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The Hydrocarbon Industry's Challenge to International Investment Law: A Critical Approach

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The research presented here challenges the contemporary view that the international investment regime has a "chilling effect" on host government policies. That critique errs in assuming that the effects of the modern bilateral investment treaties on decision making within host governments have been uniform across states and economic sectors. The main argument presented here is that in developing countries that depend on the oil and gas sectors, the international investment regime rarely deters host government rent-seeking behavior that can harm foreign investors.

In petro-dependent developing nations that have weak institutional capacity the survival of the government becomes tied to its ability to capture the industry's extraordinary profits. The governments in Bolivia, Venezuela, Nigeria, Kazakhstan, and Ecuador, to name a few, no longer rely on ordinary sources of tax revenue; rather, they tend to get trapped in a "rent dependency curse" in which the governments derive an overwhelming portion of their budgets from natural resource revenues. Their institutional stability depends on their ability to capture the rents, which consequently affects foreign investors' rights.

The decisions of investment tribunals in investor-state disputes have not changed the petro-dependent governments' propensity to choose rent-seeking policies. This phenomenon can be traced to the attitude of investment tribunals toward remedies. In an effort to maintain their reputation, tribunals have been timid in ordering performance remedies—such as ordering a state in violation of its treaty obligation to halt its offending behavior—and instead have relied heavily on compensatory damages. This results in a paradox: in petro-dependent states, host governments violate treaty provisions and capture oil and gas rents for their benefit, and simply use these rent proceeds to pay pecuniary remedies when ordered by international tribunals.

INTRODUCTION

Today, the global investment regime is composed of a network of 3271 international investment agreements ("IIAs"); 2926 are bilateral investment treaties ("BITs") and 345 are other types of instruments, mainly investment

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chapters in free trade agreements.[1] The agreements contain provisions providing for both substantive rights to foreign investors against government interference as well as procedural rights to bring claims against host states through international arbitral proceedings.[2] Most of these agreements were signed in the 1990s, and as time has passed and economic crises have affected the developing world, litigation over the interpretation of treaty terms has risen in international arbitral tribunals.[3] As of December 2014, foreign investors had initiated close to 500 cases against governments in all regions of the world and regarding a diversity of sectors such as agriculture, fishing, forestry, information, communication, finance, services, trade, oil, gas, mining, construction, tourism, water, sanitation, and flood protection.[4] In the most extreme cases, some states, such as Argentina, have faced up to 40 arbitration claims (with a value of over $80 billion) against government policies taken in times of economic distress.[5] Some scholars have argued that it is here in the operation of arbitral tribunals where the proliferation of the "millennium" wave of investment law is unfolding.[6]

The increase in tribunal caseloads brought a surge in academic literature that tries to explain the nature of the regime, its effectiveness, and payoffs. One of the most influential academic arguments posits that the investment regime has taken away regulatory space from states and has therefore become part of what some scholars call a type of "global administrative law."[7] Their prescriptions have affected the way new treaties, such as the Trans-Pacific Partnership, are being designed.[8] New investment agreements today tend to include exceptions to the protection of investors' rights in the face of partic-

1. U.N. Conference on Trade and Development, *World Investment Report 2015*: *Reforming International Investment Governance*, U.N. Doc. UNCTAD/WIR/2015 (2015).

2. *See generally* Rudolf Dolzer & Christoph Schreuer, Principles of International Investment Law (2d ed. 2012).

3. ICSID, The ICSID Caseload—Statistics 7–8 (Issue 2015-1).

4. *See id.*

5. *See* William W. Burke-White, *The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System*, 3 Asian J. WTO Int'l Health L. & Pol'y 199, 200–04 (2008).

6. Peter D. Cameron, International Energy Investment Law: The Pursuit of Stability xlvi (2010). Peter Cameron calls this period the "Millennium Wave" of actions taken by states against investors in the oil and gas sector, and notes that this phenomenon "appears to have no parallel in the international economy, at least in its energy and natural resources sector, since a similar wave of host state actions occurred almost three decades ago. That earlier wave led a series of published awards that have shaped our understanding of contract stability ever since and have provoked a voluminous literature. The center and origin of most of these 'classic' investor-state disputes lay in the Middle East and North Africa. By contrast, the regions that have been the source of the Millennium Wave and the most vivid illustrations of its power have been in Latin America, Eastern Europe, and Central Asia. The contract and treaty-based mechanism of stability applicable to investments in these regions have been ones designed to absorb the lessons learned from the last wave and aimed at ensuring a higher level of stability to investor-state contracts." *Id.*

7. *See infra* Part I for further discussion on the origins and proponents of the administrative law view.

8. Article 9 of the TPP allows, among other things, for amicus curiae submissions and nondisputing party submissions. It also raises the standard of review by underscoring that the Parties to the treaty can regulate in the public interest issues such as health, environment, safety, and financial stability. *See* Trans-Pacific Partnership Agreement art. 9, *opened for signature* Feb. 4, 2016 [hereinafter TPP], https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text.

ular public interest issues, such as safety, health, security, financial stability, and environmental protection.[9] The rise of these new treaty provisions, according to prominent commentators such as Professor José Alvarez, is a sign that the state is "returning" to the center of the treaty regime.[10]

Yet few of the scholars that have taken the administrative law approach have analyzed the concrete impacts and incentives generated by the investment regime in particular states, sectors, or industries.[11] The consensus is to consider the treaties and the jurisprudence of the tribunals as if they were generating the same constraining effects on government policies across the board. The work presented here questions this contemporary view by describing the paradoxes and contradictions of the investment regime when applied to the petro- or hydrocarbon sector.[12] Two fundamental questions shape the research: has the investment regime affected international oil and gas transactions? And, has it changed the incentives of governments to respect their international commitments? This sector is used as an example because the exploitation of hydrocarbons has traditionally relied on foreign direct investment and because the sector is important in many developing countries. Moreover, extractive industries litigation has comprised around 40% of the World Bank's International Center for Settlement of Investment Disputes ("ICSID") caseload over the past five years.[13]

The findings of this research show that for petro-dependent governments—those governments that depend greatly on extractive industries for their revenue—the investment regime has not substantially changed their decision-making process related to foreign investment.[14] On the contrary, the incentives of the petro-dependent governments to disregard the treaty rights persist. Why has this been so? The answer lies in the characteristics of

9. *See generally* José E. Alvarez, *The Return of the State*, 20 MINN. J. INT'L L. 223 (2011).

10. *Id.* at 228.

11. Thomas W. Wälde and Peter Cameron are exceptions. *See* Thomas W. Wälde, *Managing the Risk of Sanctions in the Global Oil & Gas Industry: Corporate Response Under Political, Legal and Commercial Pressures*, 36 TEX. INT'L L.J. 183 (2001) [hereinafter Wälde, *Managing the Risk of Sanctions*]; Thomas W. Wälde, *Law, Contract and Reputation in International Business: What Works?*, BUS. L. INT'L 190 (2002) [hereinafter Wälde, *Law, Contract and Reputation*]; Thomas W. Wälde, *Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law*, 1 J. WORLD ENERGY L. & BUS. 55 (2008) [hereinafter Wälde, *Renegotiating Acquired Rights*]; Abba Kolo & Thomas W. Wälde, *Renegotiation and Contract Adaptation in International Investment Projects—Applicable Legal Principles and Industry Practices*, 1 J. WORLD INVEST. 5 (2000); CAMERON, *supra* note 6. Nevertheless, Cameron's work focuses largely on clauses in energy contracts and on how investment arbitration affects contract stability.

12. I use the term "petro" because the term encompasses both oil and natural gas.

13. ICSID, *supra* note 3, at 12.

14. Daniel Yergin, a renowned historian and reporter on the energy sector, uses the term "petro state" to define the same characteristic. According to Yergin, "[t]he term 'petro-state' is often used in the abstract way, applying to nations that differ widely in everything – political systems, social organization, economy, culture, religion, population – except for one thing: they all export oil and natural gas. Yet certain common features do make the petro-state a useful lens. The common challenge for these exporters is to ensure that the opportunities for longer-term economic development are not lost to economic distortion and the ensuing political and social pathologies. That means having the rights institutions in place. It is very challenging." DANIEL YERGIN, THE QUEST: ENERGY, SECURITY AND THE REMAKING OF THE MODERN WORLD 109 (2011).

the revenues generated by the industry, their impact on the political economy of the developing states, and on the type of remedies ordered by investment tribunals.[15]

The scale, secrecy, and source of the revenues shape the way domestic institutions in developing nations operate. For developing countries with weak institutions, finding oil or gas and receiving foreign investment to exploit it changes the nature and operation of the government drastically. Depending on the price cycle, oil and gas extraction generates extraordinary profits, which are defined as "rents."[16] In the hydrocarbon sector, "rents" are profits "above and beyond production costs, where the costs include a normal rate of return and the capital invested."[17] The scale of these revenues is so large that governments in countries such as Venezuela, Nigeria, Ecuador, Azerbaijan, Equatorial Guinea, or Kazakhstan "find it bureaucratically easier and politically more popular to collect revenues from their oil sectors than to collect taxes from the population at large."[18] The emergence of these incentives generates what political economists call "rent-seeking behavior," in which capturing the rents from oil becomes the most important political and economic interest of the state.[19] Capturing rents in turn generates patronage, clientelism, fiscal rigidity, corruption, and an increase in the state-controlled economy (through, for example, subsidies, controls, bureaucracy, and grand projects).[20] For example, Azerbaijan and Equatorial Guinea, which before the year 2000 were not significant oil producers, increased their government expenditures by 600% and 800%, respectively, in less

15. *See* Michael Ross, The Oil Curse: How Petroleum Wealth Shapes the Development of Nations 5 (2012) (noting that "petroleum revenues have four distinctive qualities: their scale, source, stability, and secrecy").

16. Naazneen Barma et al., Rents to Riches?: The Political Economy of Natural Resource-led Development 47 (2012).

17. Ross, *supra* note 15, at 34–35. As described by Michael Ross, "[i]n most industries, firms typically earn a 'normal' profit, determined by the laws of supply and demand. If their profits were much below this normal rate, some of the firms would leave the industry, which would raise profits for the remaining firms. If their profits were much above the normal rate, new companies would enter their industry to compete for these exceptional returns, which would drive profits down to normal levels. Companies in the oil business, however, can earn rents—profits above and beyond production costs, where the costs include a normal rate of return on the capital invested." *Id.*

18. *Id.* at 31–32. According to Ross, "[i]t also makes economic sense, at least up to a point. When the treasury is brimming with oil revenues, the government can transfer some of these funds to the public by cutting taxes . . . . The distinctive size and source of oil revenues have their origins in the same unusual features of the petroleum world: the government's ownership of petroleum reserves; the industry's extraordinary profits, which since the 1970s have been largely captured by governments; and the industry's relatively small *direct* impact on the rest of the economy." *Id.* at 33.

19. *See* Yergin, *supra* note 14, at 108–10. Yergin defines "rent-seeking behavior" as one where "the most important 'business' in the country (aside from oil production itself) is focused on generating some of the 'rents' from oil—that is, some share of the government's revenues. Entrepreneurship, innovation, hard work, and the development of a competitively oriented growth economy—all these are casualties of the system." *Id.*

20. *Id.*

than a decade after receiving high levels of investment from oil companies in 2001.[21]

Thus, the operation of oil and gas companies in these countries incentivizes the governments to rely on the industry's revenues disproportionately to finance the operations of the state.[22] Controlling those resources becomes essential for the functioning of the government. In fact, during periods when there are low oil prices and reduced production due to the lack of new investments, the host countries give attractive deals to the companies in order to bolster the revenues generated by the industry. Yet every time there is a period of unexpected rents, such as higher than expected oil or gas prices, these governments have high incentives to enact policies and regulations that extract more revenue out of these investments.[23] Moreover, the increased reliance on the hydrocarbon sector tends to happen in parallel with the slow destruction of other parts of the economy, such as the agriculture and manufacturing sectors. As hydrocarbons become the most important export, the real exchange rate rises and the domestic private sector becomes less competitive, a phenomenon known as "Dutch Disease."[24] This makes the state depend even more on the oil and gas sector.

International investment tribunals have not helped to change these incentives because they have relied exclusively on compensatory damages in issuing awards between states and foreign investors. That is, tribunals have tended to view violations of absolute rights contained in investment treaties, such as the right to fair and equitable treatment, as expropriations.[25] This is important because the remedy for violations of absolute rights is ordinarily specific performance, whereas the remedy for expropriation is monetary damages. Rather than crafting remedies that order the states to halt the violations altogether, the tribunals have effectively "priced" the breach of the host state obligations into investment treaties.[26] Consequently, the prospect of a loss at an international tribunal does not deter host governments

21. ROSS, *supra* note 15, at 28.

22. *See* YERGIN, *supra* note 14, at 110; ROSS, *supra* note 15, at 5, 27. *See generally* BARMA ET AL., *supra* note 16; Osmel Manzano & Francisco Monaldi, *The Political Economy of Oil Production in Latin America*, 9 ECONOMÍA 59, 61 (2008).

23. *See generally* Manzano & Monaldi, *supra* note 22, at 60; FRANCISCO MONALDI, CENTER ON GLOBAL ENERGY POLICY, COLUMBIA, THE IMPACT OF THE DECLINE IN OIL PRICES ON THE ECONOMICS, POLITICS AND OIL INDUSTRY OF VENEZUELA 5 (2015); YERGIN, *supra* note 14, at 111.

24. ROSS, *supra* note 15, at 47–48 ("[O]il often fails to boost private-sector growth due to the 'Dutch Disease' . . . . It is the process that causes a boom in a country's natural resource sector to produce a decline in its manufacturing and agricultural sectors. This decline is the result of two effects. The first is the 'resource movement effect': as the resource sector booms, it draws labor and capital away from the agricultural and manufacturing sectors and raises production costs. The second is the 'spending effect': as money from the booming resource sector enters the economy, it raises the real exchange rate. A higher real exchange rate makes it cheaper to import agricultural and manufactured goods than to produce them domestically."); *see also* YERGIN, *supra* note 14, at 110–11.

25. *See generally* Thomas W. Wälde, *Remedies and Compensation in International Investment Law*, TRANSNAT'L DISP. MGMT., Nov. 2005.

26. *See* Rachel Brewster, *Pricing Compliance: When Formal Remedies Displace Reputational Sanctions*, 54 HARV. INT'L L.J. 259 (2013).

from implementing policies that tighten the government's control on hydrocarbon rents at the expense of investors. These governments can simply capture the windfall profits and use them to pay for the damages owed to the foreign investors, while at the same time generating resources that stabilize their political institutions. As argued by one of the leading academics on the study of international law compliance, Professor Rachel Brewster, what affects the reputation of the state is not the breach of the substantive part of the treaty, but rather avoiding participation in subsequent arbitration proceedings and not compensating investors when ordered.[27] Thus, the system "allows states to make use of the remedy regime as an alternative to performance."[28] At most, governments see the prospect of litigation in an international investment tribunal not as an opportunity and incentive to generate respect for their regimes but rather as a means through which they can lower the initial compensation requested by investors. In addition to not changing the way states behave, investors have continued to do business with states abundant with extractive resources despite those host states' records of past treaty noncompliance.[29] These investors surmise that it makes economic sense given the logical market drive in the hydrocarbon sector to secure reserves in order to increase the value of the company.[30]

The findings presented here are divided into four parts. Part I addresses the claims of the contemporary literature on what the system is doing and how a treaty reform could address its flaws. Part II centers on the characteristics of international petroleum transactions that affect the investment regime. It then proceeds to analyze petro-dependent governments' political economy and the role of international investments in these states, and it provides a case study on the history of foreign direct investment in the oil and gas sector of Venezuela. Together these sections offer a panorama view of the operation and rules of the current investment regime, which host governments must consider when making policy decisions. The themes converge in Part III, which considers the investment tribunals' decisions on remedies. This part shows how tribunals have interpreted their powers to order pecuniary remedies, and how, instead of changing host governments' incentives, the prevalence of monetary damages has actually increased the incentives for host governments to ignore the investment regime. The concluding part is a reflection on why the system has evolved the way it has and who is benefiting from the way it stands today. It further sets out the possi-

27. *See id.*

28. *Id.* at 261.

29. *See* MONALDI, *supra* note 23, at 2 ("It could seem puzzling that investors commit such significant resources after a history of cyclical reneging by many developing-country governments. In fact some of these investments have already been the object of episodes of regulatory expropriation in the last five years.").

30. *See* ROSS, *supra* note 15, at 8–11. International oil and gas companies usually have booked reserves for twenty years in advance. Their financial capability depends on booking enough reserves for that period. *Id.*

bility that the solution to enhance treaty compliance might be located in mechanisms that help to redesign the institutional capacities of these states, as opposed to continuing the practice of pricing the breach of international obligations.

I. The Goals of the System and the Contemporary Public Law Debate

This section begins with a description of the common arguments made by the original creators and advocates of the international investment regime. It then contrasts it with one of the most influential contemporary views, the "global administrative law" perspective, which employs analogies from domestic administrative and public law to understand the system's influence within the state.[31] The latter perspective argues that the regime is curtailing government's regulatory space, but without triggering the accountability mechanisms available in domestic administrative law. The section then concludes with a review of how this view has affected the system's public perception.

A. *The Purpose of the Investment Regime*

The early literature on the international investment regime argued that the international institutions, such as the World Bank, needed to design a system that would provide for international legal security for capital located in developed nations so that it would flow into less developed ones. Scholars argued that private capital was not arriving to underdeveloped nations because investors feared "political risks, such as outright expropriation without adequate compensation, governmental interferences short of expropriation which substantially depriv[ed] the investor of the control or the benefits of his investment, and non-observance by the host government of contractual undertakings on the basis of which the investment was made."[32] Legal instruments and procedures would in theory help a host government avoid driving away foreign capital—law would "bind [the host government] to the mast."[33] Proponents of this early literature assumed that

31. *See generally* Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 Am. J. Int'l L. 45 (2013).

32. Aron Broches, Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International Law 162 (1995).

33. Alvarez, *supra* note 9, at 225 ("Bilateral investment treaties (BITs) are efforts by states to bind themselves to the mast to avoid the tempting sirens calling for breaches of investment contracts or nationalizations without compensation."); *see also* Broches, *supra* note 32, at 162–63 ("No government and no investor would ever be under an obligation to go to conciliation or arbitration without having consented to do so. But once having consented they would be bound to carry out their undertaking and, in the case of arbitration, to abide by the award. For this scheme to be fully effective, it should be embodied in an international convention. . . . These proposals contemplate that, given the consent of the host government, the investor would have direct access to the conciliation and arbitration facilities, without the intervention of his national government, thus giving further emphasis to the growing recog-

states needed this commitment tool because domestic institutions, such as courts or agencies, proved ineffective in preventing states from changing their promises. Even if a particular host government sought a fair agreement with an investor, weak domestic institutions did not prevent future governments from breaching the original agreement with the investor.[34] International legal instruments, such as treaties and independent arbitral tribunals, would incentivize institutional best practices at the domestic institutional level, or at least become a substitute for them.

Developing states with abundant resources but low institutional capacity would receive foreign capital and in exchange give rights to foreign investors in international legal instruments, such as BITs or chapters in free trade agreements.[35] A key component of the system was to provide the foreign investors procedural rights that would allow them to bring claims directly against host states in an international arbitral proceeding. As such, in addition to foreign capital, developing nations would also benefit from participating in the system by avoiding diplomatic confrontations with the exporting capital states.[36] By allowing investors to bring claims directly against host governments, the system would incentivize a host state to "rely less on its sovereignty prerogative" and allow the disputes to be removed from the "intergovernmental political sphere."[37] In sum, the system would control the temptation of rent-seeking governments in countries with less-developed institutions to change regulations and policies after the investment had been made and avoid diplomatic confrontations between the capital-exporting and the recipient states.[38] Governments operating in the

nition of the individual as a subject of international law. . . . This development of existing international law would have the great merit of helping to remove investment disputes from the intergovernmental political sphere.").

