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MANAGING EXPECTATIONS: BEYOND FORMAL ADJUDICTION

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Recognizing that the proper balance of international investment law is an area of normative concern, the World Trade Institute organized a panel to explore considerations related to the appropriate equilibrium. Scholarship by Anne van Aaken and Bart Legum offers an opportunity to consider investment law more systematically, namely by considering different ways to achieve regulatory and commercial balance, to apportion discretion appropriately and to manage expectations. This Commentary offers exploratory remarks that uses latent ideas from the van Aaken and Legum papers to offer a lens for thinking systematically about managing stakeholder expectations of the international investment system.

A critical issue for international investment law relates to cognitive psychology and how to manage the expectations of differently situated stakeholders, particularly when reality does not conform to presumed pre-existing baselines. It is appropriate to think critically about what the baseline expectations should be in international investment. Although there will be overlapping interests and opportunities for joint gains, the expectations and needs of all stakeholders will not necessarily always be in perfect alignment. This means that stakeholders must manage their expectations to avoid dissatisfaction when there is a possibility of either inevitable or unexpected divergence.

There are different methods to manage stakeholder expectations and investment treaty conflict. One element of expectation management involves education, which offers basic information about international investment and its derivative legal regime. Presumably, such information can be used to make evidence-based normative choices that are more informed about the relative costs and benefits.[1] An-

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[1] Evidence-based approaches to legal norms and regulation are gaining in popularity given the tangible value of the benefits. *See, e.g.*, J.C. Oleson, *Risk in Sentencing: Constitutionally Suspect Variables and Evidence-Based Sentencing*, 64 SMU L. REV. 1329 (2001) (using evidence-based approaches to create greater legitimacy in criminal sentencing); Sephanie M. Stern, *Residential Protectionism and the Legal Mythology of Home*, 107 MICH. L. REV. 1093 (2009) (using an evidence-based approach to understand normative choices in property law); Timothy S. Jost, *Our Broken Health Care System and How to Fix It: An Essay on*

other element involves recognizing different doctrinal opportunities to manage investment treaty conflict and related regulatory discretion. To borrow concepts from administrative law for exploratory purposes, regulation of international investment law can either occur through rulemaking procedures or adjudicative processes.[2]

Both authors explore this administrative law model, albeit in different ways. Legum's paper offers a formal rulemaking perspective on international investment law that considers opportunities for textual specification. Van Aaken's paper, by contrast, explores how to capture regulatory discretion by focusing on formal adjudication. Despite the differences, the commonality is that both papers focus on formal regulatory activity.

Yet, state regulatory activity is nuanced. Regulation can involve conduct that is more complex than the simple model of formal adjudication and formal rulemaking. Rather, a sophisticated view of state regulatory activity involves formal *and* informal conduct. This suggests that there are untapped opportunities for managing stakeholder expectations and regulatory discretion through structured informal mechanisms—including informal rule-making and informal adjudication.

The international investment system has thus far depended heavily on international arbitration as a formal

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Health Law and Policy, 41 WAKE FOREST L. REV. 537 (2006) (encouraging an evidence-based approach to health care reform to ensure ideology advances policy objectives); Bernard Trujillo, *Patterns in a Complex System: An Empirical Study of Valuation in Business Bankruptcy Cases*, 53 UCLA L. REV. 357, 363 n.17 (2005) ("[A]n evidence-based law approach to doctrine can move us past anecdote and unexamined path dependence, and perhaps toward a systematization and verification of knowledge about legal doctrine."). In international investment law, it behooves scholars and stakeholders to take methodologically sound empirical evidence seriously.

[2] *See* CHARLES H. KOCH, JR., ADMINISTRATIVE LAW AND PRACTICE § 2:11 (3d ed. 2010) (describing the difference between the adjudication and rulemaking processes); *see also* Benedict Kingsbury et al., *The Emergence of Global Administrative Law*, 68 LAW & CONTEMP. PROBS. 15, 15–18 (2005) (proposing that global governance can be understood by looking at administrative processes such as rulemaking and adjudication); Benedict Kingsbury et al., *U.S. Administrative Law: A Model for Global Administrative Law?*, 68 LAW & CONTEMP. PROBS. 63 (2005) (discussing the convergence of U.S. administrative law and "Global Administrative Law" and the application of administrative law to international regulatory regimes).

adjudicative system to provide guidance and clarification on the standards contained in international investment agreements (IIAs). There has been dissatisfaction with this state of affairs that has lead to calls for the wholesale abandonment or radical overhaul of the international investment system. To prevent the baby from being thrown out with the proverbial bathwater, it is critical to think about the evidence in a realistic and balanced manner. This involves first unpacking stakeholder expectations to promote rational consideration of the evidence by: (a) recognizing where expectations may have been overly optimistic, and then (b) thinking thoughtfully and systematically about the mechanisms through which to capture and manage regulatory discretion. In an effort to do so, the remainder of this Commentary will first consider the empirical and causal links identified by van Aaken to think carefully about how to encourage the purported benefits of IIAs. Second, the Commentary then considers the inevitable tension among incentives for rent-seeking by investors, the different regulatory goals of states and the hopes of civil society.

