 475.

123 Schill, supra note 43.

124 Wäelde & Ndi, supra note 28, at 224 (noting the political tensions that can arise in the non-renewable natural resources industry between investor companies and domestic enterprises in relation to tax burdens).

125 Stiglitz, supra note 1, at 478 (citing petroleum contracts in Alaska and Alabama); see Judith Royster, Practical Sovereignty, Political Sovereignty, and the Indian Tribal Energy Development and Self-Determination Act, 12 Lewis & Clark L. Rev. 1065, 1085 (2008) (detailing Peabody Coal's efforts to reduce the royalty rate on a coal deposit in Navajo territory through manipulation of the royalty rate-setting process). See also Duke Energy Int'l Peru Inv. Ltd. 1 v. Republic of Peru, Award on the Merits, 18 August 2008, ICSID Case No. ARB/03/28; see also Kevin T. Jacobs & Matthew G. Paulson, The Convergence of Renewed Nationalization, Rising Commodities and "Americanization" in International Arbitration and the Need for More Rigorous Legal and Procedural Defenses, 43 Tex. Int'l L.J. 359, 372 (2008) (detailing how newer investment agreements address some of these opportunism risks). In their current dispute, the Government of Venezuela accuses Exxon Mobil of characterizing some oil as "bitumen" in order to reduce amounts due under their contract.

126 Ramamurti & Doh, supra note 121, at 162.

127 See Paul E. Comeaux & N. Stephan Kinsella, Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance, 15 N.Y.L. Sch. J. Int'l & Comp. L. 1, 4-5 (1994) (discussing political risk and ways an investors could try to mitigate the risk through political risk insurance).

128 See Ramamurti & Doh, supra note 121, at 157-58.

129 See Michael Feit, Responsibility of the State Under International Law for Breach of Contract Committed by a State-Owned Entity, 28 Berkeley J. Int'l L. 142, 149 (2010).

130 See Howard Shelanski & Peter Klein, Empirical Research in Transaction Cost Economics: A Review and Assessment, 11 J. L. Econ. & Org. 335 (1995).

131 See, e.g., John McMillan & Christopher Woodruff, Interfirm Relationships and Informal Credit in Vietnam, 114 Q. J. Econ. 1285 (1999); Simon Johnson, John McMillan, & Christopher Woodruff, Contract Enforcement in Transition (Eur. Bank for Reconstruction and Dev., Working Paper No. 45, 1999).

132 See Kusi Hornberger, How Do Companies Acquire Land When Looking Abroad for Their Investments?, Private Sector Blog (Feb. 16, 2010), http:// psdblog.worldbank.org/psdblog/2010/02/how-do-companies-acquire-land-when-looking-abroad-for-their-investments.html ("In the case of the own-versus-lease question, many jurisdictions do not permit foreign ownership of land. For example, many countries in East Asia, such as Indonesia and Thailand do not allow foreigners to own land. Thus, most foreign-owned companies tend to lease from private citizens. On the other hand, in numerous parts of Sub-Saharan Africa, in countries like Tanzania, Liberia and Zambia, all land is held by the government on behalf of the people and thus the only optionis for companies to lease from the government in the form of a long term lease.").

133 Jennifer Oetzel, Kathleen A. Getz, & Stephen Ladek, The Role of Multinational Enterprises in Responding to Violent Conflict: A Conceptual Model and Framework for Research, 44 Am. Bus. L.J. 331, 350 (2007).

134 Gerard P. Cachon, The Allocation of Investment Risk in a Supply Chain, 50 Mgmt. Sci. 222 (2004).

135 Richard Locke, Fei Qin, & Alberto Brause, Does Monitoring Improve Labor Standards? Lessons from Nike (Corp. Soc. Resp. Initiative, Working Paper No. 24, 2006), available at http://www.hks.harvard.edu/m-rcbg/CSRI/publications/workingpaper_24_locke.pdf.