34. *See* Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 658–59 (1997) ("Dynamic inconsistency exists when a preferred course of action, once undertaken, cannot be adhered to without the establishment of some commitment mechanism. The problem is akin to wanting to 'tie oneself to the mast' but being unable to do so . . . . In the international setting, however, the dynamic inconsistency problem is a significant barrier to efficient foreign direct investment. 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. Regardless of the assurances given by the host before the investment and regardless of the intentions of the host at the time, the host can later change those rules if it feels that the existing rules are less favorable to its interest than they could be. Domestic legal structures, critical to the credibility of contractual promises among private parties under domestic law, are no longer adequate to ensure compliance with the initial agreement.").

35. An example is chapter 11 of NAFTA. North American Free Trade Agreement art. 1135, Dec. 17, 1992, 32 I.LM. 289 (1993) [hereinafter NAFTA].

36. *See* BROCHES, *supra* note 32, at 162. Aron Broches, one of the designers of the ICSID system, argued in 1963 that the establishment of an international rule of law for foreign investment would allow companies to feel secure to make adequate investments abroad and foster development. *See id.*; *see also* Jeswald W. Salacuse, *The Emerging Global Regime for Investment*, 51 HARV. INT'L L.J. 427, 441–42 (2010); Kenneth J. Vandevelde, *A Brief History of International Investment Agreements,* 12 U.C. DAVIS J. INT'L L. & POL'Y 157 (2005).

37. BROCHES, *supra* note 32, at 263.

38. Alvarez, *supra* note 9, at 225.

shadow of the investment regime would, in essence, give up policy space or regulatory autonomy in the hope of receiving more capital flows.[39]

In order to achieve the above-mentioned goals, international investment treaties were designed to provide a combination of substantive rights for investors. For example, states agreed to guarantee the payment of fair, prompt, and adequate compensation in the event of expropriation; to not enact currency controls; to not discriminate on the basis of nationality; to treat investors as if they were nationals of the state; to treat their investments fairly and equitably; to provide full protection and security; to guarantee that investments would not be treated less favorably than the minimum standard required by customary international law; and to honor the commitments made with regard to the contracts signed with foreign investors.[40] As Part III notes in more detail, customary international law and treaties do not include a right against expropriation. In order for expropriation to accord with international law, it must be done for public purposes, and the host government must pay effective, prompt, and adequate compensation when it happens.[41] This is an important distinction from the rest of the investment law obligations. Discriminatory, unfair, and inequitable treatments or omissions to protect the investment are contrary to international treaty obligations. They are drafted as absolute rights. The only exceptions to their application in some BITs are extraordinary circumstances, such as threats to national security, health emergencies, or public disorders.[42] Unlike for expropriation, BITs in general do not contain conditions under which these otherwise illegal government acts could accord with international law.[43]

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39. Jason W. Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L L. 397 (2010) ("The central premise of investment treaties is that states that agree to the disciplines and rigors of international investment law will enjoy benefits that offset the various costs. In exchange for giving up what might be called 'policy space,' or some measure of regulatory autonomy, host states expect, or hope, to receive increased flows of investment.").

40. I have taken this list from Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1530–33 (2005).

41. The common wording of the expropriation clause is: "Investments of investors of either Contracting Party shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation . . . in the territory of the other Contracting Party except for a public purpose related to the internal needs of the expropriating Party, on a basis of non-discrimination and against prompt, adequate and effective compensation." Agreement Concerning the Promotion and Reciprocal Protection of Investments art. 5, Den.-Lith., Mar. 30. 1992, 1787 U.N.T.S. 245, 247 [hereinafter Denmark-Lithuania BIT]. The relevant portion of NAFTA states: "No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ('expropriation'), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6." NAFTA, *supra* note 35, art. 1110.1.

42. Burke-White, *supra* note 5 (discussing the application of extraordinary circumstances in the context of Argentina's financial crisis).

43. The common wording in the treaties is: "[n]either Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, use, enjoyment or disposal of investments in

B. The Critique of the System from a Public Law Perspective

Most of investment treaties were signed in the 1990s in the midst of the expansion of global liberalization reforms.[44] With the collapse of the liberalization process and the economic crises of the last decade, the system began to see an explosion of litigation.[45] States had to back down from the promises that they had made in the 1990s, and consequently investors began to bring arbitration cases against them.[46] With the rise of litigation came critiques of the system. One of these contemporary views of the investment regime, reflected in the work of scholars such as Gus Van Harten and Stephan Schill, argues that the system is now becoming part of a "global administrative law" that has affected the way states decide and guide public policy matters.[47] According to this view, international investment tribunals "control domestic authority against yardsticks of international law" and "often take the role of administrative or constitutional adjudication, which is taken to be deficient in the host country."[48] It is administrative law imposed from the outside, and characterized by the fact that these tribunals

its territory" and "[n]either Contracting Party shall in its territory subject investments . . . to treatment less favorable than that which it accords to investment or returns of its own investors or any third States." Denmark-Lithuania BIT, *supra* note 41, art. 5. NAFTA's wording is as follows: "Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors;" "shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments;" "shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." NAFTA, *supra* note 35, arts. 1102, 1103, & 1105.

44. David Kennedy, *The "Rule of Law," Political Choices, and Development Common Sense*, *in* The New Law and Economic Development 95, 137–47 (David M. Trubeck & Alvaro Santos eds., 2006).

45. Alvarez, *supra* note 9, at 251.

46. Burke-White, *supra* note 5, at 228.

47. *See* Gus Van Harten, Investment Treaty Arbitration and Public Law 166 (2007); *see also* Armin Von Bogdandy & Ingo Venzke, *On the Functions of International Courts: An Appraisal in Light of Their Burgeoning Public Authority*, 26 Leiden J. Int'l L. 49 (2013); Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 Eur. J. Int'l L. 121, 121–22 (2006) ("Our argument is that, owing to this unique conjunction of features, the regulatory conduct of states is, to an unusual extent, subject to control through compulsory international adjudication. Having highlighted these features, we then claim that investment arbitration is best analogized to domestic administrative law rather than to international commercial arbitration, especially since investment arbitration engages disputes arising from the exercise of public authority by the state as opposed to private acts of the state . . . . [T]he regime of international investment arbitration which has been rapidly developing since the 1990s provides not simply a singularly important and under-appreciated manifestation of an evolving system of global administrative law but . . . owing to its unique features, it may in fact offer the only exemplar of global administrative law, strictly construed, yet to have emerged."). On broader views of global administrative law, see generally Armin Von Bogdandy et al., *Developing the Publicness of Public International Law: Towards a Legal Framework for Global Governance Activities*, *in* The Exercise of Public Authority by International Institutions 3 (Armin Von Bogandy et al. eds., 2010); Sabino Cassese, *Administrative Law Without the State?—The Challenge of Global Regulation*, 37 N.Y.U. J. Int'l L. & Pol'y 663 (2004); Benedict Kingsbury & Stephan Schill, *Investor-state Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law* (NYU School of Law, Public Law Research Paper No. 09-46 2009); Stephan Schill, *Introduction*, *in* International Investment Law and Comparative Public Law (Stephan W. Schill ed., 2010).

48. Von Bogdandy & Venzke, *supra* note 47, at 57–58.

have moved "into the space of political decision-making that has, at least traditionally, been reserved for administrators or legislatures."[49] For example, an expansive interpretation of an investment treaty in an environmental law case can transform the provisions designed to give security and predictability to investors into "strategic swords" that prevent domestic regulators from adequately addressing contemporary environmental challenges.[50] The mainstream media has echoed this narrative as well. Anthony DePalma observed in the *New York Times*: "[T]he way a small group of international tribunals handles disputes between investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations challenged. And it is all in the name of protecting the rights of foreign investors under the North American Free Trade Agreement."[51]

The critique of the system from a "global administrative law" perspective is that investment arbitration tribunals lack the legitimacy to impose regulatory policy on the state.[52] As opposed to domestic systems in which courts and administrators are surrounded by a set of "checks and balances"—such as the requirements for transparency, efficiency, due process, hearings for all affected parties, and the control of superior courts—the investment regime uses procedures that were molded out of commercial arbitration rules that do not privilege transparency and whose arbitrators are not accountable to anyone.[53] For example, Gus Van Harten argues that because the investment regime was modeled on procedures designed for private law litigation, where a reviewing court cannot revise decisions to provide some coherence to their substantive sections, the investment regime cannot be an adequate and legitimate way to shape public policy.[54] In other words, states are changing their decision-making processes in order to satisfy an illegitimate

49. *Id.* at 58.

50. Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment—NAFTA's Investment Protections and the Misguided Quest for an International Regulatory Takings Doctrine,* 78 N.Y.U. L. Rev. 30, 34–35 (2003) (noting that provisions like those in NAFTA's chapter 11 "enable the proliferation of claims challenging environmental and land use regulations through out the world . . . turning shields—'provisions designed to ensure security and predictability for the investors'—into strategic swords that have 'created uncertainty and unpredictability for environmental (and other) regulators'") (citing Howard Mann & Konrad von Moltke, Private Rights, Public Problems: A Guide to NAFTA's Controversial Chapter on Investor Rights 6 (2001)).

51. Anthony Depalma, *Nafta's Powerful Little Secret; Obscure Tribunals Settle Disputes, But Go Too Far, Critics Say*, N.Y. Times (Mar. 11, 2001), http://www.nytimes.com/2001/03/11/business/nafta-s-powerful-little-secret-obscure-tribunals-settle-disputes-but-go-too-far.html.

52. *See* Van Harten, *supra* note 47, at 5. *But see* Von Bogdandy & Venzke, *supra* note 47, at 58 (claiming that "the review of public acts against general standards by an independent institution is one of the most powerful legitimating mechanisms"); Daniel C. Esty, *Good Governance at the Supranational Scale: Globalizing Administrative Law*, 115 Yale L.J. 1490, 1493 (2006) (arguing that global policy making could develop legitimate standards as the U.S. federal agencies did to remedy legitimacy concerns at the domestic level).

53. Van Harten, *supra* note 47, at 159, 173.

54. *See id.* at 166; Franck, *supra* note 40, at 1547–57.

authority, and in the process they are giving away an essential part of their sovereignty.

Although the literature described above might accurately illustrate how arbitral tribunals decide cases that deal with public policy issues, these scholars have failed to disaggregate and analyze the investment regime according to sectors and states to confirm their claim that the arbitral decisions are distorting domestic policy. For example, as mentioned above, almost 40% of contemporary ICSID litigation deals with issues related to extractive industries, yet the picture described by the administrative law scholars does not square with the fact that states in these cases keep enacting cumbersome regulations on the hydrocarbon sector, passing executive decrees that hurt foreign investors, or forcing renegotiation of contracts upon foreign investors.[55] Some scholars who specialize in the intersection of energy and investment law argue that the investment regimes affect the way these states behave. The examples these scholars cite, however, do not actually represent any meaningful policy changes on the part of the host regime. For instance, Professor Peter Cameron of the University of Dundee has argued that stabilization clauses in contracts and concessions have evolved, which has in turn modified the way in which investment claims are litigated.[56] Yet an evolution in contractual language and an increase in litigation say nothing about the incentives to behave in a way contrary to the investment regime. Even Professor Cameron recognizes that "provisions which prohibit a host state from making future changes in its law as it relate[s] to the contract are often accompanied (without any apparent sense of irony) by provisions which set parameters on a future revision if it is initiated by the host state; all in the same contract."[57]

To summarize, both the traditional view and its "administrative law" critique assume that: 1) the existence of the investment regime affects the decisions of foreign investors who seek and require international legal protection before investing abroad; 2) states are trading sovereignty for credibility in order to attract these investors, and host governments are persuaded by the regime to modify policies and regulations; and 3) international legal proceedings can help to improve domestic institutions by modifying the decision-making process that privileges rent-seeking behavior.[58] These assumptions do not capture the actual operation of the international investment regime in some of the more controversial hydrocarbon cases between

55. ICSID, *supra* note 3, at 12.

56. Cameron, *supra* note 6.

57. *Id.* at xlviii.

58. *See* Zachary Elkins et al., *Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960–2000*, 2008 U. Ill. L. Rev. 265, 289 (2008) ("[C]ompetitive reputation building, through BITs, can set off a sequence of treaty signings among countries that compete with one another. Although all countries may be subject to such competitive pressures to some degree, we expect governments with greater indigenous credibility to be less willing to pay the sovereignty and other political costs associated with concluding BITs. . . . The more corrupt a state is perceived to be, the more necessary it becomes to lure investors with an explicit promise to delegate adjudication to an authoritative third party.").

investors and host states. None of these approaches are helpful in explaining the empirical evidence regarding how investments in this sector are made, the types of decisions that governments are making, and the nature of these capital-intensive markets. The next sections show how these assumptions prove inaccurate when applied to the oil and gas sector.

II. Is the Investment Regime Changing the Incentives of Petro-dependent Governments?

Are states changing their policies for fear of stepping on investors' rights? Or, in the terms of the global administrative law narrative, have the investment tribunals in their administrative role "shape[d] expectations and guide[d] the decisions and actions of civil servants"?[59] For this latter claim to be true, there should be evidence that the governments consider the jurisprudence of the tribunals and modify their behavior and expectations accordingly. The arguments presented in this section show that this is not the case for petro-dependent governments that depend heavily on foreign capital for their development. In order to sustain this claim, section A of this part reviews the characteristics of international investments in oil and gas and how fiscal regimes, fluctuation of oil prices, and production plans affect them. Section B further describes how these operations affect the way states behave and shows how the investment regime, as a set of background rules, has little or no impact on government decisions. The focus narrows in section C to the history of foreign direct investments in the hydrocarbon sector of Venezuela and, more specifically, to the interaction of the investment regime with the decision-making process of its government.

A. *Characteristics of International Oil and Gas Investments in Developing Countries*

Oil and gas investments have four qualities that make legal protections available in the international investment regime less effective. First, most of the necessary investments to operate an oil field are sunk costs that are difficult to recover. Second, the contractual relationship with the state suffers from a time consistency problem, as the relative bargaining power of the investor and the government shifts dramatically once the investments solid-

59. *See* Karen J. Alter, The New Terrain of International Law: Courts, Politics, Rights 200 (2014). Building on the framework of Kingsbury, Krish, and Stewart, Karen Alter argues that investment tribunals do perform a type of administrative role: "Even if one does not embrace this normative objective, [global administrative law] scholars are clearly correct in pointing out that global regulatory rules take many forms, and can have informal, judicial, and loosely coordinated origins . . . . Administrative review checks that administrative decisions adhere to correct procedure, are not arbitrary, and faithfully apply the law. Although administrative review examines the decisions of public administrators, both the dispute settlement and administrative review roles contribute to the regulative role of law, using law to shape expectations and guide the decisions and actions of civil servants, firms and private citizens." *Id.* at 199–200.

ify. Third, the production plans and prices are highly unstable. This in turn generates extraordinary rents that are difficult to capture through normal tax regulations. Finally, international oil companies tend to integrate the risk in investing in developing countries through different mechanisms, and the investment regime is just one more factor, but not the defining one. The existence or absence of an investment regime is an *ex post*, secondary consideration for foreign investors—the primary consideration *ex ante* only extends to the potential profitability of the extraction.

One of the main characteristics of the sector is that oil and gas investments are mainly sunk costs for international companies.[60] The exploration wells, pumping stations, platforms, pipelines, and seismic studies, for example, are all assets that become immobilized before the hydrocarbon field starts generating any profit: "Once deployed, the ex post value of these assets in alternative uses is very low," and "[t]he operating firm benefits from continuing to operate as long as it can recover operational and nonsunk assets, even if it cannot recover the sunk costs."[61] This fact makes them highly vulnerable to government interference and extortion; foreign investors cannot threaten to pack up and leave if they feel that the state is changing the rules of the game to their detriment.

These sunk costs have increased in the past decade as the geological risks of exploring and exploiting hydrocarbons have changed. The increase in global demand has forced companies to increase their drilling in new areas with more complicated geological and political characteristics.[62] Before the oil shocks of the 1970s, rich countries were "70 percent more likely to produce oil than poor countries, not because they [were] sitting on top of more petroleum, but because they ha[d] more money to invest in locating and extracting it."[63] Yet today things have shifted. More and more low- and middle-income countries now produce oil with the help of foreign capital.[64] For example, as oil prices increased between 1998 and 2006, the number of oil producing states increased from 38 to 57; countries such as Belize, Brazil, Chad, East Timor, Mauritania, and Mozambique, and many low-income countries in Africa, became hydrocarbon exporters in those years.[65] According to Professor Michael Ross, one of the leading political economists on the effects of oil and gas extraction in developing countries, booming oil prices have driven this change because, alongside a rise in oil demand due to the

60. *See* Manzano & Monaldi, *supra* note 22, at 75; *see also* Ross, *supra* note 15, at 41 ("The extraction of oil requires large up-front investments, which are used to purchase highly specific assets—things like concessions, wells, pumping stations, and pipelines that cannot be easily moved to other places, or used for other purposes. Once companies make these investments, it becomes prohibitively expensive for them to withdraw, since they would have to leave these investments behind.").

61. Manzano & Monaldi, *supra* note 22, at 75; *see also* Ross, *supra* note 15, at 6 ("Oil and gas facilities have large sunk costs, making them vulnerable to extortion.").

62. *See* Yergin, *supra* note 14, at 244–65.

63. Ross, *supra* note 15, at 9.

64. *See id.* at 9–10.

65. *Id.*

expansion of the Indian and Chinese economies, "companies found that the risks of working in poor, remote, and often badly governed countries were increasingly outweighed by the benefits of the new reserves."[66] Even with the recent fall in oil prices, Ross maintains that the trend will hardly change and that in the future "the world's new hydrocarbon supplies will come from developing countries."[67] This is because today most of these territories are unexplored and have big potential for the future of the industry, while the fields in developed countries, such as the United States, Canada, and Norway, have been heavily explored and exploited.[68]

In addition to being located in developing countries, the majority of the new hydrocarbon discoveries is located in nonconventional areas, such as deep-water fields, or consists of heavy crude deposits, and consequently requires a high level of investment and expertise.[69] States rarely use their national companies to invest in these nonconventional fields because they generally lack the required know-how and expertise to manage the risks involved in the exploration stage.[70] As such, governments in these developing countries must offer more fiscally attractive deals to foreign companies to entice them to invest in riskier areas.[71] Before they make any investments, foreign companies enjoy a better bargaining position because host governments depend on their expertise to explore and set up production plans in the field.

The need to rely on foreign investment to exploit those resources relates to the second characteristic of international petroleum transactions: the time consistency problem.[72] The state and investors typically strike the initial bargain to extract the resource during periods when prices are down and the state is consequently suffering macroeconomic and fiscal instability.[73] Hence the deals tend to leave aside the prospect of capturing windfall profits and lower the government's take of production so as to attract companies to do business in the state.[74] As time passes and the investment becomes opera-

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66. *Id.* at 10.

67. *Id.*

68. *Id.* at 18.

69. *See* YERGIN, *supra* note 14, at 244–65.

70. *See* Manzano & Monaldi, *supra* note 22, at 76; *see also* ROSS, *supra* note 15, at 18 ("While the developing countries are heavily dependent on foreign investment, including expensive Western technology, to develop their oil sectors, the rich democracies have more domestic investment available.").

71. *See* Manzano & Monaldi, *supra* note 22, at 76.