This Commentary ultimately suggests that formal adjudication has a critical place in the judicialization[3] of international investment law, yet there is value in moving beyond primary reliance upon formal adjudication. Put simply, there is real value in expanding the acceptable—and necessary—methods of investment regulation. There should be increased attention to formal codification of investment rules at the front end and the express prioritization of competing investment values. Meanwhile, there should be enhanced focus on the untapped value of structured—yet informal—regulatory activity, including informal rulemaking and informal adjudication.

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[3] *See* Robert E. Hudec, *The Judicialization of GATT Dispute Settlement, in* IN WHOSE INTEREST? DUE PROCESS AND TRANSPARENCY IN INTERNATIONAL TRADE 9 (Michael M. Hart & Debra P. Steger eds., 1992); David M. Trubek, *Transcending the Ostensible: Some Reflections on Bob Hudec as Friend and Scholar*, 17 MINN. J. INTL. L. 1, 3-4 (2008); Andrea Kupfer Schneider, *Not Quite a World Without Trials: Why International Dispute Resolution is Increasingly Judicialized*, 2002 J. DISP. RESOL. 119, 119–24 (2006) (arguing that certain international disputes are increasingly judicialized).

I. Managing Expectations About Investment

The Washington Consensus was based upon the premise that international investment and development objectives were necessarily aligned. A corollary assumption was that foreign investment would yield a net positive benefit for both the investor and the State.[4]

Yet, there have been concerns that the purported benefits of international investment are not supported by the data. Whether the dysjunction between the expectation and outcome derives from either a lack of information or cognitive processing errors that lead to the overestimation of positive outcomes,[5] the effect is the same. It is unrealistic to assume that a causal chain will function every time, whereby: (1) signing an IIA will lead to investment, (2) the investment will lead to growth, and (3) growth leads to better quality of life for the population. At each step of that causal chain, problems can arise.

There is not necessarily single uniform monolithic narrative of international investment that always results in a happy outcome. Van Aaken is correct to urge caution lest one be overly optimistic about the benefits of international investment, and thereby be disappointed when reality di-

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[4] *See generally* THE WASHINGTON CONSENSUS RECONSIDERED: TOWARDS A NEW GLOBAL GOVERNANCE (Narcis Serra & Joseph E. Stiglitz eds., 2008); *see also* Jeswald W. Salacuse, *The Emerging Global Regime for Investment*, 51 HARV. INT'L L.J. 427, 470 (2010) ("The Washington Consensus--the shared belief . . . that increased investment, open economies, privatization, and economic deregulation would result in increased global prosperity and economic development--was a powerful force for the spread of investment treaties and the development of the regime that they created."); *see also* THEODORE H. MORAN, HARNESSING FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT: POLICIES FOR DEVELOPED AND DEVELOPING COUNTRIES 72–74 (2006) (proposing a "build-up" approach which involves greater liberalization of the economy and can be used by poorer developing countries to harness FDI and development).

[5] *See* Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1524–25 (1998) (identifying overoptimism as a common feature of human behavior which leads people to think that their probability of a bad outcome is far less than others); DANIEL KAHNEMAN, THINKING, FAST AND SLOW (2011) (exploring cognitive biases and their effects in increasing peoples' perceived positive outcomes); DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS (2008) (discussing the role cognitive biases play in everyday decision-making, counteracting the presumption that individuals make decisions based on rational choice).

verges from expectation. There are inevitably narratives of success, horror stories, and still other situations where outcomes are mixed. In other words, risks related to international investment are complicated, and stakeholders would do well to first think in a more nuanced way to better manage expectations and promote better decisionmaking.

II. Understanding the Causal Link between IIAs and Investment

Data is a critical element of managing expectations and disrupting of cognitive biases that lead to poor predictive conclusions. This section therefore considers the value that data can offer in evaluating the causal link between the value of an IIA and derivative investment flows.