136 Id. at 10.

137 Id. at 10-11.

138 Id. at 11.

139 Suk-Jun Lim & Joe Phillips, Embedding CSR Values: the Global Footwear Industry's Evolving Governance Structure, 81 J. Bus. Ethics 143, 148-49 (2007).

140 Dong-Sung Cho & Wujin Chu, Determinants of Bargaining Power in OEM Negotiations, 23 Indus. Marketing Mgmt. 343-55 (1994) (detailing how Nike attempted to force a major Korean footwear manufacturer to abandon its relationship with Reebok, terminated its original equipment manufacturer agreement to move to China and found itself unable to achieve the same reliability with Chinese firms and returned to Korea, paying a fifty percent increase in price to do so).

141 See Hornberger, supra note 132.

142 Id.

143 Id.

144 Id.

145 See Yackee, Empirical Studies of Bilateral Investment Treaties, supra note 2.

146 Yackee, International Investment Law, supra note 72, at 133.

147 Dalia Marin & Monika Schnitzer, Contracts in Trade and Transition: The Resurgence of Barter 11 (2002).

148 Wäelde & Ndi, supra note 28, at 226-27.

149 Paul E. Comeaux & N. Stephan Kinsella, Protecting Foreign Investment under International Law: Legal Aspects of Political Risk 130-32 (1997).

150 Gaetan Verhoosel, Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking A "Reasonable" Balance between Stability and Change, 29 Law & Pol'y **Int'l** Bus. 451, 453 (1998).

151 Shemberg, supra note 27 (citing G.R. Delaume, Transnational Contracts: Application Law and Settlement of Disputes: Law and Practice, Booklet 8 301, 307-09 (July 1983)).

152 Id. at 2.

153 Id. P 125.

154 Cotula, supra note 28, at 162 (citing Texaco Overseas Petroleum Co. v. Libyan Arab Republic, 53 ILR 389 P 59 (1977)); Kuwait v. American Indep. Oil Co., Arbitration Award, 21 ILM 976 (1982); AGIP Co. v. Congo, Arbitration Award, 21 ILM 726 (1982); S.K. Chatterjee, The Stabilization Clause Myth in Investment Agreements, 5 J. **Int'l** Arb. 97, 98 (1988); Verhoosel, supra note 150, at 456.

155 The study also conducted a literature review and a review of reported contract and investor-state disputes that may be relevant to understanding the legal enforceability of such clauses as well as interviews with negotiators, lenders and lawyers who negotiate investment contracts or litigate disputes for states and investors, and with nongovernmental organizations members who have conducted research on stabilization clauses. Shemberg, supra note 27.

156 Id.

157 There is the additional factor that these law firms, at least with respect to international arbitration, are highly Americanized. Kevin T. Jacobs & Matthew G. Paulson, The Convergence of Renewed Nationalization, Rising Commodities and "Americanization" in International Arbitration and the Need for More Rigorous Legal and Procedural Defenses, 43 Tex. **Int'l** L.J. 359, 368 (2008).

158 After reviewing the data summarized in the Shemberg Study, I interviewed six attorneys (two partners and four senior associates) at large private law firms in Washington, D.C. to obtain at least anecdotal evidence as to 1) the extent that international arbitration practitioners were involved in pre-investment advising and 2) the relationship between stabilization clauses and BITs.

159 Shemberg, supra note 27, at 42-43.

160 There is some reason to believe that certain international lenders are more likely to require stabilization clauses, especially freezing clauses. Wäelde & Ndi, supra note 28, at 228-29 (emphasizing that a financial institution's "core concern is the ability of the project to repay its debt.") .

161 Shemberg, supra note 27, P 47, at 13.

162 Id. P 25.

163 Id. P 63.

164 Wäelde & Ndi, supra note 28, at 218-19 ("[I]n the last ten to twenty years, stabilization clauses have undergone a substantial revolution... Instead of targeting the legislative power of the state founded on sovereignty, these commitments are designed to set up a contractual mechanism of allocating the financial effect of political risk to the state enterprise."); see also Mohamed Al Faruque, Typologies, Efficacy and Political Economy of Stabilization Clauses: A Critical Appraisal, 4 Transnat'l Dispute Mgmt. 31-33 (2007).