72. *See* ROSS, *supra* note 15, at 41. Ross explains the "time consistency" problem in the following terms: "Before the initial investments, companies are in a strong bargaining position and can negotiate highly favorable contracts with host governments. But once they make their investments, companies lose much of their bargaining power—leaving host governments free to abrogate any contract terms they dislike, with little fear that the companies will withdraw their investments." *Id.*

73. *See* Manzano & Monaldi, *supra* note 22, at 77.

74. Manzano and Monaldi explain: "When governments are willing to offer foreign investors access to their oil reserves, net exporters with substantial oil reserves generally have the upper hand in their negotiations with international oil companies, given that these companies have few alternatives for increasing their reserves. These countries typically open the projects with lower rent generation first. When the price of oil in the international market rises significantly, net exporters are in the best position to

tional, the relative bargaining power between governments and investors shifts, generating a so-called "obsolescing bargaining problem."[75] The problem typically emerges when the exploration conducted by the private company is highly successful, and even more so when the price of oil goes up.[76] The original bargain is no longer attractive to the state. Once fields are operational, the state imposes measures (including nationalization in the extreme cases) in order to realize more revenues from the extraction.[77] Because a company's in-country fixed assets have increased, it has less leverage to negotiate.

The third characteristic of petroleum transactions—the existence of extraordinary profits or rents—feeds into the time consistency problem and the problems resulting from the shift in bargaining power over the life of the investment.[78] Companies plan production in a particular field expecting a particular price of oil that generates a "normal" profit. Any increase in the

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negotiate, whereas international oil companies with existing sunk assets in the country have a particularly weak bargaining position if the government attempts to change existing conditions. As a result, resource nationalism and tax increase are common among net exporters when the price of oil rises substantially. . . . In general, governments with oil and gas reserves are in a better position to increase the government's take and control if they have higher oil reserves and higher prospectivity (that is, the likelihood of finding oil and gas in exploration) since international oil companies would be interested in entering and staying in this type of country. . . ." *Id.* at 78–79.

75. Barma and her co-authors explain: "The timeframe from resource discovery to production or extraction can be long—typically multiple years for oil, on average more than 20 years for mining—and an obsolescing bargain problem is inherent to the life cycle of extractive industries projects . . . . Contract negotiations in the hydrocarbon and mineral sectors are characterized by asymmetric capacity and information between the parties, but the relative bargaining power between governments and investors shifts over the life cycle of extractive industry projects. As a result of these asymmetries, commitment problems are inherent in the upstream part of the natural resource value chain. In addition, over a project lifecycle, government and investors take on different forms of risk and uncertainty at different stages. Institutional design is crucial to resolving this specific challenge of the obsolescing bargain; in short, investors need to be assured that their contractual arrangements are stable. BARMA ET AL., *supra* note 16, at 40, 80; *see also* Emma Aisbett, *Bilateral Investment Treaties and Foreign Direct Investment: Correlation Versus Causation*, *in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 395, 398 (Karl P Sauvant & Lisa E Sachs eds., 2009) ("The need for an externally supported commitment device is motivated by the presence of sunk costs of investment which can lead to dynamic inconsistency of optimal policy for the host. Before the investor makes the investment, the host's optimal policy is to promise good conditions such as low taxes. After the investment takes place and costs are sunk, the optimal policy for the host is to extract rents up to the value of the sunk costs, that is, to directly or indirectly expropriate the investment.").

76. *See* BARMA ET AL., *supra* note 16, at 80.

77. *See* Manzano & Monaldi, *supra* note 22, at 76 ("Contracts typically do not incorporate clauses that allow the government to capture all the large rents that arise after significant new discoveries."); *see also* Stephen M. Schwebel, *Foreword* to CAMERON, *supra* note 6 ("Investments in the finding, production, transport, refining, and marketing of petroleum have been, and remain, huge. They are necessarily long term. The complex and expensive arrangements require contracts and concessions. Those instruments are at once inherently stable—that is in their nature as undertakings for years—yet they have been subjected to reinterpretation, renegotiation, revision, and rupture. The search for stability has been unending. It might be said that it has been unsuccessful, but that would be simplistic. In point of fact, there has been a measure of stability in the international exploitation of petroleum, but sufficient stability remains elusive.").

78. *See* BARMA ET AL., *supra* note 16, at 40–41.

price above that number is a "rent," or extraordinary profit.[79] Naturally, not all of the companies receive the same rent. Rents are "differential" in that they vary depending on each field and the quality of oil being extracted.[80] For example, an oil price of $60 per barrel might yield a profit of $10 per barrel for a deep-water field in the Gulf of Mexico, where the cost of production is around $50 per barrel, but might yield a $50 per barrel extraordinary profit for an onshore field in Saudi Arabia, where the cost of production is only about $10 per barrel.[81]

Consequently, changes in prices affect the production rates of the fields. As prices fluctuate the fields' production rates are affected because they "determine how much oil in commercially marginal fields can be sold at a profit."[82] Why are these "rents" so peculiar to the hydrocarbon industry? The nature of hydrocarbon production makes profits hard to predict and control. They are subject to price volatility, and governments are highly ineffective at capturing them through traditional taxation systems.

The first characteristic of rents is that when industry faces periods of extraordinary profits, the high capital costs make it difficult for new companies to enter the business quickly. As mentioned above, due to the hydrocarbons' geographical characteristics, there is a limited set of explored fields with low extraction costs and high product quality; even if new companies can access some of them, it takes years before the fields can become operational.[83] It also takes several months for the fields to supply enough oil in response to the higher price. Oil companies as such can "earn 'scarcity rents' when the demand for oil temporarily outpaces the supply."[84]

The second characteristic of hydrocarbon rents is the prevalence of price volatility. For projects that are supposed to last between 20 and 30 years, the fluctuation of the price of oil between $10 to $120 per barrel has generated different incentives, both for the companies and the petro-dependent governments. For companies, it has changed their rates of production dra-

79. Manzano & Monaldi, *supra* note 22, at 74 ("Oil exploitation generates significant rents. For example, the cost per barrel in the region (and the world) typically varies from as low as US$1 to as high as US$15. When the oil price recently rose above $70 dollars per barrel, rents skyrocketed.").

80. Ross, *supra* note 15, at 35 (Favorable geography "gives some producers access to cheaper and better-quality oil than their competitors. Some reserves yield oil of relatively low quality at a high price and earn only a normal profit, but others yield high-quality oil at a low cost and hence will generate 'differential' rents for the owner. Since there is a limited supply of fields with low extraction costs and high-quality oil, new companies that enter the petroleum business cannot easily obtain these rents.").

81. *See Explore and Discover the Winners When Gas Prices Fall*, U.S. Global Investors (Nov. 17, 2014), http://www.usfunds.com/investor-library/frank-talk/explore-and-discover-the-winners-when-gas-prices-fall/.

82. Ross, *supra* note 15, at 22.

83. *See id.* at 35.

84. *Id.* ("Producers can also earn 'scarcity' rents when the demand for oil temporarily outpaces the supply. In theory, the supply of oil will eventually catch up with the demand, or the demand will eventually fall to meet the supply. But these adjustments can take years, either because oil supplies are growing scarce, or even if they are not scarce, because the price elasticity of the supply is relatively low, meaning that it takes a long time for producers to deliver more oil to the market in response to higher prices.").

matically, as well as the number of commercially prospective fields. High prices make it more profitable to invest in more difficult and lower-quality fields. For governments, the rise of prices has represented a potential increase in revenues, depending on the type of arrangement made with the companies. This is what has happened with the majority of projects since the 1980s. The volatility of oil prices correlates with "the rise and fall of a country's reserves, [and] can produce large fluctuations in a government's finances."[85] An oil price spike becomes what former President of Venezuela, Carlos Andrés Pérez, once called "a trap" for the oil-exporting developing country.[86]

As to the third characteristic of rents, petro-dependent governments have difficulties in capturing these extraordinary profits because the domestic tax and contractual frameworks are typically not progressive.[87] They "have a hard time capturing oil rents in different price scenarios."[88] Governments typically have a diversity of tax mechanisms to try to capture rents: income taxes, royalties, increase in the government's take of production, a tax on windfall profits, a share in profits, and a tax on the repatriation of dividends.[89] I do not intend to delve into hydrocarbon tax regimes, but suffice it to say the analysis provided by two of the leading political economists, Professors Francisco Monaldi and Osmel Manzano, is that "tax systems are relatively ineffective at capturing rents, particularly when prices rise, and they typically generate significant distortions."[90] For example, these mechanisms tend to reduce the rate of production,[91] especially of high-value fields;[92] some taxes tend to be hard to calculate due to the fact that govern-

85. *Id.* at 6 ("Governments are saddled with tasks they are seldom able to manage because of this financial instability, which can help explain why they frequently squander their resource wealth. Revenue instability also aggravates regional conflicts, making it harder for governments and rebels to settle their differences.").

86. YERGIN, *supra* note 14, at 1124 ("As [President Pérez] traveled the world, he looked at different models for economic development and the struggle for reforms, and reflected on the costs and inefficiencies and defects of the overweening, oil-fed state. 'An [oil] price spike is bad for everyone, but worst for developing countries that have oil,' he had concluded. 'It is a trap.'").

87. Manzano & Monaldi, *supra* note 22, at 76; *see also* BARMA ET AL., *supra* note 16, at 113 ("A tax regime that is progressive and based on profits is commonly considered best practice for natural resource-endowed countries. These regimes promise to capture the bulk of resource rents from the sector, while ensuring the required investment associated with capital-intensive extractive industries. But developing countries often find this model challenging and even impossible to enforce. Instead, underlying political economy drivers and the resulting institutionally weak and fragmented review administration often lead to an excessive reliance on regressive fiscal regimes.").

88. Manzano & Monaldi, *supra* note 22, at 77 ("Volatile oil prices generate volatile oil rents. We have already argued that fiscal systems have a hard time capturing oil rents in different price scenarios; price volatility is particularly problematic as a result.").

89. *See id.* at 62–74.

90. *Id.* at 74.

91. *See id.* at 67.

92. *Id.* at 69 ("[T]he reduction in reserves developed in high-value fields, as a consequence of the royalty, is larger than in the case of low-value fields. The reason for this is that high-value fields lose a larger proportion of income relative to the costs of development, leading to a larger reduction in reserves.").

ments lack information on the investment and costs for each extraction;[93] and some of the taxes tend to induce overinvestment in low quality fields.[94] For all these reasons, Monaldi and Manzano conclude that the *ex ante* tax regimes in developing countries "tend to have the problem of leaving rents with the producing firms."[95] Each rise in prices "give[s] the governments incentives to enter into an expropriation cycle."[96] In order to capture the rent, the host country forces a renegotiation of the contract, the tax regime or the concession, or, in extreme cases, a takeover of the production field by the government.[97] In fact, the phenomenon of renegotiating the regulatory and contractual framework to capture the windfall is so prevalent that some studies have identified a correlation between the increase in prices of crude oil and the amount of disputes that arise between states and investors.[98] A fight ensues to capture unexpected windfall profits.

Finally, regarding the impact of the investment regime on the decision-making process of oil companies, empirical studies show that international investors are not necessarily guided by the existence of investment treaties and their procedural guarantees.[99] These studies find that the common assumptions about the role of BITs in attracting foreign investment are unsupported and that "BITs do not appear to be important—directly or indirectly—when determining where, and how much, to invest abroad."[100] In fact, some of the studies show that there is no correlation between BITs that have strong arbitration provisions and an increase in foreign direct in-

93. *Id.* at 71, 73 ("[T]he optimal taxation of the oil sector could be viewed as a problem of asymmetric information. The oil sector is characterized by relatively good information on oil quality, prices, reservoir depth, and so forth, but governments have less information on the investment and costs required to develop a field. . . . For this reason, some governments may have decided to use the royalty more extensively than an income tax.").

94. *Id.* at 71 ("[T]hese instruments end up being a form or rate-of-return regulation. The theory of regulation shows that rate-of-return regulation can induce overinvestment by the firms. Giving the government a share of profits or taxes on dividends may have similar effects. The literature also outlines the perverse incentive that tax brackets may have for the investment decisions of firms on the resource sector.").

95. *Id.* at 74.

96. *Id.*

97. *Id.* at 70–74.

98. *E.g.*, PAUL STEVENS ET AL., CHATHAM HOUSE, CONFLICT AND COEXISTENCE IN THE EXTRACTIVE INDUSTRIES (2013); CAMERON, *supra* note 6, at xlvii.

99. Lauge N. Skovgaard Poulsen, *The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence*, 2010 Y.B. ON INT'L INV. L. & POL'Y 2009/2010 539, 539 (2010) ("A great number of studies and surveys indicate, however, that the vast majority of multinationals do not appear to take BITs into account when determining where—and how much—to invest abroad."); *see also* Yackee, *supra* note 39, at 400 ("The results of these three lines of inquiry [political risk rankings calculation, surveys of providers of political risk investment, and surveys with general counsels in large U.S.-based corporations] provide evidence that BITs do not meaningfully influence FDI [foreign direct investment] decisions. BITs are not strongly correlated with political risk rankings, and providers of political risk insurance only inconsistently take BITs into account when making underwriting decisions. Indeed, the majority of providers surveyed do not view BITs as relevant to their underwriting decisions. Finally, general counsel report relatively low corporate familiarity with, or appreciation of, BITs as risk-reducing devices."). *See generally* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT, *supra* note 75.

100. Poulsen, *supra* note 99, at 542.

vestment, which is supposed to be one of the main attractions of the international investment system.[101] The same studies "appear to support the conclusion that [BITs] are not a particularly important factor in the establishment phase for the vast majority of foreign inventors."[102] Instead, foreign investors seem to be more preoccupied by the existence of double taxation agreements.[103] The same finding is confirmed by studies that review whether agencies that deal with political risk insurance take the investment regime into account. According to these studies "BITs are basically aimed at reducing the risk of investing abroad, but the vast majority of public and private agencies that price the risk of foreign investments rarely take them into account to any serious extent."[104] It is safe to argue then that when it comes to foreign investment, the international legal regime generally is not crucial in the decision-making process of investors.[105]

Oil and gas companies tend to integrate the risk of investing in countries with dubious domestic institutions. For them, the investment regime is just another factor included in the risk of investing, but it would not be the decisive one.[106] There are other market-based mechanisms to mitigate the risk of doing business with these countries, such as "[e]ntering into joint ventures with local companies, obtaining financing from local creditors, structuring investments over long time periods, or bringing in powerful partners such as major foreign banks."[107] Today the relationship between

101. *Id.* at 545–46 ("Similarly, BITs which incorporate a legally binding consent to arbitrate a wide range of investment disputes with private investors are likely to be valued higher by investors than BITs where such consent is limited or absent. Both of these propositions have been tested, however, and none have been convincingly confirmed to date. . . . [E]ven BITs with 'strong' arbitration provisions do not appear to impact international investments, which is remarkable if one accepts that arbitration clauses should be the most attractive feature of a BIT from the perspective of foreign investors.").

102. *Id.* at 549 ("One [survey] asked 602 corporate executives to what extent an international investment agreement, such as a BIT, influences which markets their company invests in. Around one fourth of the survey respondents replied that investment agreements did not at all affect their decisions to invest, slightly less than half said to a limited extent, and a little less than a fifth said investment agreements were very important.").

103. *See id.* at 549–50 ("Two surveys . . . indicate that double taxation agreements, in particular, are probably much more important for foreign investors in the establishment phase compared to BITs. Accordingly, when the European Commission asked only about the role of BITs for European investors, half of the 300 respondents had never heard of them and only 10 percent had used them in their professional activity.").

104. *Id.* at 566. Poulsen concludes that the studies "appear to contradict the thesis that BITs are fundamental instruments to decrease the risk of investing abroad," and that they "suggest[ ] that only when dealing with exceptionally questionable jurisdictions, or investor-state relations, do BITs have investment-promotion potential." *Id.*

105. *Id.* ("All in all, it is therefore unlikely that BITs are crucial to the decisions of most foreign investors about where, and how much, to invest abroad. This is implied by both econometric and survey evidence, by the limited interest BIT-negotiations tend to receive from investors themselves, and by the lack of attention of political risk insurers to the treaties.").

106. *See* Jason W. Yackee, *Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*, 42 L. & SOC'Y REV. 805 (2008).

107. *Id.* at 567–68; *see also* Aisbett, *supra* note 75, at 399 (noting that two other "alternative legal mechanisms, which in some cases may be close substitutes for BITs" are provisions in contracts that refer the disputes to U.S. commercial courts and noting that "firms may purchase political risk insurance that

national oil companies and international private ones is deeply interrelated: "The business of oil is now run by a combination of NOCs [national oil companies], private sector firms, and hybrid companies that combine state and private ownership."[108]

The foreign investor's profit prospectus, the calculation of future cash flows, the tax regime applicable to the contract, the amount of the government's take on production, and the extraction plans are more salient for the decision to invest than having treaty protections.[109] Moreover, the capacity of oil and gas companies to secure hydrocarbon reserves in different parts of the world is valued highly by the institutions and stock markets that finance their operations. A hydrocarbon company that cannot keep in its bookings enough reserves for the next twenty years is seen as losing market space.[110] Given these characteristics, companies feel pressured to keep investing in new fields regardless of the existence of legal security in the countries where they are located. Investors show interest in BITs or consider them important once the dispute has arisen, but not as an element at the establishment phase.[111] It is a tool of last resort, not a prerequisite or incentive for investing abroad; it might affect how the investments are structured, but it "does not necessarily imply that these investments would not have taken place in the absence of BITs."[112] In other words, with or without them, the investor would have made the bet if it made economic sense.

After analyzing the above characteristics of international petroleum transactions it is safe to conclude that there are high incentives, and sometimes good opportunities, for governments to try to capture profits generated by the oil and gas industry to the detriment of a foreign investor's rights. Why is this not happening in all states in which extractive industries are operating, such as Norway, the United States, or the United Kingdom? Why

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is offered by private firms, source governments, host governments, and the Multilateral Investment Guarantee Agency of the World Bank group").

108. Ross, *supra* note 15, at 41–43 ("Today the relationship between NOCs and private companies vary widely in form. In a handful of countries—mostly in the Middle East—NOCs exercise day-to-day operational control of the industry and only hire international companies on service contracts to carry out specific tasks. In most other countries, governments have signed concession agreements, production-sharing agreements, or joint ventures with foreign companies, giving the companies greater control over day-to-day operations. The business of oil is now run by a combination of NOCs, private sector firms, and hybrid companies that combine state and private ownership. Most are so large and complex that it is difficult to know their true value.").

109. *See* Poulsen, *supra* note 99, at 568 ("Rather than using legal protections in treaties, the management of political risk is thus often handled through business strategies on the ground.").

110. *See* Ross, *supra* note 15, at 8–12.

111. *See* Poulsen, *supra* note 99, at 550.

112. *Id.* at 541 ("That BITs can be important for some investors establishing investments abroad is indisputable. This is confirmed by reports of treaty shopping, for instance, where investors choose to invest from countries that have a BIT with the host country rather than investing from their home country. But the fact that BITs at times can impact how investments are structured does not necessarily imply that these investments would not have taken place in the absence of BITs. Similarly, anecdotal reports that some investors have postponed already planned investments until BITs were in place do not tell us much about the treaties' impact on the decision to invest in the first place.").

would developing nations be more susceptible to these effects? The answer lies in the political economy of developing nations where the resources are located.[113]

B. Domestic Institutions and the Effects of Oil and Gas Exploitation in Developing Countries

Depending on their internal politics and the structural institutional factors of developing states, there is a tendency for governmental actors to become dependent on the profits generated by the extraction of hydrocarbons; this is what political economists call the "resource curse."[114] As mentioned above, the scale of oil resources is so extensive that, "[o]n average, the governments of oil-producing countries are almost 50 percent larger (as a fraction of their country's economy) than governments of non-oil countries. In low-income countries, the discovery of oil can set off an explosion in government finances."[115] In other words, petro-dependent governments grow at extraordinary rates, not because they tax more citizens or their economies become more efficient, but because they can easily capture industry rents.[116] Furthermore, in most of these countries, as opposed to the United States for example, the state is the owner of the petroleum reserves which gives it "a much larger claim on the industry's revenues, and allows [it] to collect these revenues directly."[117]

What variables drive the "resource curse" and push states to violate treaty obligations? The consensus in the political economy literature is that in de-

113. *See* Ross, *supra* note 15, at 5 (discussing the relevance of the size and source of oil revenues for developing and developed countries).