The first link in Van Aaken's causal chain requires assessment of the value of entering into a treaty. The existing empirical literature suggests there is a binary choice, with two competing narratives, namely: (1) IIAs do facilitate foreign investment,[6] and (2) IIAs do not facilitate foreign investment.[7]

Yet, recent research suggests the intriguing possibility that the merits of signing an IIA are more nuanced than an "either-or" dichotomy. Scholarship by Tobin and Rose-Ackerman[8] suggests that there is sometimes a positive rela-

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[6] *See* Deborah L. Swenson, *Why Do Developing Countries Sign BITS?*, 12 U.C. DAVIS J. INT'L L. & POL'Y 131, 152–55 (2005) (evaluating statistical information of BITs throughout the 1990's, and concluding that countries that signed BITs were rewarded with increased levels of foreign investment); UNCTAD, World Investment Report 2011: Non-Equity Modes of International Production and Development, UNCTAD (2011), http://www.unctad-docs.org/files/UNCTAD-WIR2011-Full-en.pdf (detailing the year-to-year growth of FDI flow around the world, and the increase of foreign investment dollars being invested among various States).

[7] *See* KARL P. SAUVANT & LISA E. SACHS, THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS (Karl P. Sauvant & Lisa E. Sachs eds., Oxford Univ. Press 2009) (analyzing data that looked at the most widely quoted studies, in order to determine whether IIA's are effective legal instruments in attracting foreign investors, with the author's conclusions varying from IIA's having a strong effect on international investment flow to IIA's having no effect at all).

[8] Jennifer L. Tobin & Susan Rose-Ackerman, *When BITs Have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties*, 6 REV. INT'L ORGAN. 1 (2011).

tionship between IIAs and investment flows; but the story is typically complicated and without a universal narrative. In particular, they suggest that IIAs are a complement to—not a substitute for—the domestic regulation that facilitates investment.[9] Their empirical scholarship indicates that: (1) political risk can moderate the efficacy of an IIA,[10] and (2) the presence of other IIAs can affect the benefits of a treaty.[11] Similarly, recent scholarship by Jason Yackee analyzed whether the presence of an IIA motivated international investors' investment decisions. He explained that "grandiose claims about the historically demonstrated ability of [IIAs] to promote investment should be consumed with caution. [IIAs] may influence certain investment decisions."[12]

This recent and nuanced research provides credible evidence that the value of IIAs is not monolithic. Rather, IIAs must be evaluated in nuanced way. Using a particularized country-by-country and dyad-by-dyad understanding will aid States in making more realistic and evidence-based assessments of the value of IIAs. While this necessarily means more complexity, it reflects real-world variance that stakeholders ignore at their peril. Put simply, while IIAs can lead to investment in certain circumstances, stakeholders may need to decrease their expectations about the degree and potential effect of IIAs so that they do not end up unnecessarily disappointed. They need to consider the likely

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[9] *Id.* at 28.

[10] As political risk decreased, there were increases in investment. *See id.* at 21 ("Across all of the specifications, decreased political risk (a higher risk indicator) has a positive impact on FDI flows . . . for each one point that a country improves on the political risk scale, the impact of an additional BIT equates to a 1.1% increase in FDI flows."). In the examples Tobin & Rose Ackerman offered, this translated into increased capital flow of US$1-1.2 million for every IIA signed. *Id.* at 22.

[11] In the global competition for capital, the overall number of IIAs in a country and world-wide may suppress the positive investment flow that might otherwise be expected from an IIA. *See id.* at 17 ("As a country enters into greater numbers of BITs, if other countries do so as well, any positive impact is moderated by those other countries' actions.").

[12] Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L L. 397, 400 (2010); *see also* Todd Allee & Clint Peinhardt, *Delegating Differences: Bilateral Investment Treaties and Bargaining Over Dispute Resolution Provisions*, 54 INT'L STUD. Q. 1 (2010) (exploring how differences variables, particularly treaty dispute resolution mechanisms, can implicate investment decisions).

net benefit of "the grand bargain"[13] and then consider how to strategically maximize those benefits.

III. Alignment of Interest in Investment

Even assuming all IIAs are reliably linked to increased investment flows, it is not guaranteed that investment will result in a positive development outcome. Another element of managing expectations to avoid unnecessary dissatisfaction, involves systemic evaluation of the permutations of the potential investment outcomes. While outcomes can theoretically be positive for host State development, the interests of all stakeholders are not always in perfect alignment.[14]

Investors, States and civil society groups all have important roles to play in the evolution of international investment law. As relevant stakeholders, their positions should be evaluated to consider the scope of potential variations. While overly simplistic, even a simple model that considers: (1) the experience of the three key sets of stakeholders,[15] and (2) the potential outcomes of investment,[16] demonstrates the realistic probability for divergence. Chart 1 provides a visual representation of this possibility. Presuming these different permutations are all equally weighted, in only *one* out of eight options is there perfect alignment between the effects of all interested stakeholders.