165 Shemberg, supra note 27, PP 26-27, at 6-7.

166 Id. at 8.

167 Id. at Summary of Analysis.

168 Id. P 22.

169 Id. P 31, at 8.

170 Cotula, supra note 28, at 160.

171 Shemberg, supra note 27, at 15 fig. 5.1. The contracts and models analyzed include eleven from Sub-Saharan Africa; fourteen from East Asia and Pacific; sixteen from the Middle East and North Africa; ten from Eastern Europe, Southern Europe and Central Asia; five from South Asia; nineteen from Latin America and the Caribbean; and thirteen from OECD countries (other than Turkey, which is included in Eastern Europe, Southern Europe and Central Asia). Figure 5.1 shows the distribution of contracts and models used in the study.

172 Id. at pt. 6.1.

173 One investment agreement with a sub-Saharan state provided an initial duration of fifty years with an option of extending for another fifty years at the discretion of the investor. In addition, the investment is exempt from all host state taxes except the royalty payment due under the agreement. Id.

174 Id. at 23, fig. 6.3.

175 Id. at pt. 6.1.

176 Shemberg, supra note 27, at 17-19, pt. 6.1.

177 Id. P 118, at 33 ("It is less clear that the stabilization practice in non-OECD countries, other than those of Sub-Saharan Africa, can be explained by country risk perception. Of the remaining non-OECD regions, the ratings are quite mixed. According to Moody's historical data, 7 countries in East Asia and Pacific obtained investment grade, 4 speculative grade, and 3 were not rated. For the Middle East and North Africa, there were 8 countries with investment grade, 4 with speculative grade, and 5 not rated. For Southern, Eastern Europe and Central Asia, 3 countries obtained investment grade, 3 speculative grade, and 4 were not rated. In Latin America, 1 country obtained investment grade, 15 speculative grade, and 3 were not rated. And in South Asia, 1 country obtained investment and 4 speculative grade.").

178 Id.

179 Wäelde & Ndi, supra note 28, at 224 (explaining that more often political tension arises in the exploitation of non-renewable natural resources industry because the tax burden is raised on the standard fiscal regime, but only foreign companies are permitted or able to gain favorable tax provisions, such as accelerated depreciation, under the BIT which in turn is perceived as a discriminatory favor to benefit foreign investors at the expense of domestic enterprises).

180 Shemberg, supra note 27, PP 55-58, at 15-16. Six of the investment agreements in the Shemberg Study contain limited freezing clauses of which four had fiscal freezing clauses. Two contracts from the Middle East and North Africa in oil and gas, one power contract from South Asia, and one Sub-Saharan African mining contract. The two other limited freezing clauses

included at least some nonfiscal issues. One from Eastern, Southern Europe and Central Asia for a gas pipeline project and one from Latin America and the Caribbean in transportation.

181 Id. at 18 tbl. 6.1.

182 As Cotula notes, the 1997 AGIP/British Petroleum/Etal-Kazakhstan "Kashagan" Production-Sharing Agreement requires parties to take action to restore the "overall economic benefit" of the agreement should any change in Kazakhstani law have a material adverse effect on the investor's economic benefits. Cotula, supra note 28, at 161 n.14.

183 Shemberg, supra note 27, P 69, at 21.

184 Id. P 20, at 5.

185 Id. P 81, at 25.

186 Id. P 83, at 25.

187 Rose-Ackerman & Rossi, supra note 69, at 1470 n.123 ("Under a BOT arrangement, the contractor builds the plant and then sells the power that is produced for a period of time. Once one is committed to a risky environment, more control over the environment may be preferred to less. In some cases the firm may only consider the extremes of equipment sales or a BOT project. An intermediate case where the firm accepts much of the risk and has little control over its magnitude may be the worst possible strategy. Thus the structure of the deals reflects guesses about the stability of the political regime and the legal system.").