114. Barma et al., *supra* note 16, at 43 ("Contemporary political economy research suggests that whether a country falls prey to the resource curse depends on a number of structural and economic factors. . . . [T]he quality of existing institutions is perhaps the key factor that mediates a resource-dependent country's economic outcomes."); *see also* Manzano & Monaldi, *supra* note 22, at 77–78 ("If the country is a substantial net exporter, one key issue is whether oil revenues can represent a significant source of fiscal income. In that case, policy makers have powerful incentives to maximize generation and the appropriation of rents from oil exports. Depending on the politicians' discount rate, the level of the country's oil reserves, and future market expectations, this rent maximization could imply a strategy focused on short-term fiscal revenue extraction or one oriented toward increasing long-term production. Net exporters are typically more reluctant than net importers to privatize national oil companies, because national oil companies can be more easily used as cash cows or piggy banks than private companies.").

115. Ross, *supra* note 15, at 28–29 ("How much of a difference does oil make? One way to answer this question is to compare the governments of oil-producing countries with those of neighboring states with similar incomes but no oil. In these examples, the oil-funded governments are from 16 percent (Azerbaijan versus Armenia) to 250 percent (Algeria versus Tunisia) larger than the neighboring states without oil. Another way to answer this question is [to] compare the size of government in countries with significant oil income . . . with those that earn less . . . . Again, the oil-producing states have dramatically larger governments—about 45 percent larger, on average.").

116. *Id.* at 5–6 ("Oil-funded governments are not financed by taxes on their citizens but instead by the sale of state-owned assets—that is their country's petroleum wealth.").

117. *See id.* at 33 ("In almost all countries, petroleum reserves are owned by governments. State ownership affects both the size and source of the oil revenues. It gives governments a much larger claim on the industry's revenues, and allows them to collect these revenues directly, without having to tax private-sector companies.").

veloping nations with low institutional capacity lucrative natural resources negatively affect governance and institutions.[118] The most common explanation relates to the fact that the dependence on natural resource rents decreases the need to grow and tap other industries to generate government revenue.[119] The rents generated by the extractive activities are so high that there is no need to improve the tax collection capacity of the state.[120] According to some studies, the scale of the dependency is such that regardless of their level of development "oil producers are about 30 percent less dependent than non-oil countries on taxes on goods and services."[121] Due to the scale of the rents generated by this industry, the government depends on the industry disproportionately more than the industry actually participates in the national economy; for the leading 31 hydrocarbon-rich countries the oil industry accounts for 19% of the economy on average but finances 54% of state expenditures.[122]

In countries with weak institutions, this effect in turn reduces the incentive for tax-captive citizens to require more accountability from the government. Instead of requesting better services from the taxes extracted, citizens come to rely on the "good will" of the government in power to redistribute some of the rents generated by the extractive industry.[123] The state then engages in patronage. The highest commodity is public office or access to those in power.[124] In other words, reducing the need to rely on taxation weakens accountability between the petro-dependent government and society.[125] According to a group of World Bank political economists, "[n]atural resource booms turn countries into rentier states that live off unearned income; the state obtains resources through rents rather than taxes and re-

118. *See* Barma et al., *supra* note 16, at 45 ("Resource wealth introduces a specific set of dynamics into a country's political economy both because economic stakes are so high and, depending on global commodity prices, because massive amounts of rents can become quickly available.").

119. *Id.* at 48 ("Rents thus can obviate the extent to which the state must engage in costly revenue-generating activity in nonresource sectors and, quite simply, they can reduce the fiscal need for nonresource taxation.").

120. *Id.* at 45 ("[D]ependence on natural resource wealth limits other forms of government revenue generation such as tax collection. This in turn can lead to a decline in administrative and institutional capacity building, particularly as the core tax-accountability linkage between state and society is weakened . . . .").

121. Ross, *supra* note 15, at 31 ("In both low- and high-income countries, and in both autocracies and democracies, oil producers are about 30 percent less dependent than non-oil countries on taxes on goods and services.").

122. *Id.*

123. *Id.* at 33 ("When the treasury is brimming with oil revenues, the government can transfer some of these funds to the public by cutting taxes.").

124. Barma et al., *supra* note 16, at 48 ("With extraordinary rents accruing to the state, public office or access to those in public office becomes the most valuable commodity in a resource-dependent country's political economy. Resource rents induce patronage behavior, or the seeking of political influence for economic gain. Rents also generate an incumbency advantage.").

125. Ross, *supra* note 15, at 30 ("Thanks to the scale of these revenues, petroleum wealth also has a powerful impact on the source of the government's funding. Most governments are funded by taxes. But as a country's oil wealth grows, its government becomes decreasingly reliant on taxes and increasingly reliant on 'nontax revenues.'").

quires correspondingly little organizational effort from the state apparatus."[126] Other political economists, such as Professor Michael Ross, even argue that "[t]his helps explain why so many oil-producing countries are undemocratic: when governments are funded through taxes, they become more constrained by their citizens; when funded by oil, they become less susceptible to public pressure."[127]

For the investment regime this process translates into two different phenomena: on the one hand, if the petro-dependent government has to pay compensation to investors, the costs of doing so are lower than the benefits generated by capturing the windfall. The dependence on the rent is such that not capturing it and respecting the bargain with the investor means abandoning the government's main source of income and, consequently, pushing officials to increase taxes on the general population or particular groups. On the other hand, the fact that the government pays compensation using the rents extracted from the industry means that taxpayers' pockets remain unaffected by the decision; rather, these cash flows technically belonged to the investor, and they do not get subtracted from the general tax collected. The political costs of paying compensation are lower than if they were taken out of the citizens' pockets by raising taxes to pay for the consequences of the policies that affect the investor.

Another way in which governance deteriorates is political or bureaucratic fights between interest groups. Because government revenue tends to come from one concentrated source, powerful interest groups begin to fight for control over the collection and distribution of industry rents.[128] Concentrated rents raise the intensity of political fights among interest groups.[129] Maintaining a political deal might depend on the government's ability to redistribute the extraordinary profits between these actors.[130] Capturing windfalls becomes a source of political stability, even if this requires paying some compensation to investors after litigation over the long term.

The government also has fewer incentives to make long-term policy spending decisions because it knows that the industry will not necessarily sustain constant windfalls; such windfalls depend greatly on the international market prices that fluctuate in unpredictable ways.[131] Hence, officials in power are tempted to use the windfalls generated by the industry for short-term policy and political gains. This spending path increases the dependency on the industry since they are not prepared to face years of low profit generation. Furthermore, the production of oil in large quantities affects the country's exchange rates to the point of weakening the participa-

126. Barma et al., *supra* note 16, at 48.
127. Ross, *supra* note 15, at 5–6.
128. *See* Barma et al., *supra* note 16, at 45.
129. *See id.*
130. *See id.* at 47.
131. *See id.* at 45.

tion in the economy of other sectors, mainly manufacturing and agriculture, which in turn affects the interest groups that could balance the government's goals and provide other sources of income.[132]

Are there ways in which developing countries can avoid falling prey to the "resource curse"? The consensus in the political economy literature is that there is a set of mechanisms that can help to prevent the negative effects of a petro-dependent economy.[133] Yet these mechanisms all depend on the strengthening of domestic institutions. For example, to prevent other domestic business from becoming less competitive and eventually disappearing, states could segregate the revenues generated by captured rents from the rest of the economy.[134] For example, they could create sovereign wealth funds that absorb the large flow of revenues, adjust public spending downward, and avoid subsidies in the domestic oil market at the retail level. Moreover, states could adopt more progressive fiscal regimes that capture the rents as they are generated, improve their revenue administration, adopt simple and transparent fiscal regimes, and give agencies power to supervise closely the costs and investments in each oil or gas field to avoid abuse from the companies.[135] Yet all of these factors require a commitment from the ruling class to strengthen institutions and abide by their commitments to respect the rule of law. Ruling elites tend to benefit from having a weak revenue agency that cannot effectively tax their fortunes; they also tend to dislike adjusting public spending, because this would make them highly unpopular with the vast majority of the population that depends on the government's patronage and that is resource-nationalist.[136]

Given all the effects generated by the extraction of oil and gas in developing countries described above, it is fair to say that without the strengthening of domestic institutions the operation of this sector in these countries tends to weaken democratic governance. Note the paradox that this conclu-

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132. *See* Ross, *supra* note 15, at 6. Ross argues that the extraction of oil generates what economists call the Dutch disease: "[W]hen produced in large quantities, petroleum can affect a country's exchange rates and reduce the size of the manufacturing and agricultural sectors which in turn can shut off economic opportunities for women." *Id.*

133. *See* Barma et al., *supra* note 16, at 217–35 (giving a complete list of the policies proposed by the World Bank to avoid the resource curse).

134. Yergin, *supra* note 14, at 109 ("A partial cure for the [Dutch] disease is to segregate some of these earnings. The sovereign wealth funds that are now such important features of the global economy were invented, in part, as preventive medicine—to absorb this sudden and/or large flow of revenues and prevent it from flooding into the economy and thus, by so doing, insulate the country from the Dutch disease.").

135. *See* Barma et al., *supra* note 16, at 1113–14 ("Existing fiscal regimes in developing countries are typically too complex to implement correctly, subject to instability, and affected by pervasive weaknesses in revenue administration capacity.").

136. *See* Yergin, *supra* note 14, at 109–10 ("In the petro-state, no constituency is in favor of adjusting spending downward to the lower levels of income—except for a few economists who understandably become very unpopular. On the contrary, across society most hold the conviction that oil can solve all problems, that the tide of oil money will rise forever, that the spigot from the finance ministry should be kept wide open, and that the government's job is to spend the oil revenues as fast as possible even when more and more of those revenues have become a mirage.").

sion represents for the investment regime. As mentioned in Part I, the regime was created to attract foreign investors to regions where weak institutions could not provide enough guarantees for them. Yet the operation of this sector in a developing country in fact weakens existing institutions even more. The resource curse in which governments get trapped prevents them from improving the institutional quality of the state.

The next section presents a country case and analyzes how each of the factors described in this section were present when the state took actions against foreign investors.

C. *Case Study: Venezuela*

Venezuela is perhaps the paradigmatic case study of the failure of the investment regime to dissuade rent-seeking behavior in a developing country with weak institutions.[137] Venezuelan oil reserves are some of the largest in the world, and have helped to position the country as the second largest producer and largest exporter in Latin America.[138] Hydrocarbons production in Venezuela is the source of around 50% of the government's revenues and represents around 80% of the country's exports.[139] After periods of successful attraction of foreign investment, followed by increases in the prices of oil, the government has taken actions against foreign investment, including contract renegotiation, enactment of extraordinary taxes, and even nationalizations.[140] This Latin American petro-dependent state has "generally behaved as a typical significant net exporter with short-term horizons, maximizing short-term rents and heavily subsidizing the domestic oil products market."[141]

From World War I through 1958, Venezuela received high levels of foreign investment in the hydrocarbons sector, allowing the country to increase its production and reserves.[142] In the 1960s the government changed the tax regime on oil production and declined to renew some concessions. Conse-

137. *See id.* at 108; *see also* Manzano & Monaldi, *supra* note 22, at 86.

138. Manzano & Monaldi, *supra* note 22, at 86; *see also* Yergin, *supra* note 14, at 106–07 ("Because of the scale of its resources, Venezuela could be described as the only OPEC 'Persian Gulf country' not actually in the Persian Gulf. In 1997 it was actually producing more petroleum than either Kuwait or the United Arab Emirates and almost as much as Iran. Its position in the Gulf of Mexico and its role as a Western Hemisphere producer made it a bulwark of U.S. energy security, as it had been going back to World War II. But Venezuela had also become the very embodiment of what is called a petro-state.").

139. Manzano & Monaldi, *supra* note 22, at 86; *see also* Yergin, *supra* note 14, at 110 ("In the 1980s and 1990s, oil could generate more than 70 percent of Venezuela's central government's revenues.").

140. *See generally* Monaldi, *supra* note 23; *see also* Manzano & Monaldi, *supra* note 22, at 89 ("The case of Venezuela exemplifies the dynamics of investment and expropriation cycles. The periods of contract negotiation have coincided with the end of successful cycles of investment, and nationalizations have occurred during oil boom periods.").

141. Manzano & Monaldi, *supra* note 22, at 86.

142. *See* Yergin, *supra* note 14, at 107 ("The decisive event for Venezuela's fortunes came in 1922. The giant Barroso well in the Maracaibo basin blew out with an uncontrolled flow of 100,000 barrels a day. . . . With the Barroso gusher, Venezuela's oil age had begun. Thereafter, increasing wealth poured into the country as more and more oil flowed out of the ground.").

quently, the level of foreign investment in future exploration and development fell.[143] Since investments were already in place and industry was exploiting existing fields more intensively, production capacity continued to rise until reaching its peak in the early 1970s.[144] As the price of oil began to increase in 1973, the administration of President Carlos Andrés Pérez was able to quadruple government spending.[145] According to Pérez, this increase in government revenues was going to "pull Venezuela out of her underdevelopment" by increasing public spending in infrastructure, fostering industrialization, and expanding the middle class.[146] In 1976, as prices kept going up, the government of Venezuela nationalized the oil industry, and the state-owned company Petróleos de Venezuela, S.A. ("PDVSA") benefited from the prevailing high oil prices.[147] At that time, the state-owned company was highly insulated from politics, allowing it to reinvest the profits in the fields and continue production in a relatively efficient way.[148]

143. *See* Manzano & Monaldi, *supra* note 22, at 23 ("The higher tax rate and the expectation of further tax increases in the future finally induced radical change in the strategy of the oil companies. They decided to significantly reduce investments in exploration and development. Some of them used the liberated capital to increase investments in Canada and the Middle East . . . . [A]fter 1958 there was a very significant decline in oil investment. Not only the capital stock did not continue to grow, it [also] significantly dropped. After its peak in 1959 the capital stock declined systematically for almost twenty years until the downward tendency was finally reversed in 1977–78, after nationalization. In the period, 1959–1976 the capital stock declined 68% in real terms. The average annual growth rate in that period was -2.7% and it fell as low as -5.5% in 1967. These negative growth rates reflect, not only that new investments did not compensate for depreciation, but also that the oil companies moved out of the country part of the exploration and development equipment that was now sunk, and reduced maintenance to a minimum.").

144. *Id.*

145. YERGIN, *supra* note 14, at 111 ("[Carlos Andrés Pérez's] first term as president of Venezuela was during the height of the oil boom in the 1970s when revenue far greater than anyone had ever contemplated was flowing into the national treasury. As a result of the quadrupling of the oil price in 1973–74, he had gained, on an annualized basis, four times as much money to spend as his immediate predecessor.").

146. *Id.* at 24. In contrast to the reduction in future development investment, "the production of oil continued its upward trend throughout the 1960's. From 1958, when Venezuela produced 2.6 million barrels per-day (MBD), until production reached its peak in 1970 (3.8 MBD), oil production rose 44% (1.2 MBD). This large increase in production, in a period of declining capital investment, was possible due to the more intensive exploitation of oil camps. As it is typical in high-sunk costs industries, the effects of investment decline on production had a significant time lag. It took twelve years of underinvestment to face its effects on production. After 1970, production capacity declined sharply and by 1975, the year before nationalization, production reached 2.4 MBD, a decline of 1.4 MBD from 1970.").

147. *Id.* ("In 1976 [President Carlos Andrés Pérez] engineered the government takeover of the oil industry, in accord with the great wave of resource nationalism that was sweeping the developing world in that decade. But Venezuela carried out its nationalization in a careful and pragmatic way. Considerable talent had been built up throughout the industry during the years that the international majors ran the sector. Prior to nationalization, 95 percent of the jobs in the industry, right up [to] the top management, were held by Venezuelans. So nationalization would be a change of ownership but not of personnel. The new state-owned company, Petróleos de Venezuela, S.A. (PDVSA), was generally run on professional grounds. It was the holding company, overseeing a series of cohesive, operating subsidiaries.").

148. *See* Manzano & Monaldi, *supra* note 22, at 86; YERGIN, *supra* note 14, at 113.

With the decline of oil prices again in the late 1980s, Venezuela entered into a fiscal and social crisis[149]: PDVSA was unable to keep up with production; most of the revenues were being diverted to meet interest payments on international debts; and the government could not stop rising inflation, unemployment, and a massive widening of the income gap. Millions were pushed below the poverty line in less than a decade.[150] The government reacted by reducing spending and setting a complex system of price controls. By the end of the 1980s, per capita incomes had dropped to the levels of 1973, the year that the oil boom had inspired President Pérez's crusade to transform Venezuela.[151]

The crisis reached one of its worst moments when in 1989 a wave of protests against the scarcity policies ended in riots and hundreds of dead in the capital and its surrounding towns.[152] The fierce repression against the rioters and the continuous social unrest triggered a 1992 failed coup orchestrated by young military officers.[153] One of its leaders was the 38-year-old Lieutenant Colonel and future president of Venezuela, Hugo Chávez.[154]

In 1994, President Rafael Caldera took office and was determined to put the state's public finances in order. To bolster oil production back to the 1970s levels, the country required the help of foreign oil companies to bring new fields into operation and to cover the loss in revenue generated by the decline of prices.[155] According to Monaldi and Manzano "at that time, the government's fiscal difficulties induced the opening of the oil sector to private operators using a special contractual framework that provided some credibility against government reneging, by using PDVSA and its foreign

149. *See* Yergin, *supra* note 14, at 111 ("When Perez left the presidency in 1979, the money was still flowing. But in the 1980s, the oil price plummeted and so did the nation's revenues. Yet the edifice of the new petro-state was locked in place and indeed had expanded.").

150. *See id.* at 112 ("By the end of the 1980s, Venezuela was the very paradigm for the petro-state. It was in deep crisis. Inflation and unemployment were rising rapidly, as was the share of the population below the poverty line. The widening income gap was evident in the massive emigration from the countryside to the cities and in the ever-expanding slums and shanty towns that climbed up on the hills surrounding the capital city of Caracas. Meanwhile, a substantial part of Venezuela's current revenues was being diverted to meet interest payments due to international lenders.").

151. *Id.*

152. *Id.*

153. *Id.* at 112–14.

154. *Id.* at 115 ("In the subsequent two years that followed his arrest, Chávez spent his time in prison reading, writing, debating, imagining his victory, receiving a continuing stream of visitors who would be important to his cause—and basking in his new glory as a national celebrity. Late in 1992, a second coup attempt, this by more senior officers, also failed. But its very fact demonstrated how unpopular Carlos Andrés Pérez had become. Pérez alienated the public with his policies, especially the cutbacks in the spending that was the hallmark of the petro-state. He also continued to infuriate his opponents with his economic reforms and decentralization of political power.").