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[13] Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITS Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT'L L.J. 67, 77 (2005).

[14] *See generally* Erik Albæk, *Knowledge, Interests and the Many Meanings of Evaluation: A Developmental Perspective*, 7 INT'L J. SOC. WELFARE 94, 97 (1998) (discussing economic growth in the United States and acknowledging the "increased [] awareness of the many stakeholders' divergent substantial interests as well as institutional interests").

[15] Future scholarship might undertake a more considered discussion about the nuances of different types of stakeholders in the international investment system. For the limited purposes of this exploratory essay, these three key groups have been identified as making significant contributions to international investment law.

[16] For the limited purposes of this exploratory essay, this variable is discrete in that it creates a binary variable to demarcate a distinction between: (a) positive investment outcomes, and (b) either neutral or negative investment outcomes. Future scholarship might create a uniform variable for a more nuanced evaluation of categories or even a scaled range of possible outcomes.

Investor	State	Civil Society
Positive Effect	Positive Effect	Positive Effect
Positive Effect	Positive Effect	Neutral or Negative Effect
Positive Effect	Neutral or Negative Effect	Neutral or Negative Effect
Neutral or Negative Effect	Neutral or Negative Effect	Neutral or Negative Effect
Neutral or Negative Effect	Neutral or Negative Effect	Positive Effect
Neutral or Negative Effect	Positive Effect	Positive Effect
Neutral or Negative Effect	Positive Effect	Neutral or Negative Effect
Positive Effect	Neutral or Negative Effect	Positive Effect

Chart 1: Matrix of Potential Investment Outcomes.

This should be sobering to those who assume that international investment is always a positive evolution for all stakeholders. It might even suggest that one should expect systemic dissatisfaction with investment outcomes.

This is not to say that there will not be success stories. Indeed, one would hope that investment choices are made with the objective of providing sustainable commercial opportunities for businesses, states and citizens. Yet, that hope must be tempered with reality. Human beings have cognitive predispositions to be overly optimistic and overconfident about the success of their ventures.[17] After all, if 75% or more of the population presumes that they are better than average drivers, at least 25% of the population must be

[17] *See* Karl Schweizer et. al., *Cognitive Bias of Optimism and Its Influence on Psychological Well-Being*, 84 PSYCHOL. REP. 627 (1999) (describing experiments demonstrating individuals' optimism bias and its effect).

wrong.[18] If studies regularly demonstrate the risk of error with something as basic as driving, simply consider the degree of error that may be involved in something as complex as international investment law.

It is entirely possible that the mismanagement of expectations related to investment, normal cognitive biases and information processing errors is part of the current dissatisfaction with the international investment regime. This dissatisfaction, in turn, contributes to the efforts to reclaim State regulatory authority and "policy space," which José Alavarez has called, "The Return of the State."[19]

Unitary characterizations might require unitary solutions. Yet, the reality is: international investment flows and development outcomes are complex and require complexity to provide constructive solutions. Dissatisfaction with investment outcomes may not necessarily require simple rejection or abandonment of the current IIA regime. There may be more subtle and tailored opportunities to redress perceived dissatisfaction. Stakeholders might be better served by first recognizing that perfect alignment with the social good of development will not necessarily be achieved in equal levels for all groups. Beyond this, stakeholders should consider that, more often than not, some stakeholder will be dissatisfied at some point in the investment lifecycle. The question then becomes: (1) how can stakeholder expectations best be managed, and (2) what should be done to redress the inevitable dissatisfaction with the process given the continuing need to facilitate both investment and economic development?

The next section explores these two related areas. First, it considers how we might manage expectations by thinking about the regulation of IIAs and development in a more nuanced way. Second, it identifies additional areas for

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[18] The classic study by Baruch Fischoff found "[Seventy-five to ninety percent] of drivers believe that they are better than the average." Baruch Fischhoff, *Cognitive Liabilities and Products Liability*, 1 J. PROD. LIAB. 207, 212 (1977); *see also* JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (Daniel Kahneman, Paul Slovic & Amos Tversky eds., 1982); Ola Svenson, *Are We All Less Risky and More Skillful Than Our Fellow Drivers?*, 47 ACTA PSYCHOL. 143, 146-47 (1981) (evaluating perceived driving skill and finding a self-serving bias where people viewed themselves more favorably (i.e. less risky and more skillful)).