188 Shemberg, supra note 27, P 85, at 26. Some appear to have been modeled after the ECT.

189 Id. P 87, at 26 ("The above [stabilization] provisions do not apply in cases where the purpose of the adoption of a new Law or the amendment of a Law after the Date of Signing of the Concession Contract is to implement International Standards or technical, environmental, security or policing standards in adapting to scientific or technical progress.").

190 Id. at 27 n.42 ("'The State Authorities shall take all actions available to them to restore the Economic Equilibrium established under the Project Agreements if and to the extent the Economic Equilibrium is disrupted or negatively affected, directly or indirectly, as a result of any change ... in ... Law (... excluding any ... Law(s) ... with respect to cultural heritage, health, safety, the environment and ... employment/labour relations ... to the extent such ... Laws do not impose ... conditions more onerous than those generally observed by the member states of the European Union respecting cultural heritage, health, safety, the environment and ... employment/labour relations .... The reference to 'employment/labour relations' in this Section 7.2(x) shall only apply after the later of (i) 1 January 2016, and (ii) the date the State becomes an Official EU Candidate ....' Georgian Caspian South Caucuses Pipeline project, available at http://www.bp.com/genericarticle.do?categoryId=9006628&contentId=7013497.").

191 Stiglitz, supra note 1, at 457.

192 Shemberg, supra note 27, P 95, at 28 ("For example, over 25 percent of the economic equilibrium contracts in the study contain stabilization provisions that apply in both the investor's and the host state's favor. For changes in law that create a windfall, lower costs, or higher revenues, the host state shares in the benefit. None of the freezing or hybrid contracts contains such a clause.").

193 Id. P 96.

194 Id. P 97; Cotula supra note 28, at 165 ("In the case of economic equilibrium clauses, parties are under an obligation to negotiate in good faith so as to restore the economic equilibrium following regulatory change; but they are not under an obligation to reach an agreement.").

195 Shemberg, supra note 27, P 97, at 28.

196 Id.

197 Klaus Peter Berger, Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrators, 36 Vand. J. Transnat'l L. 1347, 1359-60 (2003) (citing the Vietnam-Laslo oil concession clause, "'If after the Effective Date, new law(s) and/or regulation(s) are introduced in Vietnam adversely affecting CONTRACTOR'S interest, or any amendments to existing laws and/or regulations are made then the Parties shall meet and consult each other and shall make the necessary changes to this Agreement to ensure that CONTRACTOR is restored to the same economic conditions which would have prevailed if the new law and/or regulation or amendment had not been introduced.' In Article 11, the contract contains an arbitration agreement for 'all disputes arising out of or in connection to the contract.' In Article 17.9 the parties are granted the right to present all 'questions, which are in substance of a technical nature' to an 'independent expert of international reputation.'").

198 Thomas J. Pate, Evaluating Stabilization Clauses in Venezuela's Strategic Association Agreements for Heavy-Crude Extraction in the Orinoco Belt: The Return of a Forgotten Contractual Risk Reduction Mechanism for the Petroleum Industry, 40 U. Miami Inter-Am. L. Rev. 347, 374 (2008-2009) ("The stabilization clause itself provided that in the event that the 'Foreign Party' deemed that an event that would cause a material adverse impact had occurred, it would notify PDVSA," the Venezuelan state-owned entity that "would cooperate with the Foreign Party to pursue legal action and 'negotiate in good faith compensatory damages and/or possible modifications to the Agreement designed to restore the economic benefit that the Foreign Party would have received had the [event] not occurred.'").