155. Manzano & Monaldi, *supra* note 22, at 87 ("By the early 1990s, large new investments were needed to increase production. PDVSA significantly increased capital expenditures. At the same time, the government's fiscal difficulties induced the opening of the oil sector to private operators . . . ."); *see also* Yergin, *supra* note 14, at 116 ("By the middle 1990s, it was clear that Venezuela urgently needed to increase its oil revenues to cope with the country's problems. Since world petroleum prices were not going up, the only way to raise additional revenues was to increase the number of barrels that Venezuela produced.").

assets as a guarantee."[156] The "opening," or *apertura* as it was called in Spanish, offered foreign investors the fields that required high levels of investment, where sophisticated know-how was required due to the geological and physical components of the oil, and where, due to the low prices of oil, profits were not expected to be high.[157] This new set of offerings included matured or abandoned oil fields and the extra-heavy crude of the Orinoco Belt where PDVSA did not have the necessary technology to invest.[158] With the exploitation of these fields, Venezuela expected to double its production capacity over the next decade and capture additional revenues, but as economist Daniel Yergin has emphasized "none of this could be accomplished without foreign investment."[159]

In order to attract international companies back to Venezuela, the government lowered tax rates applicable to extra-heavy crude projects that required expensive upgrading (to a 1% royalty and 34% income tax for heavy crude projects), compared to what PDVSA was being charged for the more profitable fields (roughly 17% and 67%, respectively).[160] Furthermore, as a sign of good faith to foreign investors, Venezuela ratified the ICSID Convention in 1995[161] and signed several BITs in the early 1990s.[162] In most of its contracts and concessions Venezuela also consented to the use of international dispute arbitration forums like ICSID.[163] Over the next few years, several contracts were signed with international oil companies, and billions of dol-

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156. Manzano & Monaldi, *supra* note 22, at 87.

157. *Id.* ("The projects offered to private investors involved lower rent generation, mature or abandoned oil fields (high costs), extra-heavy crude that requires expensive upgrading (high costs), and exploration. Consequently the contracts with private operators generally lowered the implicit tax rates."); *see also* Yergin, *supra* note 14, at 116–17 ("The most significant initiative, and one with global impact, was *la apertura*—'the opening' (really, a reopening)—inviting international oil companies to return to Venezuela to invest in partnership with PDVSA, to produce the more expensive and technologically challenging reserves. This was not a winding back to nationalization, but rather reflected the trend toward greater openness in the new era of globalization. It was also a pragmatic effort to mobilize very large-scale investment that the state could not shoulder by itself.").

158. Yergin, *supra* note 14, at 117 ("The states did not have the resources to fund the full range of required investment, and social programs were a huge competing call on the government's money. Moreover, despite its competence, PDVSA did not have the advanced technology that was needed. *La apertura* would bring in international capital and technology. Output would increase from older fields. And, at last, Venezuela would be able to use technology and large-scale investment to liberate the huge reserves of very heavy oil in what is called the Faja, the Orinoco region, that up to then could not be economically produced.").

159. *Id.* at 117.

160. *See* Manzano & Monaldi, *supra* note 22, at 87 n.47.

161. For a list of the signatory parties of the ICSID Convention, see *List of Contracting States and Other Signatories of the Convention,* ICSID, https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/List%20of%20Contracting%20States%20and%20Other%20Signatories%20of%20the%20Convention%20-%20Latest.pdf (last visited June 19, 2016).

162. For example, Venezuela signed a BIT with the United Kingdom in March 1995, with the Netherlands in October 1991, with Canada in July 1996, with Spain in November 1995, with Sweden in November 1996, and with Switzerland in November 1994. For a full list of the BITs with Venezuela, see *BITs-Bolivarian Republic of Venezuela*, UNCTAD Inv. Pol'y Hub, http://investmentpolicyhub.unctad.org/IIA/CountryBits/228 (last visited June 19, 2016).

163. Julían Cárdenas García, *Rebalancing Oil Contracts in Venezuela*, 33 Hous. J. Int'l L. 235, 238–39 (2010).

lars of international investment entered the country, allowing Venezuela to reactivate production, mainly of heavy crude oil in the Orinoco Belt.[164] International oil companies like ExxonMobil that had been expropriated in the 1970s reacted positively and decided to reenter the country under the new terms.[165] By 1998, six years after the *apertura*, Venezuela was able to increase its production by 40%.[166] Despite the expansion in production, however, government revenues did not increase at the level needed to put the country back on its feet.

In the late 1990s, many other oil-producing countries had expanded their output in an effort to increase their market share, thus driving the price of oil down.[167] Not even the members of the oil cartel OPEC were able to agree to respect output quotas.[168] In addition, a financial crisis in Asia caused prices to sink lower still, to the point that the price of a barrel of oil in U.S. dollars reached single digits.[169] This ended up "ravaging the budgets of the oil-exporting countries."[170] Although the producing countries tried to reverse the decline by agreeing to production cutbacks, the price declined faster than the reduction in supply.[171] The price of oil below $10 per barrel was something "intolerable" for the petro-dependent states.[172] In Venezuela, this again ended up generating a financial and economic crisis. By 1998, poverty was rising rapidly, social tensions were mounting, and people were disappointed with the existing political parties that had proved unable to bring the country back on its feet since the late 1980s.[173] These circum-

164. *See* Manzano & Monaldi, *supra* note 22, at 87; MONALDI, *supra* note 23, at 13.

165. Manzano & Monaldi, *supra* note 22, at 23, 30–31 (discussing how ExxonMobil reentered Venezuela by signing an Association Agreement with PDVSA to develop the Cerro Negro Project); Simon Romero & Clifford Krauss, *In Venezuela, a Showdown Looms over Oil*, N.Y. TIMES (Apr. 10, 2007), http://www.nytimes.com/2007/04/10/business/10showdown-web.html?_r=0 ("Companies like Exxon, which had Venezuelan assets nationalized in the 1970s and returned in the 1990s, know the pitfalls of operating here and figure that Mr. Chávez will not be around forever.").

166. YERGIN, *supra* note 14, at 119.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.* ("In March 1998 Venezuela, Saudi Arabia, and non-OPEC Mexico met in Riyadh and worked out a set of production cutbacks for exporters, OPEC and non-OPEC alike. Most of the other exporters went along, out of self-interest and sheer panic. But it was not enough to deal with the drop in demand from the Asian crises.").

172. *Id.* at 122.

173. *Id.* ("By late 1998 Venezuela was deep into an economic crisis, poverty was rising rapidly, and social tensions were high—and mounting. 'Economically, Venezuela is reeling, with oil prices under $10 a barrel,' reported the *New York Times* in December 1998. It was just at this moment that Venezuela was going to the polls to elect a new president. The two dominant parties, Acción Democrática and Copei, were thoroughly discredited. They were also depleted; they seemed to have run out of ideas, energy, and conviction. For a time, the presidential frontrunner was a mayor best known for having once been Miss Universe, but she faded as the campaign progressed.").

stances helped Hugo Chávez to get elected in the December 1998 presidential election.[174]

According to Manzano and Monaldi, the *apertura* of the 1990s set the conditions for rent-seeking behavior in the future. First, by 2005, there was an increase in privately operated production to 1.2 million barrels a day, and a lower implicit tax led to increased reliance on royalties.[175] Second, after 1998 the new government of Hugo Chávez extracted more proceeds from PDVSA at the same time that PDVSA's production was declining due to a lack of investment in new areas.[176] Third, "the government's take on private sector production was lower than its earnings from PDVSA."[177] Fourth, even though the price of oil was going up in the early 2000s, the government's revenue was going down due to the nonprogressive nature of fiscal terms in contracts agreed upon in the 1990s.[178]

Until late 2004, Hugo Chávez's government honored the commitments made to international oil companies, despite the fact that it amended the constitution and the hydrocarbons law in an effort to expand the government's control over the industry.[179] Yet things began to change as prices began to increase in the early 2000s due to the recovery of Asian economies, the expansion of the Chinese market, and the effects of the cutbacks on production that were agreed to by the major producing countries back in 1998.[180] Chávez first expanded the government's control over PDVSA, and

174. *Id.* at 120 ("In the December 1998 presidential election, with just a 35 percent turnout, the deep economic and social distress that came with the oil price collapse gave Hugo Chávez, who had been released from prison only four years earlier, a 56 percent victory.").

175. Manzano & Monaldi, *supra* note 22, at 87.

176. *Id.* ("After 1998, the government extracted more resources from PDVSA. The revolutionary government of President Hugo Chávez honored the private contracts until late 2004, despite having changed the constitution and the oil law to increase government control over the oil sector . . . . The evolution of the Venezuelan government's take in the sector reflects the composition effect, that is, the relative increase in privately operated production with a lower implicit tax, combined with a reliance on royalties. PDVSA's production declined in 1998–2003, while privately operated production increased until 2005.").

177. *Id.*

178. *Id.* ("[T]he government's share of total oil revenue actually decreased even though the fiscal take per barrel increased in absolute terms from 1996–98 to 1999–2011.").

179. *Id.*; Cárdenas García, *supra* note 163, at 239–40. *But cf.* Manzano & Monaldi, *supra* note 22, at 87 ("The externally enforceable contractual framework, the institutional autonomy of PDVSA, and the fact that significant private oil investments were being deployed in 1997–2003 provided protection for the investors' property rights."). I disagree on the value that Manzano and Monaldi give to the contractual and international framework. These two elements were persistent years later, but they were not enough to prevent the government from forcing a renegotiation of the contracts and implementing new tax codes.

180. *See* YERGIN, *supra* note 14, at 123 ("While OPEC was reining in production, Asia started to recover. Demand started to snap back. And so did prices. This particular oil crisis—the crisis of the producers—was ending. The exporters, who before had been dismally staring at $10 a barrel or less, were now talking more confidently about a $22-to-$28 'price band' as their target. But by the autumn of 2000, spurred by economic recovery in Asia and OPEC's new policy, the price of oil had surged over the band, above $30 a barrel, a threefold-plus increase from where it had been just two years previously. The big increase in demand—a surge of 2.5 million barrels per day between 1998 and 2000—was having a decided impact on the oil market.").

in 2002 and 2003 he reduced the autonomy of the company, which triggered an oil strike and a direct takeover by the government. Chávez's actions affected the level of investment in and production of the state-owned company.[181] Between 2004 and 2007, right when the private oil investment cycle had concluded and the sunk costs were in place, the government forced a renegotiation of the contracts signed during the *apertura* to increase the government's participation. Under the 2003 hydrocarbons law, foreign companies were forced to relinquish their majority ownership interest in the Orinoco fields in favor of PDVSA.[182] Moreover, a new tax regime changed the royalties from 1% to 30%, and the income tax from 34% to 50%.[183] If the international companies rejected the new deals, the government would take over the operation of the fields and threatened to pay book value for their assets.[184] Around thirty-two contracts that had been signed during the *apertura* with twenty-five international oil companies had to be renegotiated with the government.[185] Only two companies, ConocoPhillips and ExxonMobil, decided to bring claims in international investment tribunals for the actions taken against their interests.[186] Even with the investment regime fully present in the contractual framework of the contracts signed during the *apertura*, the rise of prices in early 2000s to levels above $100 per barrel and a decline in the production of PDVSA gave the government incentive to violate the international regime to the detriment of foreign investors.

The new contractual and fiscal regime allowed Hugo Chávez to capture the rents generated during the price increase of the 2000s. When the price of oil reached $147 per barrel in 2008, Hugo Chávez again passed new legislation imposing a windfall profit tax on top of the royalties and income taxes that had been imposed four years earlier.[187] Today, Venezuela has responded to twelve oil and gas investment arbitration cases generated by the government's diverse actions against investors.[188] Most of the captured rent

181. Manzano & Monaldi, *supra* note 22, at 87–88; *see also* YERGIN, *supra* note 14, at 131–34.

182. Cárdenas García, *supra* note 163, at 240.

183. *Id.* at 240–41; Daphne Eviatar, *The Oil Baron*, AM. LAWYER, June 2008, at 5.

184. Cárdenas García, *supra* note 163, at 241.

185. Eviatar, *supra* note 182, at 4 (noting that these 32 operating agreements were producing around 500,000 barrels of oil per day).

186. Cárdenas García, *supra* note 163, at 241; Eviatar, *supra* note 183, at 5; *see also* ConocoPhillips v. Bolivarian Republic of Venez., ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits (Sept. 3, 2013); Venez. Holdings B.V. v. Bolivarian Republic of Venez., ICSID Case No. ARB/07/27, Award (Oct. 9, 2014); Mobil Cerro Negro v. Petróleos de Venez., S.A., ICC Arbitration Case No. 15416/JRF/CA, Final Award (Dec. 23, 2011).

187. Cárdenas García, *supra* note 163, at 242 ("Later, as a result of a further increase in oil prices that reached $147/barrel in July 2008, the Venezuelan government sought greater profits by approving the Law on the Special Contribution on Extraordinary Prices in the International Hydrocarbons Market. This law established a new windfall profit tax called Special Contribution that should be added to the fiscal regime of royalties and taxes set forth in the OHL. The Special Contribution tax reached 50% when oil prices reached $70/barrel, and up to 60% when the price exceeded $100/barrel in a given month. The tax is paid by exporters of natural or upgraded liquid hydrocarbons and derivative products.").

188. Eni Dación B.V. v. Bolivarian Republic of Venez., ICSID Case No. ARB/07/4, Settlement Announcement (Apr. 18, 2008); Venez. Holdings B.V. v. Bolivarian Republic of Venez., ICSID Case No.

was used for public sector expenditures (reaching a historical high of 51% of gross domestic product ("GDP")), which includes subsidies to gasoline, price control mechanisms, clientelism, and foreign assistance to other left-leaning governments in the region, mainly Cuba.[189] These policies allowed the government to reduce poverty significantly between 2004 and 2008.[190] As a result of the same policies, however, during the peak oil prices in 2011 and 2012 Venezuela suffered economically: the country was running a public deficit of around 17% of GDP; the currency was severely overvalued; the average inflation rate was the highest in the region; shortages of food and basic goods were constant; external public debt went from $37 billion in 1998 to $102 billion in 2013; and the economy was in a deep recession.[191] By the end of his third term in 2012, Chávez had "not only spent most of the profits without generating any significant rise in productive investment, but he [had] also rapidly increased the foreign debt."[192] Paradoxically, due to the reforms that affected foreign investors, between 2003 and 2012 "Venezuela received the largest commodity windfall in Latin America."[193] Today, production is stagnant and most of the projects would require an oil price of $170 per barrel in order to break even.[194] Chávez's successor, former vice president Nicolás Maduro, has maintained high levels of social spending, but has modified the regulatory framework to offer more investor-friendly

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ARB/07/27, Award (Oct. 9, 2014); ConocoPhillips v. Bolivarian Republic of Venez., ICSID Case No. ARB/07/30, Decision on Jurisdiction and Merits (Sept. 3, 2014); Universal Compression Int'l Holdings, S.L.U. v. Bolivarian Republic of Venez., ICSID Case No. ARB/10/9, Order of the Tribunal Suspending the Proceeding (Sept. 16, 2013); Opic Karimun Corp. v. Bolivarian Republic of Venez., ICSID Case No. ARB/10/14, Award (May 28, 2013); Highbury Int'l AVV v. Bolivarian Republic of Venez., ICSID Case No. ARB/11/1, Award (Sept. 26, 2013); Nova Scotia Power Inc. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/11/1, Award (Apr. 30, 2014); Crystallex Int'l Corp. v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/11/2, Order Closing Proceeding (Dec. 24, 2015); Rusoro Mining v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/12/5, Constitution of Tribunal (Jan. 4, 2013); Anglo Am. PLC v. Bolivarian Republic of Venez., ICSID Case No. ARB(AF)/14/1, Constitution of Tribunal (Oct. 2, 2014); Highbury Int'l AVV v. Bolivarian Republic of Venez., ICSID Case No. ARB/14/10, Constitution of Tribunal (Nov. 21, 2014); *see also* Mobil Cerro Negro, Ltd v. Petróleos de Venez., S.A., ICC Arbitration Case No. 15416/JRF/CA, Final Award (Dec. 23, 2011) (dispute between Exxon Mobil subsidiary and Venezuelan national oil company).

189. *See* Monaldi, *supra* note 23, at 5.

190. *Id.* at 6.

191. *Id.* ("Venezuela was among the most vulnerable of the major oil producers in terms of its macroeconomic situation when the price of oil collapsed in 2014. Even at peak oil prices in 2011–2012, the country was running very high public sector deficits of around 17% of GDP, the foreign debt was increasing at an unsustainable pace, the domestic currency was severely overvalued, shortages of basic goods were widespread, and a recession had begun. Paradoxically, this precarious situation was generated during the largest oil income in the history of the country.").

192. *Id.* at 5.

193. *Id.* at 6. ("At 304% of GDP, Venezuela received the largest commodity windfall in Latin America in 2003–2012 compared to a regional average of 120% for net commodity exporters. In contrast, it had one of the highest average inflation rates in the region (and more recently the world, with an official figure of 68.5% in 2014).").

194. *Id.* at 9. ("The current outlook for the Venezuelan economy is similarly gloomy as it depends highly on an improvement in oil revenues in the short term. This is unlikely since even the most optimistic oil price forecast for the end of 2015 ($80-85 per barrel for the US oil) are very far from the fiscal breakeven of $170 per barrel in 2014 and oil production is stagnant.").

policies.[195] As of 2013, the contractual framework gives international companies greater control over cash flow and operations, and the government has reduced the windfall profit tax for existing projects and waived it for new projects.[196] Moreover, the royalty rate is expected to be reduced to 20%, and foreign investors will be able to take advantage of the depreciated official exchange rate with the U.S. dollar.[197] International oil companies, such as Chevron, CNPC, Repsol, and Perenco, are already negotiating deals with the Venezuelan government under these new conditions.[198]

This section briefly described a country that has fallen into a pattern of rent dependency and that has taken actions against foreign investors once hydrocarbon investments are in place and there has been a boom in oil prices. Venezuela has taken these actions more than once and then had to lure foreign investors back into the country once oil prices went down and the government's fiscal stability was vulnerable. The case further examines how lawsuits brought against the Venezuelan government and the payment of compensation to investors did not change the pattern of behavior. What happened in Venezuela parallels what other petro-dependent states have faced in similar situations.[199] Nigeria, the eighth-largest OPEC-producing country and one where around 70% of GDP comes from oil and natural gas production, went through a similar process in the 1970s, and again between 2003 and 2006.[200] Today Nigeria is facing an ICSID arbitration case for a variety of actions taken against foreign investors.[201] The same can be said of Ecuador, a country that had an opening to foreign investment in the 1990s that led it to depend on oil and gas activities for 25% of its government revenues.[202] The regime in Quito forced renegotiation of contractual and tax agreements in 2007, which triggered nine cases in international arbitral forums.[203] Former Soviet republics in the Caspian Sea region (for example,

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195. *Id.* at 5. ("The macroeconomic imbalances generated by higher social spending during the extended electoral cycle in 2011-2012 made necessary a severe adjustment even during peak oil prices, but Chávez's successor, Nicolás Maduro, has been unwilling to take the tough decisions that the situation demands, with disastrous economic consequences. Legislative elections in December 2015 make unlikely any serious macro adjustment beforehand. The country is more dependent on oil than ever, but the oil industry is in poor condition with production declining and margins thinning. Since 2013, oil policy has become more pragmatic and investor friendly, but it is unlikely to bring significant results in the short term.").

196. *Id.* at 13–14.

197. *Id.* at 14.

198. *Id.* at 13.

199. Nigeria, Ecuador, Bolivia, Mexico, and Kazakhstan are also examples of petro-dependent states. For estimates of the dependency of a state on natural resource extraction, see *Priority Countries*, NAT. RESOURCE GOVERNANCE INST., http://www.resourcegovernance.org/countries (last visited June 19, 2016).