[19] José E. Alavarez, *The Return of the State*, 20 MINN. J. INT'L L. 223 (2011).

structure regulatory authority. Finally, it suggests that strategic choices of these different opportunities will create better institutional balance in international investment law that more properly manages expectations, promotes stakeholder choice, and hopefully increases satisfaction with international investment and its regulation.

IV. Systemic Regulatory Opportunities

Global administrative law, or global regulatory law, posits that there is a new administrative legal space that exists beyond the traditional nation-state boundaries. Instead, rather than the traditionally public bodies exercising regulatory conduct, a confluence of public, private, and public-private hybrid actors perform key regulatory functions.[20] Scholarship has begun to apply these concepts to international investment law.[21] Thinking about investment law through this framework provides an opportunity for systemic evaluation.

[20] SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION (2009); *see also* Nicko Kricksn & Benedict Kingsbury, *Introduction: Global Governance and Global Administrative Law in the International Legal Order*, 17 EUR. J. INT'L L. 1, 3 (2006) (providing a detailed explanation of Global Administrative Law – how administrative and regulatory functions are performed in a global context – and providing examples of a number of different forms in which regulatory functions of global governance take place); Alex Mills, *Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration*, 14 J. INT'L ECON. L. 469, 485-86, 489 (2011) (exploring how investment law's use of arbitration can be viewed as a law-making administrative process); Stephan W. Schill, *System-Building in Investment Treaty Arbitration and Lawmaking*, 12 GERMAN L.J. 1083, 1101, 1107–08 (2011) (investigating regulatory functions outsourced by treaties and its implications).

[21] *See* Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L. 121, 121 (2006) (explaining four key features of investment treaties and how together, international investment arbitration best exemplifies global administrative law); *see generally* Montt, *supra* note 20 (recognizing investment arbitration as a form of public law adjudication while trying to fill in the gaps regarding the political and legal consequences of developing countries in investment treaties).

A. The Framework of Global Administrative Law

Administrative law occurs primarily through rulemaking or adjudication. Both forms of regulation involve a policy choice that has a normative application to the lives of individuals. Adjudication is a more specific application of law to an individualized context. Adjudication can involve, for example, a judge or other third-party neutral adjudicating the facts before him or her in light of the applicable legal regime. Rulemaking, by contrast, is more generalized. It does, however, require the articulation of legal rules and, potentially, interpretive guidelines or examples to guide the application of the broader principles. These forms of administrative regulation can happen through both formal and informal mechanisms.[22] In theory, this means that there are at least four categories of regulatory activity: (1) formal rulemaking, (2) formal adjudication, (3) informal rulemaking, and (4) informal adjudication.

Currently, international investment law occurs almost exclusively through a formal paradigm. Regulation starts initially through the context of formal rulemaking. This limited formal activity involves treaty drafting. It can also take the shape of treaty renegotiation or the drafting of interpretive statements issued by entities with designated authority.[23] These processes have created an international law regime with broad standards concerning the treatment of investment. Despite the formality of the rule creation framework, there have been few clear articulations of individualized rules or textual explanations of how the

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[22] In the United States, for example, regulatory discretion operates through the rubric of the Administrative Procedure Act (APA) that sets the standards through which regulatory discretion operates. *See* Administrative Procedure Act, 5 U.S.C. §§ 500–596 (2000); *see also* 3 CHARLES H. KOCH, JR., ADMINISTRATIVE LAW AND PRACTICE § 10:1 (3d ed. 2011) (providing a brief overview of the four fundamental processes of Administrative Law – formal and informal adjudication and rulemaking); David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT'L L. 547 (2005).

[23] For example, the North American Free Trade Agreement (NAFTA) Free Trade Commission has issued an Interpretative Note. *See* NAFTA, *Notes of Interpretation of Certain Chapter 11 Provisions*, FOREIGN AFFAIRS AND INTERNATIONAL TRADE CANADA (July 31, 2001), http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA-Interpr.aspx?lang=en&view=d.

regulatory regime should be applied. Given this gap, it is perhaps no surprise that – to date – the majority of regulation in international investment law has occurred through the context of formal adjudication. By virtue of both the creation of broad standards and the treaty's outsourcing of the adjudicative function, international arbitrators have become the de facto regulators of international investment law.