199 See Foreign Investment in Venezuela Decreases in the Third Quarter, El Universal Daily News (Nov. 18, 2008), http:// english.eluniversal.com/2008/11/18/en_eco_esp_foreign-investment-i_ 18A2134141.shtml; see also Amy L. Chua, The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries, 95 Colum. L. Rev. 223, 288 (1995) (implying that regulatory interventions can help modify the swings between nationalization and privatization).

200 Shemberg, supra note 27, P 104, at 30. Limited economic equilibrium clauses from the OECD contracts in the study generally limit stabilization coverage to laws that are discriminatory toward the investor, and in some cases offer risk-sharing or compensation for specific laws pertaining to the sector or project. Laws for public policy issues such as safety and security, even if discriminatory toward the investor, often are explicitly excluded from stabilization. Id. PP 88, 96.

201 Id. P 107.

202 Id. P 111.

203 Id.

204 Id. P 113.

205 Id.

206 Id. P 105.

207 Id.

208 Id.

209 Cotula supra note 28, at 166-67 ("Overall, the case law suggests that a regulatory taking only occurs when regulation entails 'substantial' deprivation of property rights that is such to render these rights economically 'useless,' as evidenced by criteria such as control over the investment, or interference with day-to-day management or with payment of dividends."). See also Pope & Talbot Inc. v. The Government of Canada, Award on the Merits of Phase 2, P 100 (Apr. 10, 2001), available at http:// www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Award_ Merits-e.pdf.

210 Shemberg, supra note 27, P 109, at **31**.

211 Id. ("One is a Latin American power contract that covers all laws, except income tax, but includes enacted laws not yet in force. Similarly, a road contract for South Asia covers all laws, including those known at the time of the contract but not yet in force.").

212 Id. P 108.

213 Id. P 110 ("The first contract for the project dates from the 1990s and provides economic equilibrium for all environmental law changes having an economic impact after one year prior to its signature. The 2000s contract maintains the original reference date of the 1990s contract for environmental changes in law in its equilibrium clause. This means that pursuant to the later contract, the investor is entitled to adjustments in the contract or compensation for all changes to environmental laws that make greater requirements than those in force 10 years prior, even if a foreseeable change in environmental law in the 2000s would differ from what was foreseeable in the 1990s.").

214 Id. P 112.

215 Id.

216 Id.

217 Elkins, Guzman & Simmons, supra note 11, at 843.

218 Schill, supra note 43, at 23.

219 The authors of the study are bound by confidentiality agreements even if they knew more about the contracts (including the parties) which in many cases they did not.

220 Franck, supra note 50, at 364.

221 Shemberg, supra note 27, P 26, at 6-7.

222 U.N. Conference on Trade & Development, Bilateral Investment Treaties in the Mid-1990s, U.N. Doc. UNCTAD/ITE/IIT/7, U.N. Sales No. E.98.II.D.8 (1998); see Mary Hallward-Driemeier, World Bank, Do Bilateral Investment Treaties Attract FDI? Only a Bit...and They Could Bite (June 2003), available at http://elibrary.worldbank.org/docserver/download/3121.pdf? expires=1299043967&id= id&accname=guest&checksum=1533EFC78091AE5A951658478E593FC0; see also Vahe Lskavyan & Mariana Spatareanu, Host Country's Governance and the Size of Foreign Investors, 100 Econ. Letters 258 (2008).

223 Schill, supra note 43.

224 Emily A. Witten, Arbitration of Venezuelan Oil Contracts: A Losing Strategy?, 4 Tex. J. Oil, Gas & Energy L. 55, 56-57 (2008); ICSID Admits Exxon's Charges Against Venezuela from 2006 Only, El Universal, June 11, 2010, http://english.eluniversal.com/2010/06/11/en_eco_esp_icsid-admits-exxons_ 11A4003971.shtml.

225 See, e.g., Rex J. Zedalis, The Legal Dimensions of Oil and Gas in Iraq: Current Reality and Future Prospects 4-8 (2009) (detailing the history of British, Dutch and French company concessions in the area now known as Iraq dating from 1911).