200. YERGIN, *supra* note 14, at 134–36.

201. Interocean Oil Dev. Co. v. Fed. Republic of Nigeria, ICSID Case NO. ARB/13/20, Constitution of Tribunal (Dec. 11, 2013).

202. Manzano & Monaldi, *supra* note 22, at 90.

203. Murphy Exploration & Prod. Co. Int'l v. Republic of Ecuador, ICSID Case No. ARB/08/4, Award (Dec. 10, 2010); Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012); Perenco Ecuador v. Republic of Ecuador, ICSID Case No. ARB/

Azerbaijan, Kazakhstan, and Turkmenistan) have also opened up their doors to foreign investors since 1991, but have initiated renegotiations with foreign investors for several projects following economic difficulties.[204]

These petro-dependent governments might factor in the costs of litigation and of the plausible damages awarded to investors in arbitration proceedings, but the dependency of national budgets on the sector make it such a fundamental economic variable for the state to operate that any other concern is seen as secondary or irrelevant.[205] In other words, if the state depends on the sector for its survival, it will act as if the investment treaty did not exist.[206]

Is the investment regime an adequate intervention in petro-dependent countries to change the trajectory of the resource curse? In other words, does the existence of an investment treaty help state institutions reduce or avoid the incentives to renege on the original bargain struck in the initial investment? I address this question in the next part.

III. The Arbitral Tribunals and the Regime: Generating the Wrong Incentives

If the host governments have an incentive to ignore investors' rights in this sector, then what is the real nature of these "rights"? Those who promote the international investment system argue that the regime is supposed to "tie their hands" precisely in this type of situation.[207] The treaties grant investors rights that in theory allow them to argue that the state has a duty to avoid engaging in discriminatory, unfair, or inequitable practices against them and request whenever possible that arbitrators stop and reverse the disputed action (that is, respect the regulatory framework, maintain the concession, fulfill the contractual obligations). One of the oldest legal maxims is that for there to be an interest protected by the law there must also be an

08/6, Decisions on Remaining Issues of Jurisdiction and Liability (Sept. 12, 2014); Repsol YPF Ecuador, S.A. v. Republic of Ecuador, ICSID Case No. ARB/08/10, Order Taking Note of the Discontinuance of the Proceeding (Feb. 9, 2011); Chevron Corp. v. Republic of Ecuador, UNCITRAL, PCA Case No. 2009-23, Claimants' Notice of Arbitration (Sept. 23, 2009).

204. *See* Liman Caspian Oil BV v. Republic of Kaz., ICSID Case No. ARB/07/14, Award (June 22, 2010); Caratube Int'l Oil Co. v. Republic of Kaz., ICSID Case No. ARB/08/12, Decision on the Application for Annulment (Feb. 21, 2014); Türkiye Petrolleri Anonim Ortaklığı v. Republic of Kaz., ICSID Case No. ARB/11/2, Award (Aug. 18, 2014); Caratube Int'l Oil Co. v. Republic of Kaz., ICSID Case No. ARB/13/13, Constitution of Tribunal (Jan. 7, 2014); Aktau Petrol Ticaret A.Ş. v. Republic of Kaz., ICSID Case No. ARB/15/8, Constitution of Tribunal (June 30, 2015).

205. *See* Barma et al., *supra* note 16, at 40 ("Resource-dependent countries are highly vulnerable to exogenously determined commodity price volatility as well as to production shocks that can occur for commercial and domestic political reasons. This vulnerability intensifies the payoffs from rent-seeking practices when commodity prices are high. Furthermore, oil, gas, and mining resources are nonrenewable and exhaustible, which limits the extent to which elites view decision making in the sector as an iterated game with cumulative consequences over time.").

206. *See id.* (discussing how governments have external perverse incentives to ignore investment treaties, viewing "decision making in the sector as an iterated game").

207. *See supra* Part I.A; *see also* Alvarez, *supra* note 9, at 255; Guzman, *supra* note 34, at 650–59.

adequate remedy available to the injured party. Yet investment tribunals have almost never ordered the host state to take measures to rectify these violations. Arbitral tribunals have issued remedies that are not monetary compensations in only two of the 228 ICSID cases in which investors won.[208] Every other time, tribunals have treated all the rights contained in the BITs as expropriations warranting monetary damages, instead of requiring specific performance from the host country to rectify the ongoing violation. This has become such a common practice that commentators assume the system was designed exclusively as a compensatory mechanism for the affected foreign investments.[209] Yet the opposite is true.[210]

In the following discussion, section A will first address the concept of remedies in the design of the BITs and the ICSID Convention. Section B will review the principles of international law applicable to the consequences of the wrongful acts of the state and contrast them to the investment regime. Finally, section C will analyze the decisions of investment tribunals and their rationales for ignoring performance remedies, and instead relying almost entirely on monetary compensation.

A. Compensation in the BITs and ICSID Convention

The ICSID Convention and the vast majority of the BITs are silent regarding the type of remedies that an arbitrator can order.[211] One of the few international investment agreements signed in the 1990s that specifically

208. In 46% of the 497 cases administered by ICSID, the tribunals upheld the investor's claims. ICSID, *supra* note 3, at 14.

209. *Cf.* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT (2004) (dedicating a whole chapter of his textbook on compensation for nationalization of foreign investments and reviewing the methods and debates around the payment of "full" compensation); IRMGARD MARBOE, CALCULATION OF COMPENSATION AND DAMAGES IN INTERNATIONAL INVESTMENT LAW 7–8 (2009) (similarly framing the problem as one of compensation but only covering the existing principles for calculating damages).

210. In an October 2, 2015, keynote address given at the Fourth Annual Damages in International Arbitration Conference in Vienna, Christoph Schreuer posed this question to the audience: "We tend to take it for granted that the objective of international arbitration is to obtain the payment of compensation. This is certainly true but it may be questioned whether it is the whole truth. Is the outcome of a successful pursuit of international arbitration always a pecuniary remedy in the form of damages or compensation or are there other potential rewards?" Christoph Schreuer, Alternative Remedies in Investment Arbitration, Keynote Address before the Fourth Annual Damages in International Arbitration Conference in Vienna (Oct. 2, 2015) [hereinafter *Alternative Remedies*].

211. *See* Convention on the Settlement of Investment Disputes between States and Nationals of Other States art. 54, Oct. 14, 1966, https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf [hereinafter ICSID Convention]; Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment art. VIII, U.S.-Arg., Nov. 14, 1991, S. Treaty Doc. No. 103-2; Honduras Bilateral Investment Treaty art. XI, X, U.S.-Hond., Jul. 1, 1995, Treaty Doc. No. 106-27; Ecuador Bilateral Investment Treaty art. VI, VII, U.S.-Ecuador, Aug. 27, 1993, Treaty Doc. No. 103-15; Treaty between the Federal Republic of Germany and the Argentine Republic on the Encouragement and Reciprocal Protection of Investments art. 10, Ger.-Arg., Apr. 9, 1991; Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela art. 12, Neth.-Venez., Oct. 22, 1991. It is noteworthy that article 34 of the current U.S. model BIT from 2012 replicates the NAFTA chapter 11 formula, but many of the BITs signed in the 1990s did not include such detailed provisions on remedies.

mentions the type of remedies that could be ordered is NAFTA's chapter 11, which expressly limits remedies to monetary damages, the restitution of property, or a combination of both.[212] Nevertheless, this is an exception.[213] BITs "are typically silent on the matter of available remedies in cases of a breach of the obligations contained in the treaty,"[214] but those that do mention remedies often open the possibility for ordering other types of remedies beyond monetary compensation.

For example, the Energy Charter that deals with oil and gas investments only states that "[t]he awards of arbitration, which *may* include an award of interest, shall be final and binding upon the parties to the dispute. An award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu *of any other remedy granted*."[215] Similarly, article 54 of the ICSID Convention states that "[e]ach Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State."[216] This means that a domestic court or other competent authority need not recognize the award for a party to have the pecuniary damages section of the award enforced at the domestic level.[217] For the rest of the

212. NAFTA, *supra* note 35, art. 1135 ("1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only: (a) monetary damages and any applicable interest; (b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and pay applicable interest in lieu of restitution."); *see also* Agreement between the Government of the Republic of South Africa and the Government of Canada for the Promotion and Protection of Investments, Nov. 27, 1995 ("A tribunal may award, separately or in combination, only: (a) monetary damages and any applicable interest; (b) restitution of property, in which case the award shall provide that the disputing Contracting Party may pay monetary damages and any applicable interests in lieu of restitution.").

213. For another exception, see the Agreement between the Republic of Austria and Bosnia and Herzegovina for the Promotion and Protection of Investments art. 22, Oct. 2, 2000 (The tribunal shall "award the following forms of relief: (a) a declaration that an action of a Party is in contravention of its obligations under this Agreement; (b) a recommendation that a Party brings its actions into conformity with its obligations under this Agreement; (c) pecuniary compensation for any loss or damage to the requesting Party's investor or its investment or (d) any other form of relief to which the Party against whom the award is made consents, including restitution in kind to an investor. (2) The arbitration award shall be final and binding upon the parties to the dispute.").

214. Ursula Kriebaum, *Restitution in International Investment Law*, *in* INTERNATIONAL INVESTMENT LAW AND GENERAL INTERNATIONAL LAW: FROM CLINICAL ISOLATION TO SYSTEMIC INTEGRATION 201, 204 (Rainer Hofmann & Christian J. Tams eds., Schriften zur Europäischen Integration und internationalen Wirtschaftsordnung, Bd. 24, Nomos, 1. Aufl ed. 2011).

215. The International Energy Charter art. 26(8), Apr. 16, 1998, http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECTC-en.pdf (emphasis added). For an analysis of the Energy Charter Treaty and its remedies section see Anna De Luca, *Non-Pecuniary Remedies Under the Energy Charter Treaty*, 3 OIL, GAS & ENERGY L. 1, 3 (2015) (explaining that the option of pecuniary remedies for actions taken by subnational governments was introduced in the Treaty as a compromise solution with Canada that raised concerns on the Federal government's constitutional authority to compel state governments to modify legislation or policies in breach of the Treaty).

216. ICSID Convention, *supra* note 211, art. 54.

217. Schreuer, *Alternative Remedies*, *supra* note 210, at 5 ("Arguments against the permissibility of non-pecuniary remedies sometimes seek to rely on Article 54 of the ICSID Convention. That provision

remedies, the winning claimant would need to have the award recognized domestically.[218] The history of the negotiation of the ICSID Convention shows that the drafters "emphasized that awards could well order the performance or non-performance of certain acts."[219] Pecuniary obligations were not considered to be the norm. Rather, tribunals were to consider them the auxiliary option in case the state did not perform the action as ordered by the tribunal, or in cases in which there was a clear lack of effective, prompt, and adequate compensation for expropriation.[220] In the words of Aron Broches, General Counsel of the World Bank at the time of the ICSID negotiations and the alleged principal designer of the contemporary investment regime, "[i]t may be assumed . . . that awards will wherever possible impose pecuniary obligations, in the form of liquidated damages, penalties or otherwise, in case of non-compliance with obligations of specific performance."[221] Hence, both the ICSID Convention and the Energy Charter recognize that a tribunal may award other types of remedies.[222] Pecuniary compensation is one option, but not the only available remedy.

Furthermore, some investment tribunals have explicitly recognized that they could order other types of remedies because "in addition to declaratory powers, [tribunals have] the power to order measures involving performance or injunction of certain acts."[223] For example, the tribunal in *Micula v. Romania*, after explaining that it had "the power to order pecuniary or non-pecuniary remedies, including restitution, that is, re-establishing the situation which existed before a wrongful act was committed," stated that "the fact that restitution is a rarely ordered remedy [was] not relevant at this

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foresees enforcement only for pecuniary obligations. However, the availability of a specific mechanism for the enforcement of pecuniary obligations does not support an argument against the availability of non-pecuniary relief. The Convention's *travaux* clearly indicate that tribunals can order a party to perform or to refrain from certain acts. The restriction in Article 54 to pecuniary obligations was the result of doubts concerning the feasibility of an enforcement of non-pecuniary obligations and not of a desire to prohibit tribunals from imposing such obligations.").

218. Christoph Schreuer, The ICSID Convention: A Commentary 1129 (Cambridge Univ. Press, 2d ed. 2009) [hereinafter ICSID Commentary] ("[A]n obligation of specific performance, like restitution, or an obligation to desist from a certain course of action that is spelt out in an award, is subject to recognition and will enjoy the effect of *res judicata* even though it is not subject to enforcement.").

219. *Id.* at 1137.

220. *Id.*

221. Broches, *supra* note 32, at 235 ("It will be noted, first, that enforcement under Article 54 is limited to the pecuniary obligations imposed by the award. In other words, enforcement does not extend to negative or positive injunctions. It may be assumed, however, that awards will wherever possible impose pecuniary obligations, in the form of liquidated damages, penalties or otherwise, in case of non-compliance with obligations of specific performance.").

222. De Luca, *supra* note 214, at 1 ("By only limiting the power of tribunals to award non-pecuniary remedies in the case of unlawful measures of sub-national governments or authorities of Contracting States, the provision vests, as a rule, arbitral tribunals instituted under the ECT with the authority to grant both pecuniary remedies (i.e., compensation) and non-pecuniary remedies (i.e., orders for specific performance) in all other cases.").

223. Enron Corp. v. Argentine Republic, ICSID Case No. ARB/01/3, Decision on Jurisdiction, ¶ 81 (Jan. 14, 2004).

stage of the proceedings."[224] The possibility of ordering performance remedies has also been confirmed in cases involving oil and gas companies. For example, in *Mohammad Ammar Al-Bahloul v. Republic of Tajikistan,* the tribunal asserted that it had the "power to grant specific performance" since it "is a permissible remedy in international law."[225] The same was confirmed in *Petrobart v. Kyrgyz Republic*, where the Kyrgyz Republic accepted that performance was the primary remedy and consented to pay for the delivery of the previously agreed-upon gas; however, the company argued that since it was no longer operating in that country, the specific performance remedy was materially impossible.[226] In sum, the Convention and the decisions of investment tribunals both recognize that international investment tribunals may award nonpecuniary relief, such as injunctive relief.[227] The practice of investment tribunals using compensatory damages might have "eclipsed" the use of other remedies, but the availability of nonpecuniary remedies is "beyond doubt in principle."[228]

B. International Law on the Responsibility of States for Internationally Wrongful Acts

The possibility of ordering remedies beyond compensation is not exceptional when compared to the general principles of international law applicable to wrongful acts committed by states. According to the International Law Commission's Draft Articles on Responsibility of States for Internation-

224. Micula v. Romania, ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility, ¶ 166 (Sep. 24, 2008).

225. Al-Bahloul v. Republic of Taj., SCC Case No. V064/2008, Award, ¶ 47 (Sept. 2, 2009). The tribunal asserted the power to grant specific performance after recognizing that the 2001 Draft Article on the Responsibility of States for Internationally Wrongful Acts of the International Law Commission of the United Nations was applicable to the case. *See id.*

226. Petrobart v. Kyrgyz Republic, SCC Case No. 126/2003, Award, ¶ 78 (Mar. 29, 2005) ("The Kyrgyz Republic states in this respect that specific performance is the primary remedy for breach of obligations in international law and that the Republic could therefore be ordered to accept delivery of the remaining gas condensate allegedly due under the Contract and to pay for it. The Republic does not consider that any form of specific performance is now impossible. An award in favour of Petrobart could, in the Republic's opinion, seek to return Petrobart to the position in which Petrobart found itself prior to the Republic's alleged interference. . . . The Arbitral Tribunal notes Petrobart's explanation that the company no longer has any activity in the Kyrgyz Republic and that its supply contract with Uzneftegazdobicha is no longer in operation. In such circumstances, the Arbitral Tribunal considers that specific performance is no longer a practical option and finds that also in regard to lost profits monetary compensation would be the only appropriate remedy in this case.").

227. *See* Christoph Schreuer, *Non-Pecuniary Remedies in ICSID Arbitration*, 20 ARBITR. INT'L 325, 325 (2004) [hereinafter *Non-Pecuniary Remedies*].

228. Schreuer, *Alternative Remedies*, *supra* note 210, at 9; *see also* Kriebaum, *supra* note 215; Gisele Stephens-Chu, *Is It Always All About the Money? The Appropriateness of Non-pecuniary Remedies in Investment Treaty Arbitration*, 30 ARBITR. INT'L 661 (2014); Patrick Dumberry, *Satisfaction as a Form of Reparation for Moral Damages Suffered by Investors and Respondent States in Investor-state Arbitration Disputes*, 3 J. INT'L DISPUTE SETTLEMENT 205 (2012); Steffen Hindelang, *Restitution and Compensation: Reconstructing the Relationship in Investment Treaty Law*, *in* INTERNATIONAL INVESTMENT LAW AND GENERAL INTERNATIONAL LAW: FROM CLINICAL ISOLATION TO SYSTEMIC INTEGRATION? 161 (Rainer, Hofmann & Christian J. Tams eds., Schriften zur Europäischen Integration und internationalen Wirtschaftsordnung, ed. 2011).

ally Wrongful Acts of 2011 ("ILC Articles"),[229] ignoring the obligations contained in a treaty—such as a BIT—"constitutes a breach of an international obligation of the State."[230] Once a breach of an international obligation is found, the state is bound by international law to repair fully the injury caused by the act in "the form of restitution, compensation and satisfaction, either singly or in combination."[231]

The ILC Articles consider restitution as the act that re-establishes "the situation which existed before the wrongful act was committed, provided and to the extent that restitution . . . is not materially impossible [or] does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation."[232] On the other hand, compensating for the damage caused by the wrongful act "shall cover any financially assessable damage including loss of profit insofar as it is established" and "insofar as such damage is not made good by restitution."[233] In the words of one of the leading scholars in the field of damages in investment law, Borzu Sabahi, "[c]ompensation, thus, should fill the gaps when restitution or its monetary equivalent is inadequate to repair fully the financially assessable harms incurred by the injured party."[234]

The ILC Articles recognize that the varied forms of reparation are not mutually exclusive and that "full reparation may only be achieved in particular cases by the combination of different forms of reparation."[235] Yet ac-

229. Responsibility of States for Internationally Wrongful Acts, *in* Report of the International Law Commission of its Fifty-third Session, U.N. GAOR 56th Sess., Supp. No. 10, U.N. Doc. A/RES/56/10 (2001) [hereinafter ILC Articles] (indicating that the ILC Articles address secondary rules of state responsibility, or "the general conditions under international law for the State to be considered responsible for wrongful actions or omissions, and the legal consequences which flow therefrom"); *see also* Borzu Sabahi, Compensation and Restitution in Investor-state Arbitration 9 (2011) ("It is widely held that the ILC Articles codify the customary law of state responsibility and reparation . . . . [T]hey identify fundamental concepts of state responsibility, such as proportionality, attribution, various aspects of the doctrine of reparation and so forth, [and] are a convenient starting point for a study of the norms governing determination of state responsibility in investment treaty disputes as well as the reparation due in such cases.").

230. According to article 2 of the ILC Articles, which defines the elements of the internationally wrongful act of a state, "[t]here is an internationally wrongful act of a State when conduct consisting of an action or omission: (a) is attributable to the State under international law; and (b) constitutes a breach of an international obligation of the State." ILC Articles, *supra* note 229, art. 2.

231. Sabahi, *supra* note 229, at 11 ("This duty requires the responsible state to provide full reparation for the material or moral injury (or harm or damage) caused as a result of its wrongful (or illegal) acts. In disputes involving foreign investment, injury is mostly material, involving economic or financial harm to the investor's rights. The ILC Articles, however, do not include such harm as an element of state responsibility.") (citation omitted). Furthermore, according to article 34 of the ILC Articles, "Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of this chapter." ILC Articles, *supra* note 229, art. 34.