This focus on formal regulation has benefits. First, it is a move beyond the violence associated with gunboat diplomacy.[24] Second, it provides a check on the unfettered discrediscretion of diplomacy and creates standards for evaluating the merits of economic rights.[25] Third, it promotes judicialization of economic rights and provides a chance for enhanced predictability.[26] Finally, placing regulatory decisions into the hands of neutral parties can prevent undue politicization.[27] Focusing on the expedient resolution of economic rights in a neutral forum has the potential to de-

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[24] *See generally* JAMES CABLE, GUNBOAT DIPLOMACY 1919-1991: POLITICAL APPLICATIONS OF LIMITED NAVAL FORCE (3d ed. 1994) (giving background information and the history of Gunboat Diplomacy); Fergus MacErlean, *Argentina Launches Naval Campaign to Isolate Falkland Islands*, THE TELEGRAPH (Dec. 5, 2011, 8:28 PM), http://www.telegraph.co.uk/news/worldnews/southamerica/falklandislands/8936750/Argentina-launches-naval-campaign-to-isolate-Falkland-Islands.html (discussing the naval campaigns Argentina has recently launched to isolate the Falkland Islands which symbolizes a present day gun-boat diplomacy).

[25] *See* 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, 480–81 (2009) (explaining why it is difficult for investors to enforce promises made by host states as well as the drawbacks that weaken diplomatic protection in forcing host states to comply with those promises); Andrea K. Bjorklund, *Sovereign Immunity as a Barrier to the Enforcement of Investor-State Arbitral Awards: The Re-Politicization of International Investment Disputes*, 21 AM. REV. INT'L ARB. 211 (2010) (discussing how the sovereign immunity laws of a specific state plays a role in preventing investors from enforcing a judgment against the host state).

[26] *See supra* note 3 at 9 (discussing the legalization international economic law).

[27] *See* IBRAHIM F. I. SHIHATA, TOWARD A GREATER DEPOLITICIZATION OF INVESTMENT DISPUTES: THE ROLES OF ICSID AND MIGA, IN INVESTING WITH CONFIDENCE: UNDERSTANDING POLITICAL RISK MGT. IN THE 21ST CENTURY 2–35 (Kevin W. Lu et al. eds., 2009) (discussing how international investment disputes has evolved through the years, from politicized disputes requiring the exercise of diplomatic protection and use of force, to the formation of organizations that offer a forum for conflict resolution and depolitization of investment disputes).

crease economic risk and increase investment—hopefully with the concomitant objectives of development.

Nevertheless, exclusive reliance on formal regulation has costs. Such reliance ignores the value potentially derived from thinking systemically about informal regulatory regimes. This means that value is either potentially left on the table or otherwise lost. Moreover, the current system is heavily skewed towards only one form of regulation—formal adjudication. This has certain negative implications. First, as arbitrators are not necessarily from the State or States involved in the IIA, this creates concerns related to a potential democracy deficit.[28] Second, the fragmented nature of the adjudicative regime can create challenges in generating a stable and predictable system.[29] This lack of predictability may, in turn, create negative externalities for the efficacy of investment law and the economic value derived from IIAs. Third, the abundance of discretion related to the application, can give rise to concerns related to abuse of discretion or improper interpretation.[30] Finally, the nearly exclusive outsourcing of regulatory authority to non-State actors raises concerns about the proper balance of State authority and the rights of individuals or corporations.[31]

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[28] *See* Ilhyung Lee, *Practice and Predicament: The Nationality of the International Arbitrator (with Survey Results)*, 31 FORDHAM INT'L L.J. 603, 604 (2008) (discussing how the practice of national neutrality is widely followed and parties commonly insist that the arbitrator be a national of a country other than those of the parties).

[29] Charles N. Brower, *The Evolution of the International Judiciary: Denationalization Through Jurisdictional Fragmentation*, 103 AM. SOC'Y INT'L L. PROC. 171, 184 (2009) (illustrating the potential for the fragmentation of the international legal system through the poignant example of the conflict between the ICTY and ICJ over legal doctrine, giving rise to disparate results depending on which tribunal was viewing the problem).

[30] *See* David Schneiderman, *Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes*, 30 NW. J. INT'L L. & BUS. 383, 405 (2010) (discussing inconsistent Argentinean arbitration awards, based upon identical or similar facts, in order to try and shed light on the process of arbitral decision-making); Jan Paulsson, *Moral Hazard in International Dispute Resolution*, 25 ICSID REV. 339, 343–47 (2010) (illustrating the possibility of improper arbitrator activity by reference to anecdotal information).

[31] *See* Suzanne A. Spears, *The Quest for Policy Space in a New Generation of International Investment Agreements*, 13(4) J. INT'L ECON. L. 1037, 1072–73 (discussing the new generation of IIAs and the attempts to balance private adjudication and public policy).