226 Shemberg, supra note 27, P 25, at 6. In the author's view, one reason for the discrepancy may be that the expressed views came from leading large law firms whose practices are not necessarily representative of modern contract practice generally.

227 Interview with practicing attorney who spoke on condition of anonymity (July 7, 2010).

228 See Compania de Aguas del Aconquija S.A. & Compagnie Generale des Eaux v. Argentine Republic, Case No. ARB/97/3, Award, PP 56-61, 96 (ICSID 2000), available at http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC548_En&caseId=C159 (distinguishing a breach of the BIT and a breach of contract). According to Laura Henry, "The overwhelming majority of cases have held that BIT Tribunals will

not have jurisdiction over a contract claim between a State and an alien unless the government's conduct at the time of the contractual breach also breached a substantive obligation under the treaty." Investment Agreement Claims Under the 2004 Model U.S. BIT: A Challenge for State Police Powers?, 31 U. Pa. J. Int'l L. 935, 962 (2010). See also Thomas J. Pate, Evaluating Stabilization Clauses in Venezuela's Strategic Association Agreements for Heavy-Crude Extraction in the Orinoco Belt: The Return of a Forgotten Contractual Risk Reduction Mechanism for the Petroleum Industry, 40 U. Miami Inter-Am. L. Rev. 347, 362 (2008-2009) (citing MCI Power Group v. Ecuador, "[o]ne can only assume that had the investor had the desire and leverage to memorialize its expectations in a well-drafted stabilization clause, the tribunal may have reached a different result."); Parkerings-Compagniet v. Republic of Lith. Case No. ARB/05/8, Award, P 332 (ICSID 2007), available at http://icsid.worldbank.org/ICSID/FrontServlet? requestType=CasesRH&actionVal=showDoc&docId=DC682_En&caseId=C252 ("Save for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment."); Duke Energy Int'l Peru Inv. Ltd. 1 v. Republic of Peru, Case No. ARB/03/28, Award (ICSID 2008), available at http://ita.law.uvic.ca/documents/DukeEnergyPeruAward_ 000.pdf (enforcing tax stabilization provisions).

229 El Paso Energy Int'l Co. v. Argentine Republic, Case No. ARB/03/15, Decision on Jurisdiction, PP 84-88 (ICSID 2006), reprinted in 21 ICSID Rev. (2006) (determining that the umbrella clause in the U.S.-Argentina BIT does not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the State or a State-owned entity, but will cover additional investment protections contractually agreed by the State as a sovereign, such as a stabilization clause inserted into an investment agreement). However, there is no doubt that if the State interferes with contractual rights by a unilateral act, whether these rights stem from a contract entered into by a foreign investor with a private party, a State autonomous entity or the State itself, in such a way that the State's action can be analyzed as a violation of the standards of protection embodied in a BIT, the treaty-based arbitration tribunal has jurisdiction over all the claims of the foreign investor, including the claims arising from a violation of its contractual rights.

230 John W. Boscariol, Foreign Investment Protection Treaties: Opportunities in the Petroleum Industry, 44 Alta. L. Rev. 115, 141 (2006).

231 See Robert E. Greig et al., How Bilateral Investment Treaties Can Protect Foreign Investors in the Arab World or Arab Investors Abroad, 25 J. Int'l Arb 257, 259, 272 (2008) (giving the example of the United Arab Emirates-France BIT, which protects corporations that are directly and indirectly controlled by French nationals or economic entities); Ranjan, supra note 8, at 221 (citing Fedax v. Venezuela, July 11, 1997, 37 I.L.M. 1378 (1998) in which holders of promissory notes who were not entitled to investment protection transferred the notes to a Dutch company which then enabled treaty protection); Van Harten, supra note 1, at 29 (describing how a domestic business can bring a claim under a BIT by making itself "foreign" by establishing a holding company in the foreign country (citing South African and Pakistani reservations about BITs concluded in the 1990s (citing Tokios Tokeles v. Ukr. 20 ICSID Rev. 205 (2005)))).