232. ILC Articles, *supra* note 229, art. 35.

233. *Id.* art. 36.

234. Sabahi, *supra* note 229, at 12.

235. ILC Articles, *supra* note 229, cmt. art. 34, ¶ (2) (It further states that "[w]iping out all the consequences of the wrongful act may thus require some or all forms of reparation to be provided, depending on the type and extent of the injury that has been caused.").

cording to some commentators there is a hierarchy among them: "Restitution is to be the primary remedy," and "compensation is due insofar as restitution does not make good the damage. Satisfaction is subsidiary to restitution and compensation: the obligation to give satisfaction exists insofar as restitution or compensation do not provide a remedy."[236]

Some commentators argue that this particular section of the ILC Articles only applies to disputes between states.[237] Yet they also recognize that the commentaries to the ILC Articles explicitly mention that they could also apply to investment claims.[238] For their part, investment tribunals have recognized this point and emphasized that the ILC Articles, by enshrining customary international law, serve as a guideline for their decisions.[239]

The use of other types of remedies beyond simple compensation in investor-state claims would also be consistent with the spirit of the ILC Articles and the historical context in which they were drafted. According to Sabahi, the doctrine of state responsibility and reparation emerged out of European civil law theories of extracontractual liability as applied by tribunals in the late nineteenth century.[240] As such, it had a strong origin in private law.[241] Yet those who believe in the twentieth century version of state responsibility wanted to move beyond monetary compensations because as international law expanded "the great majority of the harms seemed to be non-material and better dealt with through non-monetary remedies."[242] Hugo

236. Schreuer, *Alternative Remedies*, *supra* note 210, at 3 ("[T]here is a clear hierarchy among the three remedies.").

237. *See* Kriebaum, *supra* note 214, at 201–03 ("[T]he rules prevailing in the realm of interstate cases are not as such applicable in investor-State cases. . . . The commentary to Article 36 nevertheless refers to ICSID tribunals and points out in a footnote that ICSID tribunals have jurisdiction to award damages or other remedies.").

238. *See id.* at 203.

239. *See* Quiborax S.A. v. Bolivia, ICSID Case No. ARB/06/2, Award, ¶ 555 (Sept. 16, 2015) ("[T]he ILC Articles restate customary international law and its rules on reparation have served as guidance to many tribunals in investor-state disputes . . . . [T]he remedies outlined by the ILC Articles may apply in investor-state arbitration depending on the nature of the remedy and of the injury which it is meant to repair."). Another example can be found in the case of the MTD Annulment Committee that applied, by analogy, the consequences of the breach of international diplomatic protection under the ILC Articles to a breach of a BIT. MTD Equity Sdn. Bhd. v. Republic of Chile, ICSID Case No. ARB/01/7, Decision on Annulment, ¶ 99 (Mar. 21, 2007) ("Part II of the ILC Articles, in which Article 39 [dealing with contribution to the injury by the injured party] is located, is concerned with claims between States, though it includes claims brought on behalf of individuals, e.g., within the framework of diplomatic protection. There is no reason not to apply the same principle of contribution to claims for breach of a treaty brought by individuals.").

240. Sabahi, *supra* note 229, at 12–15.

241. *Id.* at 44 ("At the beginning of the twentieth century, the law forming on reparations for the commission of international wrongs, similar to state responsibility doctrine . . . was mainly based upon private law notions. Arbitral tribunals of the time also heavily relied on private law notions.").

242. *Id.* at 46 ("Despite the weight of arbitral practice and scholarly writings, Anziloti (and his followers) in his theory of state responsibility gave priority to restitution in kind over monetary compensation for breaches of international law. This was, it is submitted, inevitable, given that he wanted to apply the concept of state responsibility from the narrow field of injury to foreign nationals to a broader field; that is, the entire law of state responsibility and reparations for committing international wrongs. In the latter fields, the great majority of the harms seemed to be non-material and better dealt with through non-monetary remedies.").

Grotius's idea of considering money as "the common measure of valuable things" was considered anachronistic when these investment principles were being drafted.[243]

In the context of acts taken against foreign investors, the first international court to move beyond monetary compensation was the Permanent Court of International Justice ("PCIJ").[244] In *Factory at Chorzów*, a 1928 case involving the Polish government's illegal expropriation of a German company, the PCIJ determined that the "essential principle contained in the actual notion of an illegal act . . . is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed."[245] Only when restitution in kind was impossible would "payment of a sum [be made,] corresponding to the value which a restitution in kind would bear."[246] The PCIJ, under the guidance of President Judge Dionisio Anzilotti, diverted attention away from the individual material harm, instead focusing on the restoration of the disrupted legal order.[247] What matters under this view is the fact that a "violation of a rule of international law ipso facto would cause damage, irrespective of whether the victim or state had suffered any material damage."[248] The successor of the PCIJ, the International Court of Justice ("ICJ"), confirmed in two important 1980s decisions that the role of an international court is to restore the violated order by calling for the cessation of internationally wrongful acts or omissions, as opposed to allowing the wrongful behavior to continue.[249] Based on these

243. Sabahi, *supra* note 229, at 45–51. In citing the Lusitania Arbitration case of 1923 where Hugo Grotius' scholarship informed the basis of awarding monetary compensation, Sabahi writes: "It is a general rule of both the civil and common law that every invasion of private rights imports an injury and that for every such injury the law gives a remedy. Speaking generally, that remedy must be commensurate with the injury received. It is variously expressed as 'compensation', 'reparation,' 'indemnity', 'recompense', and is measured by pecuniary standards, because, says Grotius, 'money is the common measure of valuable things.'" *Id.*

244. Factory at Chorzów (Ger. v. Pol.), Merits, Judgment No. 13, 1928 P.C.I.J. Ser. A No 17 (Sept. 13). The case dealt with an expropriation of a German company in Poland. Germany argued that the expropriation violated the Treaty of Versailles and Articles 6-22 of the Convention Concerning Upper Silesia. The PCIJ found first that the expropriation had been illegal and then stated its doctrine on the consequences.

245. *Id.* ¶ 124.

246. *Id.*

247. Sabahi, *supra* note 229, at 47 ("To achieve this doctrinal outcome, Anzilotti stated that breach of the international legal order required restoration of the disrupted legal order, focusing more on the legal order than on the material damage suffered by an individual.").

248. *Id.* at 47, 51 ("[I]n giving restitution in kind priority over monetary compensation, the Court seems to have deviated from the *jurisprudence constante* of the time. Even in the modern international law of foreign investment, the primary remedy sought and awarded by the arbitral tribunal is monetary. The Court's approach, however, was in line with the previously described movement to extend the law on protection of aliens to the entire fields of state responsibility in international law. In fact, it mirrored Anzolitti's doctrinal views in his 1906 article, which should not be surprising, as Anzilotti presided over the PCIJ in this case.").

249. Case Concerning United States Diplomatic and Consular Staff in Tehran (U.S.A. v. Iran), Judgment, 1980 I.C.J. Rep. 3, ¶ 95 (May 24); Case Concerning the Military and Paramilitary Activities in and Against Nicaragua (Nicar. v. U.S.A), 1986 I.C.J. Rep. 14, ¶ 292 (June 27).

cases, the Secretary-General of the United Nations, serving as an arbitrator to the 1990 *Rainbow Warrior* case, held that a competent tribunal has "inherent powers" to provide "for the cessation or discontinuance of a wrongful act or omission" when it is confronted "with the continuous breach of an international obligation which is in force and continues to be in force."[250] In its most recent cases the ICJ has even ordered states "by means of [their] own choosing" to cancel arrest warrants that were unlawful under international law,[251] or to review and reconsider convictions and sentences against nationals in another case as a form of reparation.[252] In cases involving a state's violations of the rights of foreign nationals, these were concrete orders to perform certain acts, as opposed to orders for monetary compensation.

The PCIJ and the ICJ have not been alone on the view that international courts that face wrongful acts of states must try to restore the breached order.[253] Some of the international tribunals that dealt with the nationalization process in the 1970s—such as the *Texaco (TOPCO) v. Libyan Arab Republic* tribunal—decided that "any possible award of damages should necessarily be subsidiary to the principal remedy of performance itself."[254] In that case, the tribunal found that the Libyan government had violated the deeds of concession of the investors through the enactment of nationalization measures, and as such ordered the *restitutio in integrum* of the contractual relationship because the government was "legally bound to perform these contracts and to give them full effect."[255]

250. Case Concerning the Difference Between New Zealand and France Concerning the Interpretation or Application of Two Agreements Concluded on 9 July 1986 Between the Two States and Which Related to the Problems Arising from the *Rainbow Warrior* Affair, Award, 30 Apr. 1990, 20 R.I.A.A. 215, 270 ("The authority to issue an order for the cessation or discontinuance of a wrongful act or omission results from the inherent powers of a competent tribunal which is confronted with the continuous breach of an international obligation which is in force and continues to be in force. The delivery of such an order requires, therefore, two essential conditions intimately linked, namely that the wrongful act has a continuing character and that the violated rule is still in force at the time in which the order is issued.").

251. The Arrest Warrant of 11 April 2000 (Dem. Rep. Congo v. Belg.), 2002 I.C.J. Rep. 3, ¶ 78 (3) (Apr. 11).

252. La Grand (Ger. v. U.S.A.), 2001 I.C.J. Rep. 466, ¶ 125; Case Concerning Avena and other Mexican Nationals (Mex. v. U.S.A.), 2004 I.C.J. Rep. 12, ¶ 153 (9) (Mar. 31).

253. *But see* SABAHI, *supra* note 229, at 45–46. Sabahi has a different opinion. In his work he identified cases involving the protection of foreign nationals where "monetary compensation was the preferred remedy" of the late nineteenth and early twentieth century tribunals. Yet he recognized that this approach presented a "*jurisprudence constante*" because "the great majority of the international disputes that were, in fact, *litigated* at the time involved economic or other injury to foreign nationals or their property." *Id.*

254. Texaco Overseas Petroleum Co. v. Gov't of the Libyan Arab Republic, Award on the Merits, 53 I.L.R. 389, 508 (Jan. 19, 1977).

255. *Id.* It is important to note that in *LIAMCO*, another case regarding the Libyan nationalization process, the arbitrators took the opposite approach; since the claimants were not requesting restitution, the tribunal did not consider it as a possible remedy. Libyan American Oil Company (LIAMCO) v. Government of Libyan Arab Republic, 20 I.L.M. 1, 125 (1981). Nevertheless, I argue that this case was in fact reviewing a traditional expropriation issue, and hence the compensation-expropriation prism was the appropriate one. For a distinction of this prism and its application to other types of investment rights, see the discussion *infra* in this section.

In conclusion, according to the general principles of international law and the practice of international courts, restitution is the first remedy available to a court when it finds a violation of international law. Only when restitution is not possible should monetary compensation be an adequate remedy, and compensation is only "designed to take the place of restitution."[256] In investment arbitration, this would translate not only into first ordering the restoration of a material good, but also reversing unlawfully adopted juridical acts such as amending legislation, or revoking an executive or administrative act.[257]

C. *The Decisions of Investment Tribunals to Rely on Monetary Compensation*

If the public international law view on the wrongful acts of the state and the spirit of the investment regime allow an investment tribunal to order performance remedies before considering monetary compensation, why have investment tribunals decided to stick to pecuniary awards? Some commentators argue that the claimants have "defined their demands in pecuniary terms" as opposed to requesting other types of remedies.[258] Others, such as Professor M. Sornarajah, focus on the difficulty of enforcing other types of remedies and take the view that it would be futile for the tribunals to order them.[259] Yet even pecuniary damages are difficult to recover from entities that enjoy sovereign immunity in most jurisdictions. While "ICSID awards are more enforceable than most international obligations," they still "rest in the end on the legitimacy of the obligation and a state's desire to comply."[260] Furthermore, as stated by the arbitral tribunal in *Mohammad Ammar*

256. Factory at Chorzów, *supra* note 244, at 47–48; *see also* SABAHI, *supra* note 229, at 12 (agreeing with the construction of the ILC Articles and the *Chorzów Factory* dictum that "[r]estitution, following the formula devised by the *Chorzow Factory* case, is the first ranked remedy in public international law"); Schreuer, *Alternative Remedies*, *supra* note 210, at 2. After quoting the PCIJ in *Chorzow Factory*, Schreuer agreed with the following sentiment: "Under this statement, restitution in kind is the primary remedy. Payment of compensation is to take its place if restitution is not possible." *Id.*

257. *See* SABAHI, *supra* note 229, at 12 ("ILC Article 35 considers restitution to require the re-establishment of the *status quo ante*, i.e., the situation that existed before the occurrence of the wrongful act. Restitution in this sense could, for example, require the restoration of an expropriated property or its monetary equivalent (immediately before the taking) to the aggrieved owner."); Schreuer, *Alternative Remedies*, *supra* note 210, at 5 ("As the ILC's Commentary to Article 35 points out, restitution may take the form of material restoration, or the reversal of some juridical act, or some combination of them. This may involve the amendment or revocation of legislation enacted in violation of international law or the rescinding of an administrative or judicial measure unlawfully adopted in respect to a foreign investor or its property.").

258. Schreuer, *Non-pecuniary Remedies*, *supra* note 227, at 332 ("In the cases so far published, most ICSID tribunals have nearly always framed the obligations imposed by their awards in pecuniary terms. This is not due to a belief that they lack the power to proceed otherwise. Rather, the cases involved situations in which the investment relationship had broken down and the claimants have preferred to frame their demands in monetary terms.").

259. SORNARAJAH, *supra* note 209, at 281 ("[W]hat is fought in an award is not a legal opinion but an award capable of enforcement and there does not exist any machinery for the enforcement of an award against a state party for the specific performance of a contract.").

260. Alvarez, *supra* note 9, at 224 ("[I]t is always hard to secure payment from an entity that enjoys sovereign immunity. Although ICSID awards are more enforceable than most international obligations,

Al Bahloul v. Tajikistan, "possible problems of enforcement do not in and of [themselves] make specific performance an impermissible remedy."[261]

Other skeptical commentators argue that ordering performance remedies would infringe on sovereign rights.[262] According to one of the most recognized academic authorities in the field, Professor Christopher Schreuer, "a frequently advanced argument is that a State cannot or should not be compelled to reverse action that it has taken in its official capacity."[263] This seemed to have been the approach taken by some early arbitral tribunals and some ICSID contemporary tribunals. For example, the tribunal in *LIAMCO v. Libya* found that there had been an expropriation of investor assets, but concluded that "it is impossible to compel a State to make restitution, [because] this would constitute in fact an intolerable interference in the internal sovereignty of States."[264] The tribunal continued by noting that "restitution presupposes the cancellation of the nationalization measure at issue, and as such cancellation violates the sovereignty of the nationalizing State. Moreover, nationalization is sometimes qualified as an 'Act of State,' which is immune from control, judicial or otherwise."[265] In *LIAMCO*, the claimants recognized the impossibility of restitution but requested an award "declaring the invalidity of Libya's title" to the property rights of the oil extracted from LIAMCO's concession.[266] The tribunal rejected the claimant's requests on the grounds that the declaration would be as impossible to achieve as restitution given that "such arguments do not stand against the legal con-

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they are not immune from the fundamental weakness of all such obligations: namely, that enforcement rests in the end on the legitimacy of the obligation and a state's desire to comply."). *See generally* Edward Baldwin et al., *Limits to Enforcement of ICSID Awards*, 23 J. INT'L ARBITR. 1 (2006); Charity L. Goodman, *Uncharted Waters: Financial Crisis and Enforcement of ICSID Awards in Argentina*, 28 U. PA. J. INT'L ECON. L. 449 (2007).

261. Mohammad Ammar Al-Bahloul v. Republic of Taj., SCC Case No. V, ¶ 50 (064/2008). In this particular case, however, the tribunal found that it was materially impossible to implement the specific performance remedy because new investors had been operating many years in the specific areas where the licenses had been withheld. *Id.* ¶¶ 51–63.

262. Schreuer, *Alternative Remedies*, *supra* note 210, at 10.

263. *Id.*

264. LIAMCO, *supra* note 255.

265. *Id.* at 124–27. In this particular case, the tribunal recognized that the claimants were not requesting restitution, but in fact "LIAMCO admitted implicitly the impossibility of restitution in kind, and consequently requested the Arbitral Tribunal to award remedies in lieu of restoration of Claimant to its rights in Libya. Apart from other remedies, especially damages, LIAMCO requested the issue of a Declaratory Award that Libya's acts are unlawful and not entitled to international recognition, and that Libya does not have title to oil extracted from LIAMCO's Concessions. . . . In other words, LIAMCO requested an award declaring the invalidity of Libya's title to said property rights until effective payment of LIAMCO's claims for said rights." *Id.*

266. *Id.* at 127–28. According to the tribunal, "[i]n support of this demand, LIAMCO cites some international arbitral precedents in which similar declaratory judgments were delivered. It cites also the German-Swiss Arbitration Treaty of 1921 (Article 10) and the General Act for the Pacific Settlement of International Disputes of 1929 (Article 32), in which it is provided that failing restitution in integrum, equitable satisfaction of another kind shall be awarded to the injured party. It likewise cites other precedents, in which it was asserted that 'ex injuria jus non oritur' [law does not arise from injustice], and that 'nemo plus jure transferre potest quam ipse habet' [no one can transfer a greater right than he himself has]." *Id.*

sideration of the sovereignty of States and of the so-called 'Acts of States,' which . . . include nationalization measures. They are, in any case, faced with the same practical impossibility of enforcement as that of the remedy of *restitutio in integrum*."[267]

Other tribunals expressed similar skepticism. The tribunal in *British Petroleum v. Libya* concluded that "when by the exercise of sovereign power a State has committed a fundamental breach of a concession agreement by repudiating it through a nationalization of the enterprise and its assets in a manner which implies finality, the concessionaire is not entitled to call for specific performance by the Government of the agreement and reinstatement of his contractual rights, but his sole remedy is an action for damages."[268] Other early tribunals have even referred to domestic legislation when determining the consequences of the acts of states. In *Amoco International Corporation v. Islamic Republic of Iran*, the tribunal noted that "in no system of law are private interests permitted to prevail over duly established public interest, making impossible actions required for the public good. Rather private parties who contract with a government are only entitled to fair compensation when measures of public policy are implemented at the expense of their contract rights." The court concluded: "No justification exists for a different treatment of foreign private interests . . . ."[269]

Note that all of these cases dealt with expropriation or nationalization processes. They did not entail cases closer to the ones that contemporary BITs envision, such as discriminatory treatment or unfair and inequitable practices against investors. Some of the recent ICSID tribunals have nonetheless followed in the footsteps of those decisions.[270] The *LG&E v. Argentina* tribunal recently denied the request of the claimant to restore a gas tariff that the state and the company had agreed to but that had been unlawfully abrogated. According to the tribunal, ordering restitution would

> imply a modification of the current legal situation by annulling or enacting legislative and administrative measures that make over the effect of the legislation in breach. The Tribunal cannot compel Argentina to do so without the sentiment of undue interference with its sovereignty. Consequently, the Tribunal arrives at

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267. *Id.* at 128 ("In fact, LIAMCO's interests and rights are undivided and it is difficult to distinguish the product of these rights from that of the co-owners' rights. Any Declaratory Award as requested would be practically unenforceable." *Id.*.

268. British Petroleum v. Gov't of Libyan Arab Republic, Award, 53 I.L.R. 297, 354 (Oct. 10, 1973) (observing that *restitutio in integrum* depends on the will of the wrongdoing state, rather than the will of the home state of the foreign investor, in state-to-state international disputes arising from the exercise of diplomatic protection).