These concerns are no small matters and are, perhaps, contributing to the current backlash against investment treaty arbitration.[32]

B. Exploring Untapped Value

The focus on formal adjudication has consequences. It both undervalues the possible role for formal rule-making and leaves potential value of informal regulatory activity untouched. This outcome suggests three things. First, the status quo may necessitate a rebalancing of the regulatory pendulum to focus on complimentary or complete alternatives to capture regulatory discretion. Second, it necessitates stakeholders making more informed and systemic choices about where they choose to place regulatory discretion. Finally, any adjustments in stakeholders' approaches to the management of investment risk have the capacity to more adequately manage expectations about the role of investment and the role of state authority. Put simply, in the investment context, optimism must be met with realism; realism requires re-assessment of the most appropriate method(s) for regulating international investment; and stakeholder expectations should be tempered accordingly.

C. Formal Rulemaking

One of the most critical areas of untapped value is formal rulemaking. Utilizing formal rulemaking capacity could take a variety of forms.

In the first instance, it could require greater particularization of international investment rules. In their current shape, the broad standards in international investment treaties provide minimal guidance of the shape of the law

[32] *See* MICHAEL WAIBEL ET AL., THE BACKLASH AGAINST INVESTMENT ARBITRATION: PERCEPTIONS AND REALITY (Michael Waibel eds., 2010) (discussing the current backlash, both procedural and substantive, against investment arbitration, through a multitude of viewpoints concerning the present state of investment arbitration within the larger international legal regime); *see also* Asha Kaushal, *Revisiting History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime*, 50 HARV. INT'L L.J. 491 (2009) (giving a historical perspective on the backlash against international investment law and arbitration).

and its application. Given the academic quagmire of the rules versus standards debate[33] and vague treaty standards outsourcing interpretation, the adjudicative capture of regulatory authority is not surprising. States may, therefore, be well served by reclaiming their regulatory space by providing greater detail in the text of their investment treaties. Such detail need not only include more specificity regarding the text of substantive investor rights. It may also include: (1) specific defenses, exclusions and non-precluded measures in the text of treaties, (2) clear guidance to tribunals as to how they *must* interpret the substantive text of the treaty, (3) express statements about procedural matters, including any requirements about pleading damages with specificity in the request for arbitration or articulating the methodology for calculating damages, (4) identification and definition of the values that underlie that interpretive guidance, such as sustainable development, or (5) an express prioritization of the rights contained in the treaty. In other words, States should consider how best to recapture their own discretion and then precisely outsource discretion granted to arbitrators. This, in turn, offers arbitrators a greater decree of guidance as to how they should and must apply the law. It also sets the expectations of stakeholders before, during and after the dispute.

A higher degree of specificity in the text of treaties is not the only answer. Much like NAFTA Free Trade Commissions,[34] States may derive value in constituting an inter-State panel or other agency that is delegated the task of providing greater provision about the meaning and application of

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[33] *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992); *see also* Anne van Aaken, *International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis*, 12 J. INT'L ECON. L. 507 (2009); Daniel A. Crane, *Rules Versus Standards in Antitrust Adjudication*, 64 WASH. & LEE L. REV. 49 (2007); Daniel Bodansky, *Rules vs. Standards in International Environmental Law*, 98 AM. SOC'Y INT'L L. PROC. 275 (2004); Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 HARV. INT'L L.J. 333 (1999); John Braithwaite & Valerie Braithwaite, *The Politics of Legalism: Rules versus Standards in Nursing Home Regulation*, 4 SOC. & LEGAL STUD. 307 (1995); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

[34] *See supra* note 23 (examining the ability of NAFTA's Free Trade Commission to engage in interpretive rulemaking, in clarifying the meaning of the treaty).

international investment law. Overall, the objective of such formal rulemaking and the codification of international investment law will avoid delegation problems, decrease the risk of principal-agent problems and provide clarity to manage stakeholder expectations.

D. Informal Rulemaking and Informal Adjudication

The other critical untapped opportunities are related to informal regulation. Simply using the term "informal" does not mean that such regulatory conduct is completely without reference to standards. Rather, it would simply provide an opportunity to offer regulation but without the comprehensive formality of treaty negotiation and ratification.[35] Such informal activity could include, for example, informal rulemaking and informal adjudication.[36]

In the context of informal rulemaking, one might imagine the creation of a Lead Government Agency (LGA) within a host State that has been delegated the task of keeping the State in compliance with its international law obligations. Such an LGA might even consider how best to create rules and internal protocols that are designed to facilitate conflict, as well as manage and promote dispute prevention.[37] Like-

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[35] The ideas in this essay are preliminary and would require additional details so as to avoid problems such as an entity being deemed to have impermissibly amending a treaty through their own regulatory authority.