232 At least one international arbitration tribunal has permitted a domestic company to become "foreign" by setting up a holding company in a neighboring state. Tokios Tokeles v. Ukr., 20 ICSID Rev. 205 (2005).

233 Yannick Radi, The Application of the Most-Favoured-Nation Clause to the Dispute Settlement Provisions of Bilateral Investment Treaties: Domesticating the 'Trojan Horse', 18 Eur. J. Int'l L. 758, 759 (2007).

234 Vandevelde, The Economics of Bilateral Investment Treaties, supra note 119, at 493.

235 This is in part because the "market for dispute resolution" is less developed at the international level than domestically. See Adam B. Badawi, Interpretive Preferences and the Limits of the New Formalism, 6 Berkeley Bus. L.J. 1 (2009) (arguing that transactors choose dispute resolution forums based in part on a preference for formal versus contextual interpretation). The certainty and predictability associated with domestic courts or tribunals adjudicating commercial disputes is significantly reduced at the level of international investment disputes.

236 Peter Muchlinski, Multinational Enterprises and the Law 497 (1995).

237 Scholars like the late Thomas Wäelde and Lorenzo Cotula do contend that their use is increasing, although it appears that those assertions are supported by impressions rather than evidence.

238 See Brower & Schill, supra note 6. In one survey of Swiss corporate executives, investor-state contracts are rated with the same importance for safeguarding investments as public investment guarantees and private insurance and only slightly lower than BITs. Jentsch, supra note 23.

239 Id. at 1, 20.

240 See Brower & Schill, supra note 6, at 481-82; Schill, supra note 43, at 29; Yackee, International Investment Law, supra note 72, at 125; see generally Jentsch, supra note 22, at 10, 17, 19, 21.

241 Vandevelde, U.S. Bilateral Investment Treaties, supra note 6, at 625-26; see Franck, supra note 50, at 348; Jentsch, supra note 22, at 25.

242 See, e.g., V.N. Balasubranyam, Foreign Direct Investment in Developing Countries: Determinants and Impact (2001).

243 Philip Moremen, Private Rights of Action to Enforce Rules of International Regimes, 79 Temp. L. Rev. 1127, 1159 (2006); Vandevelde, supra note 120, at 473; see Yackee, Empirical Study of Bilateral Investment Treaties, supra note 2, at 406.

244 Salacuse, supra note 21.

245 Wäelde & Ndi, supra note 28, at 237.

246 Stiglitz, supra note 1, at 491. Stiglitz explains that developing countries agree to BITs "because the cost to the developing country is less than the surplus they believe they will receive as a result of the trade deal." Unfortunately, this determination is often made by a limited set of government officials, excluding representatives from key ministries like health and environment whose input may change the calculation.

247 Interview with Mark Kantor, Adjunct Professor of Law, Georgetown University Law Center, in Washington D.C. (Jun. 29, 2010); see also Janet Koven Levit, Bottom-up International Lawmaking: Reflections on the New Haven School of International Law, 32 Yale J. **Int'l** L. 393, 398-408 (2007) (describing the bottom-up lawmaking process).

248 Interview with Mark Kantor, supra note 247.

249 Ranjan, supra note 8, at 230. Bangladesh, for example, has this clause in only three of fifteen BITs while Pakistan has it in twenty-eight of **thirty**-**one**.

250 See Jonathan Hamilton, Brazil's BIT Dilemma, Global Arb. Rev., Dec. 17, 2009.

251 Ratner, supra note 18, at 516.

252 Vandevelde, U.S. Bilateral Investment Treaties, supra note 6, at 625.

253 William H. Cooper et al., Congressional Research Service, The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications 3 (2010) available at http://www.fas.org/sgp/crs/row/RL34330.pdf.

254 Deborah Ball & Cassell Bryan-Low, Swiss Tax Play Lures Business, Wall St. J., (Feb. 2, 2010), http:// online.wsj.com/article/SB10001424052748703422904575039431012272.