269. Amoco Int'l Corp. v. Islamic Republic of Iran, National Iranian Oil Co., 15 Iran-U.S. Cl. Trib. Rep. 189, 243 (1987).

270. *See* AGIP S.p.A. v. People's Republic of Congo, ICSID Case No ARB771, Award, 86–88 (Nov. 30, 1979).

the same conclusion: the need to order and quantify compensation.[271]

Notably, the tribunal reached this conclusion even though it also recognized that restoring the full tariff would "result in the re-establishment of the situation that existed prior to the wrongful act."[272] The tribunal even agreed that the abrogation of the tariffs constituted a continuous breach of the international obligation that it extended to the entire period of the case, and that the State still had to perform the breached obligation even during the period of litigation.[273] Despite recognizing the value of restitution and the existence of a continuous breach, the tribunal decided to treat the act as an expropriation instead of applying the general principles on the international responsibility for wrongful acts of the state.

Using the same logic of the impossibility of enforcing an order of performance, the *CMS Gas Transmission v. Argentine Republic* tribunal recognized that "restitution is by far the most reliable choice to make the injured party whole as it aims at the reestablishment of the situation existing prior to the wrongful act," while also acknowledging that "it would be utterly unrealistic for the Tribunal to order to turn back to the regulatory framework existing before the emergency measures were adopted."[274] The tribunal also recognized that a "rebalancing of the contracts" by means of negotiation between the investor and the State "would be considered as a form of restitution."[275]

In another example of an ICSID tribunal applying the logic of expropriation to a case, the *Occidental v. Ecuador* tribunal concluded that "where a State has, in the exercise of its sovereign powers, put an end to a contract or a license, or any other foreign investor's entitlement, specific performance must be deemed legally impossible."[276] Note that the ILC Articles speak of *materially* impossible remedies, not *legally* impossible remedies in the man-

271. LG&E Energy Corp. v. Argentine Republic, ICSID Case No. ARB/02/1, Award, ¶ 87 (July 25, 2007).

272. *Id.* ¶ 84.

273. *Id.* ¶ 85 ("[T]he abrogation of the basic guarantees of the gas tariff regime constitutes a continuous breach that extends to the entire period during which such abrogation continues and remains not in conformity with the Treaty . . . and provided that the obligation is still in force, the State is under a duty to perform the obligation breached. It is also obliged to cease the wrongful act. Ceasing the wrongful act would imply restoration of the basic guarantees of the tariff regime.").

274. CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award, ¶ 406 (May 12, 2005) (recognizing also, however, that the claimants had not requested the reinstatement of the previous regulatory framework).

275. *Id.* ¶ 407 ("Just as an acceptable rebalancing of the contracts has been achieved by means of negotiation between the interested parties in other sectors of the Argentine economy, the parties are free to further pursue the possibility of reaching an agreement in the context of this dispute. As long as the parties were to agree to new terms governing their relations, this would be considered as a form of restitution as both sides to the equation would have accepted that a rebalancing had been achieved. This was in fact the first major step for the settlement of the dispute in the *Gaz de Bordeaux* case.").

276. Occidental Petroleum Corp. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Decision on Provisional Measures, ¶¶ 78–79 (Aug. 17, 2007).

ner referenced by the *Occidental* tribunal.[277] In its decisions, the *Occidental* tribunal relied on the aforementioned Libyan cases of the 1970s without distinguishing the fact that those cases dealt with a general nationalization process while the *Occidental* case instead dealt with a concrete contractual breach and a concession cancelation.[278] Furthermore, the claimants in the *Occidental* case requested explicitly provisional measures to protect the oil field from being transferred to another contractor so that, in case the tribunal found the state in breach of its treaty obligations, the tribunal could order the *restitutio in integrum* instead of arguing a material impossibility due to time and the operation of the field by another company.[279]

As these examples show, the sovereignty logic could be valid when it comes to traditional expropriation acts or nationalization processes. After all, expropriation in itself is not an international wrongful act according to customary international law and the BITs, though failing to provide adequate compensation is. Yet the sovereignty argument cannot protect acts that treaties consider unequivocally unlawful, such as discriminatory or unfair treatment. One of the few authorities to shed light on this inconsistency was the late Professor Thomas W. Wälde, one of the first experts to study the area of compensation in the investment regime.[280] According to Wälde, investment tribunals tend to avoid giving "detailed reasoning for remedies and damages" because they often leave that to experts presented by the parties.[281] And when the investment tribunals *have* done so, they have relied exclusively on the jurisprudence and logic of expropriation cases that came before the current international investment regime.[282] Investment tribunals see

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277. *Id.* (noting that the tribunal even recognized that the Claimant's request was not in itself impossible).

278. *Id.* ¶¶ 79–80 ("The tribunal recognizes that one international arbitrator in the Texaco v. Libya case granted such specific performance—under the name of *restitutio in integrum*—in the context of a nationalization, but that case is both unique and fact specific. Indeed, the arbitrator in that case insisted that specific performance could not be considered impossible because the respondent State had not presented itself before the tribunal in order to provide information regarding the impossibility of specific performance. . . . In two other Libyan cases, *restitutio in integrum* was also used as meaning specific performance or restitution in kind. In both instances, this relief was not granted. The tribunals reasoned that such a remedy of specific performance was impossible in the context of a nationalization.").

279. *Id.* ¶ 4 ("Immediately following the issuance of the *Caducidad* Decree, Respondents have proceeded to seize all of OPEC's assets and have effectively taken over all of OPEC's operations in Block 15. They have also indicated their intention to enter into a contract with another company to ensure continued production from Block 15. Unless Respondents are immediately ordered to cease or refrain from such actions and to return OPEC to its rightful operation and exploitation of Block 5, they will render the consequences of Respondents' breaches irreversible and the relief of *resitutio in integrum* sought by Claimants in the arbitration impossible.").

280. *See* Wälde, *supra* note 25; Thomas W. Wälde & Borzu Sabahi, *Compensation, Damages, and Valuation*, *in* The Oxford Handbook of International Investment Law 1049 (Peter Muchlinski et al. eds., 2008).

281. Wälde, *supra* note 25, at 5 ("After the tribunal has indulged at length in lengthy legal debates on issues the arbitrators and counsel are trained for and familiar with, the compensation award suddenly emerges as if a white rabbit was pulled by a magician out of his black hat.").

282. *Id.* at 8 ("The dominant view—both in arbitral jurisprudence and literature on remedies and damages in investment arbitration is almost exclusively formed by the experiences with un- or under-

their power to award remedies "through the prism of the expropriation debate: that means first the 'standards of expropriation' ('full, prompt, adequate', 'market or genuine value') and, second, how to value property that was taken."[283] Arbitrators have ignored the fact that contemporary BITs contain more rights than the right to receive prompt, adequate, and effective compensation in the case of expropriation. Investment tribunals, meanwhile, in their remedy decisions have given all the rights contained in BITs the same effects, even when they differ.

As mentioned above, contemporary investment cases do not deal with direct expropriations as they did in the past. Now, such cases involve actions that tend to "leave the formal property rights intact, but undermine the normal commercial functioning of a bundle of property rights in a business."[284] This stems from the fact that the state in the majority of the cases has dual power, both as regulator and as a party to a contract, and as such engages in actions that are not "expropriations" but that rather affect the "fair and equitable" treatment of the investor.[285] Such actions include discriminatory treatment, breaches of legitimate expectations of the investors, denials of justice, and harassment by police authorities, among others. The "expropriation-compensation" prism of analysis is often not appropriate to dissuade conduct tantamount to a breach of treaty obligations.[286]

Consequently, there is "a need to free tribunals from the dominance of exclusive expropriation analysis and to develop an approach to remedies and damages that is appropriate for each specific investment treaty discipline."[287] For example, tribunals could order the cessation of injurious conduct; they could fashion a declaratory award of unlawfulness; they could order a state to provide satisfaction in different ways, such as by way of apologies, public statements, or recognition of unlawfulness for insurance risk purposes or to maintain brand value and reputation; they could order the restitution, not only of tangible property, but also of intangible rights such as intellectual property or contractual rights and the cancellation of administrative and judicial orders; they could order nonmonetary compensatory remedies, such as making comparable business opportunities, or

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compensated expropriation. The background of most experiences for arbitral jurisprudence before the advent of direct investor-state arbitration are individual or large-scale expropriations . . . .").

283. *Id.*

284. *Id.*

285. *Id.*

286. *Id.* ("Moreover, the expropriation prism also dominates the view of other forms of governmental conduct affecting investors in breach of the non-conventional new disciplines of investment treaties—such as abuse of the dual power of government as both regulator and contract party to escape from the binding force of contracts, but also discrimination ('national treatment') and the types of abuse of government powers grouped together in the discipline of 'fair and equitable treatment' (e.g. denial of justice, breach of legitimate expectations). An expropriation-compensation analysis is often not appropriate for these non-conventional investment treaty disciplines. If applied to the fullest extent, it tends to lead to excessive awards, and the logic which seemingly requires expropriation-type awards then acts as a disincentive to apply the novel investment disciplines effectively and in an acceptable way.").

287. Wälde, *supra* note 25, at 8.

equivalent properties or license-based business opportunities, or participation in state companies; and they could order the restitution of a license or of permissions to transfer currency.[288] At the 2015 Annual Damages in International Arbitration Conference in Vienna, Professor Christopher Schreuer argued that

> [t]here is a wide range of possibilities for non-pecuniary obligations that awards might impose. . . . Possible . . . obligations imposed upon the host State would include the restitution of seized property, the return of an investment license that has been withdrawn, the granting of permission to transfer currency, discontinuance of harassment of the investor's personnel or desistance from imposing unreasonable taxes.[289]

If arbitral tribunals were generating changes in the state's regulatory policies as the proponents of the global administrative law view argue, they would employ precisely these types of remedies.

I do not intend to advocate here for any one of these performance remedies over the others, but rather want to emphasize how such remedies could aid investment regimes in achieving their myriad goals. Seeing compensatory damages as the only option ignores the value of other types of remedies that could be more appropriate for vindicating an infringed right.[290] When ordering other types of remedies, such as performance or declaratory remedies, arbitrators can hint at the type of behaviors that would be considered legal according to international standards while also taking into consideration the needs of the state. In a way, these remedies could help to achieve the necessary institutional changes, or at least prompt a debate about them, to prevent future actions. Remedies beyond monetary compensation can help "signal[ ] good governance standards to individual countries, in particular those who most need better governance quality to better pursue the path of prosperity and development."[291]

Keeping the contemporary compensation-expropriation prism works against the investment regime.[292] States can continue all these practices that are detrimental to investors as long as they are willing to pay the damages

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288. *Id.* at 22–25; Schreuer, *Alternative Remedies*, *supra* note 210, at 7 (giving as a possible obligation on the host state "the restitution of seized property, the return of an investment license that has been withdrawn, the granting of permissions to transfer currency, discontinuance of harassment for the investor's personnel or desistance from imposing unreasonable taxes").

289. Schreuer, *Alternative Remedies*, *supra* note 210, at 5.

290. *Contra* SORNARAJAH, *supra* note 209, at 280 ("[A]n order of specific performance against a state by an arbitrator is obviously a futile act as it cannot be enforced in any meaningful way. It may, however, serve as an indication by the arbitrator that the contract still survives despite its attempted breach by one of the parties and may also indicate the type of monetary damages that need to be paid to the injured party. It may be an indication that the damages to be paid should be higher than for an ordinary breach of a contract. It is usually premised on the illegality involved in the breach.").

291. Wälde, *supra* note 25, at 7.

292. *See* Brewster, *supra* note 26; Rachel Brewster, *The Limits of Reputation on Compliance*, 1 INT'L THEORY 323 (2009); Rachel Brewster, *Unpacking the State's Reputation*, 50 HARV. INT'L L.J. 231 (2009).

that might result from losing a case. A state's reluctance or refusal to participate in the arbitration proceeding will affect the state's reputation, not the violation of the so-called treaty right.[293] States know this and act accordingly. Arbitrators have not created incentives otherwise. The tribunals may interpret investment treaties expansively, but when it comes to awarding remedies—determining the actual consequences for the actions taken—the tribunals limit themselves to ordering states to pay compensations. As expressed above, these rights through the arbitration jurisprudence are now closer in essence to the only right that remains true to its origins: the right to receive prompt, adequate, and effective compensation in case of expropriation.

Conclusion

The view presented in the preceding paragraphs exposes a paradox in the international investment regime when it is applied to oil and gas investments in developing countries. For governments that depend disproportionately on rents generated by oil and gas companies, the international legal process that was supposed to help domestic institutions, or at least substitute for some of their functions, is weakening them further. The operation of oil and gas companies in these countries weakens domestic governance, and the international investment regime raises the incentives for rent-seekers to maintain their wrongful behavior. In other words, the investment regime weakens domestic governance not because it takes away regulatory power from domestic institutions, as argued by some scholars, but because it makes it easier for rent-seekers to continue depending on and fighting over foreign investors' profits. This fuels the resource dependency curse and further weakens domestic institutions.

At this point a clarification is needed regarding the operations of other sectors. In cases in which government revenues do not depend on the operation of foreign investment or cases involving municipal governments and foreign investors, the payoffs and incentives might be different. If a municipal authority signs a service agreement with a foreign company, depending on the financial circumstances of the local government, ignoring contractual obligations to foreign investors might be too costly if the case ends up in international litigation. The local authority might decide not to violate treaty obligations for fear of litigation consequences. In these cases, there is space to argue that the international investment regime and compensatory damages are playing a global administrative role, as they are chilling government actions. But when it comes to the oil and gas sector, the resource

293. Brewster, *supra* note 26, at 261 ("[I]nternational dispute resolution institutions can lead the audience to lower its perception of the importance of compliance and view the breaching state as cooperative if it abides by the remedy regime. Formal remedies can serve as a fine rather than a sanction. . . . [F]ines 'price' breach.").

dependency virtually compels states to capture industry rents. International investors know it, and they still invest in those countries. States know it, and they are willing to pay for it. Arbitrators know it, and that is why they restrict their decisions to finding the right amount of compensation.

As it operates with respect to the oil and gas sector, the investment regime does not protect rights but rather allows aggrieved parties the opportunity to bargain for higher compensation for violations of rights afforded by international treaties. The real question in the oil and gas cases ends up being one related to the calculation of appropriate compensation, with little comparative emphasis placed on the defense of the rights at issue or on the reestablishment of the status quo. Not surprisingly, a number of cases are negotiated in the course of the proceedings.[294]

The work presented here questions the narrative employed to describe the investment regime as one where investors receive "rights" against government interference. It contends that host-state governments may not consider themselves bound by treaty obligation, and can violate certain investor "rights" with relative impunity. The current round of BIT renegotiations, which frequently has involved adding provisions that give host government decisions more deference, is not a manifestation of a state "reasserting" its power. Rather, it is a codification of powers that never really left, even under BITs that purported to limit the autonomy of host governments.[295]

The "rights-based" description of the regime pushed by global law firms, arbitration centers, and consulting agencies serves those parties' normative interests and agendas.[296] This description resembles what Professor Anthea Roberts describes as the "public law"-oriented paradigm,[297] in which the

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294. ICSID, *supra* note 3, at 27, 29. In 2014, around 35% of the cases were settled or the proceedings were discontinued. Forty-five percent of those cases were discontinued at the request of one party; in 22% of them the dispute was settled by an agreement embodied in the award at the request of the parties, and 22% of them were discontinued at the request of both parties. *Id.*

295. Alvarez, *supra* note 9, at 230–31, 234, 235 ("[T]he international investment regime—the contemporary regime that has displaced the WTO among critics of globalization and has been seen as the greatest threat to sovereignty—is actually in the throes of serious sovereign backlash. The regime most criticized for ignoring the will of states has become the foremost example of their persistent power . . . . UNCTAD's examples of these restrictions reveal how some countries are re-asserting their 'sovereign rights' vis-à-vis foreign investors . . . . Furthermore, many recent investment protection treaties accord FDI host states greater room to maneuver, while simultaneously granting foreign investors fewer rights.").

296. Van Harten, *supra* note 47, at 166 ("Thus the incoherence that arises from the mixture of international arbitration and state liability in public law benefits large firms in their political bargaining with government, by exacerbating the regulatory chill that is otherwise generated by the threat of a damages award against the state. In some cases, depending on the degree of foreign ownership in the affected sector of a host economy, regulation carries the risk of fiscal ruin. For this reason, the burden of incoherence is borne most by those countries that lack the legal and administrative capacity effectively to fight off, or deter, investor claims (just as the risk of a cost award—although not of a damages award—falls most heavily on small and mid-sized firms contemplating claims against a large state that can extensively litigate every stage of the dispute).")

297. Roberts, *supra* note 31, at 63–64 ("Since the mid-2000s, a number of authors have argued that investment treaty arbitration should be understood as a form of international judicial review, analogous to domestic administrative or constitutional law review . . . . [T]he public law paradigm differs from the

essence of the system is analogized to human rights or administrative law.[298] Litigating under the human rights-style "public law" paradigm gives the false perception that the "absolute rights" contained in the treaty can stop government policies that hurt foreign investors. Yet, as I argued in the preceding paragraphs, there is an embedded contradiction between this narrative and the real-world consequences of breaching the treaties.[299] The BITs might use absolute rights-oriented language, but in the end they can only help investors to bargain for higher compensation when litigating against host governments, as arbitrators rarely impose performance-based remedies. The current trend within the regime of adding more exceptions to the enforcement of these so-called "absolute rights" does not signal the state recapturing its powers, as Professor José Alvarez argues; it is instead the shouting of a Leviathan that never left the scene and is now trying to calm down the discourse of those that have benefited the most from the investment litigation boom.[300] The predominant discourse holds that when states breach treaty obligations investors litigate and enforce rights to be *treated* in particular ways by states. In fact, investors are only litigating a right to be *compensated*.

My aim here was not to prescribe how remedies jurisprudence should change or how the investment system could be redesigned. That task requires a deeper study and understanding of the alternatives beyond the use of international adjudication to transform the institutional capacity of states and break the rent dependency pattern. Nevertheless, by building a bridge between the political economy literature that deals with the effects of oil and gas extraction in developing countries and the international economic law of foreign investments, this research provides a starting point for further work and reflection.

Finally, the findings presented here stand as a reminder to international lawyers that the signing of a treaty, even when coated with rights discourse, is not the end of the definition of the regime. The essence of the treaty can be transformed by the institutions and actors created by it, to the point of modifying the treaty's goals. It reminds us of the old legal realism maxim of

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public international law paradigm because it focuses on vertical relationships between unequal parties (a state acting in its public capacity and a private actor subject to that state's regulatory power) instead of horizontal relationships between equal parties.").

298. *Id.* at 48.

299. Roberts, *supra* note 31, at 48 ("States, investors, and NGOs often favor different paradigms in light of their divergent normative interests and agendas. The field's arbitrators, advocates, and academics come from diverse backgrounds, and they too frequently presume or endorse distinct templates that may lead to conceptual collisions on concrete issues. And no authoritative voice exists to resolve these differences because the system is based on thousands of bilateral investment treaties (BITs) and free trade agreements (FTAs), which, in turn, are interpreted by hundreds of ad hoc tribunals, with no centralized appellate body. As a result, the investment treaty field is a conceptual mess.").

300. Alvarez, *supra* note 9, at 256 ("What this means is that governments are empowering themselves along multiple dimensions. . . . [T]he return of the state with respect to finance and investment appears to be part of a greater trend in favor of empowering the state that is occurring outside international economic law as well.").

not confusing the law on the books with the law in action.[301] The dynamism of institutions and the practices of the law—not just the structure of the written law—determine the effectiveness of a regime.

301. *See* Roscoe Pound, *Law in Books and Law in Action*, 44 AM. L. REV. 12 (1910); Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457 (1897).