[36] Another benefit of informal regulation involves the minimization of "regulatory fatigue" that is created by more formal processes. *See* Richard B. Stewart, *Administrative Law in the 21st Century*, 78 N.Y.U. L. REV. 437, 446-47 (2003).

[37] *See* Anna Joubin-Bret & Jan Knörich, *Investor-State Disputes: Prevention and Alternatives to Arbitration*, UNCTAD SERIES ON INT'L INV. POLICIES FOR DEV. 1, 77–79 (2010), http://www.unctad.org/en/docs/diaeia200911_en.pdf [hereinafter *ADR I*] (examining the program launched by the Ministry of Commerce and the Government of Columbia creating a lead agency that would be the centralized authority for all matters related to investor-State disputes); Jae Hoon Kim, *Republic of Korea's Development of a Better Investor-State Dispute Resolution System*, UNCTAD, INVESTOR-STATE DISPUTES: PREVENTION AND ALTERNATIVES TO ARBITRATION II at 67, 69–70 (2011), http://www.unctad.org/en/docs/webdiaeia20108_en.pdf [hereinafter *ADR II*] (explaining how the Republic of Korea's efforts included the formation of a committee which is responsible for establishing policies regarding investment treaties); *id.* at 97 (elaborating on the Republic of Korea's creation of the Foreign Investment Promotion Law whose Article 1 established The Office of the Foreign

wise, although possibly more formal, this might also take the form of negotiated rulemaking to bring together different stakeholder groups to fashion rules or investment law guidance. These options can aid in the preservation of State discretion and "policy space," the promotion of State regulatory flexibility and the creation of opportunities to provide legal clarity.

In the context of informal adjudication, there are a myriad of options. Whether in the form of an LGA or an Ombuds office, it is possible to create an entity that helps resolve investment conflicts informally and prevents them from becoming full-blown formal disputes. This could take the form of, for example, Early Neutral Evaluation, Expert Determination, Evaluative Mediation or other less formalized conflict management mechanisms. The United Nations Conference on Trade and Development has already identified early successes in this area[38] as it permits flexibility and the retention of State "policy space." With the requisite degree of capacity building and protocols, it may be possible to move beyond formal adjudication to a more nuanced approach to the regulation of international investment law.

One size may not fit all when it comes to the regulation of international investment. Overreliance on formal adjudication breeds dissatisfaction, particularly where the regulatory question can be addressed more directly and effectively through an alternative process. To manage expec-

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Investment Ombudsman with the purpose of resolving issues faced by foreign-invested companies in Korea); *id.* at 63 (developing four areas for States to evolve including, "(1) putting trained officials into central posts of the administration, (2) implementing mandatory consultations, (3) establishing new types of investment treaty practice and (4) implementing continuing legal education of civil servants in investment related matters").

[38] *See ADR I*, *supra* note 37, at 68–74 (examining, in detail, how Peru has set up a government agency to distribute information on IIA's to their governmental agencies, including the creation of an alert system, as well as standardizing information and responses to potential and actual IIA disputes); *id.* at 88–93 (discussing how the Republic of Korea set up an independent ombudsman program to monitor IIA's, and assist foreign investors in navigating Korea's business environment, while working to increase the overall investment environment); *see also ADR II*, *supra* note 37, at 97 (giving additional historical background on the development of the Republic of Korea's ombudsman program, and explaining some of the remarkable success the program has experienced).

tations better and maximize the value of investment regulation, more than one process may be necessary. Perhaps more likely, a series of processes may be essential to promote a nuanced use of regulatory authority while pro-promoting choice and values of procedural justice.

V. CONCLUSION

This nuanced approach to managing the regulatory process, and a recognition that international investment will not have a positive result for all stakeholders all the time, can help to manage expectations related to international investment. In turn, this can start to alleviate dissatisfaction with the system and promote a more realistic and balanced basis for regulating international investment.

Overall, the international investment system is neither wholly evil nor wholly good. False dichotomies and overly simplistic characterizations hide the complexity of international investment and promotes an overreliance on inaccurate caricatures. Rather, an evidence-based nuanced analysis is preferable. This permits consideration of specific dynamics about stakeholder objectives in light of particularized cost-benefit analysis of an individual IIA regime. This should promote informed choices about where regulatory discretion is best placed and avoid distortion caused by inadvertent cognitive biases. The ultimate goal is to use a flexible and nuanced approach to regulatory choices to foster a more realistic assessment and utilization of the international investment regime.