255 Alvarez, supra note 42, at 41.

256 Kenneth J. Vandevelde, A Brief History of International Investment Agreements, in The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows 3, 25-26 (Karl P. Sauvant & Lisa E. Sachs eds., 2009).

257 Interview with Mark Kantor, Adjunct Professor of Law, Georgetown University Law Center, in Washington D.C. (Jun. 29, 2010). There are four departments that assist in trade treaty negotiations: the Office of the United States Trade Representative (USTR), the State Department, the Department of Commerce, and the Treasury Department. Each department is usually physically represented at negotiations as well.

258 See Yackee, Empirical Study of Bilateral Investment Treaties, supra note 2, at 462.

259 Jentsch, supra note 23, at 12 (citing an interview with the Swiss State Secretariat for Economic Affairs. Switzerland's objective is to "sign a BIT with all countries that are not members of OECD... almost every day companies having problems with host governments call SECO in order to negotiate with the foreign state.").

260 Stiglitz, supra note 1, at 489.

261 Contra Ratner, supra note 18, at 483 ("The best evidence of this general coherence is simply that the outputs of the decision-making processes form a general, albeit not uniform, pattern--that the bulk of claims of regulatory takings are rejected, typically because (1) the investor is found not to have a legitimate expectation of property right in what he claims was taken from him; (2) the governmental measure does not have the requisite severe impact on his control of the investment; or (3) the purpose and contours of the measure appear to place a fair burden on the investor compared to the public as a whole.").

262 Alvarez, supra note 42, at 23-24.

263 Andrea Carska-Sheppard, Issues Relevant to the Termination of Bilateral Investment Treaties, 26 J. of **Int'l** Arb. 755, 755-71 (2009); Van Harten, supra note 1, at 23-24.

264 Robert E. Greig, Claudia Annacker, & Roland Ziade, How Bilateral Investment Treaties Can Protect Foreign Investors in the Arab World or Arab Investors Abroad, 25 J. of **Int'l** Arb. 257, 259 (2008) (noting that renegotiations have mainly occurred with Egypt and Morocco).

265 Van Harten, supra note 1, at 45-46 ("There are reports of investment treaties being signed as photo opportunities... there was little evidence in the early 2000s when [Pakistan] faced its first BIT claim, that ministries in the Pakistani government (beyond the one that had signed them) were aware of the country's BITs and that he was unable to uncover any records demonstrating meaningful participation by Pakistan in the BIT negotiations."); Lauge Skovgaard Poulsen & Damon Vis-Dunbar, Reflections on Pakistan's investment treaty program after 50 years; an interview with the former attorney general of Pakistan, Makhdoom Ali Khan, Inv. Treaty News (Apr. 2009); Press Release, Embassy of the United States, U.S.-Pakistan Bilateral Investment Treaty Negotiations (May 12, 2005), available at http:// islamabad.usembassy.gov/pakistan/h05051203.html. Pakistan's negotiating team consisted of the Secretary of the Pakistani Board of Investment (head), and representatives of the Ministry of Foreign Affairs, Ministry of Finance, Ministry of Industries and Production, Ministry of Commerce, Central Board of Revenue, and State Bank of Pakistan. Uruguay's negotiating team consisted of representatives from its Ministry of Economy and Finance, its Ambassador to the United States, and its Foreign Minister. See Press Release, Embassy of Uruguay, United States - Uruguay Conclude Bilateral Investment Treaty (Sept. 7, 2004), available at http:// www.uruwashi.org/Archive%202004.htm#Embassy%C20Press%C20Releases%2#004.

266 See Yelpaala, supra note 39, at 241 (noting that many health and safety provisions are located in the preamble or couched in non-binding terms); see also Yackee, Empirical Study of Bilateral Investment Treaties, supra note 2, at 423-27 (describing how some variations of pre-consents are less binding than others).

31 NWJILB **261**