GOOD GOVERNANCE, LOCAL GOVERNMENTS, AND LEGITIMATE EXPECTATIONS: ACCOMMODATING FEDERALISM IN INVESTOR-STATE ARBITRATION

ANDREW LARKIN*

I. INTRODUCTION

Several recent investor-State disputes have followed a similar pattern. A federal government will work with a foreign investor to develop a project in a region whose residents oppose it. Sometimes local governments block such projects through targeted but generally applicable regulations or duly delegated veto powers.[1] At other times they manipulate the technical re-

* Candidate for J.D., 2017, NYU Law. The author would like to thank Benedict Kingsbury, Julian Arato, Thomas Streinz, and participants in the October 2016 IILJ Student Working Papers conference for thoughtful and insightful comments on various drafts. All mistakes are the author's own.

1. *See, e.g.*, Glamis Gold, Ltd. v. U.S., NAFTA/UNCITRAL, Award (June 8, 2009), http://www.italaw.com/sites/default/files/case-documents/ita0378.pdf; *Compañía de Aguas del Aconquija S.A.v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, (Aug. 20, 2007), https://icsid.worldbank.org/en/Pages/cases/casedetail.aspx?CaseNo=ARB%2f97%2f3.

quirements of permitting processes to do so.[2] Sometimes people in the region riot or protest,[3] and sometimes their opposition is suppressed.[4]

In these instances, investors may be able to recoup the value of their investments from the host State by bringing claims under investment treaties before international tribunals. In these fora, investors benefit not just from international law's relatively uncontroversial attribution rules, which hold States liable for the actions of their sub-parts, but also from tribunals who interpret these rules to demand that different governments within a State adopt consistent positions vis-à-vis an investor.[5] While governments may value federalism and delegation enough to leave their practice unchanged under the

2. Clayton v. Gov. of Can., NAFTA/UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4212.pdf; Metalclad Corp. v. United Mex. States, ICSID Case No. ARB(AF)/97/1, Award, (Aug. 30, 2000), 16 ICSID Rev. 165 (2001).

3. *See, e.g.*, Bear Creek Mining Corp. v. Rep. of Peru, ICSID Case No. ARB/14/2, Claimant's Reply on the Merits and Counter-Memorial on Jurisdiction, ¶¶ 108–19 (Jan. 8, 2016), http://www.italaw.com/sites/default/files/case-documents/italaw4458.pdf; Bear Creek Mining Corp. v. Rep. of Peru, ICSID Case No. ARB/14/2, Respondent's Rejoinder on the Merits and Reply on Jurisdiction, ¶¶ 179–92 (April 13, 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7266.pdf (presenting differing views on whether protests against foreign mining in the Puno region of Peru related to the proposed development of Claimant's mine in particular); Burlington Resources, Inc. v. Rep. of Ecuador, ICSID Case No. ARB/08/5, Decision on Jurisdiction, ¶¶ 26–35 (June 2, 2010), http://www.italaw.com/documents/BurlingtonResourcesInc_v_Ecuador_Jurisdiction_Eng.pdf (describing violent indigenous opposition to the local exploitation of oil by concessionary companies).

4. *See, e.g.*, Copper Mesa Mining Corp. v. Rep. of Ecuador, UNCITRAL, PCA Case No. 2012-2, Award, (Perm. Ct. Arb. 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7443.pdf; Aguas del Tunari, S.A. v. Rep. of Bol., ICSID Case No. ARB/02/3, Decision on Respondent's Objection to Jurisdiction, ¶ 73 (Oct. 21, 2005), http://www.iisd.org/pdf/2005/adt_decision-en.pdf (involving municipal protests against water privatization in which a protestor was killed by Bolivian authorities); William Finnegan, *Leasing the Rain*, THE NEW YORKER, Apr. 8, 2002 (describing the background of the *Aguas del Tunari* case).

5. *See generally* Int'l Law Comm'n, Rep. on Draft Articles on the Responsibility of States for Internationally Wrongful Acts, U.N. Doc. A/56/10 (2001); *see also* MTD Equity Sdn. Bdh. v. Rep. of Chile, ICSID Case No. ARB/01/7, Award, ¶ 164, (May 25, 2004), http://www.italaw.com/sites/default/files/case-documents/ita0544.pdf ("[T]he coherent action of the various of-

weight of these awards, investment tribunals' expectations of intra-governmental consistency still put pressure on local decision-making.[6] But for the same reasons that national governments may value giving power to local authorities, including enhancing participatory democracy and improving governmental responsiveness, investor-State tribunals may be ill-advised to demand complete intra-national consistency.

This Note argues that investment treaty jurisprudence should amend its interpretation of the "fair and equitable treatment" standard to allow for intra-governmental disagreement. Investors should be required to consult with different jurisdictions interested in their investment, rather than relying on officials at one level of government for assurances about the overarching legal framework, in order to form protected expectations about what a given government will do. In part, such a standard would incentivize investors to engage with communities and generate buy-in where they are proposing to develop projects. Yet current requirements of consistency and transparency which tribunals have read into investment treaties' obligations of fair and equitable treatment make it difficult for nations with different and sometimes divergent internal authorities to comply. This is true even though commitments to the importance of subsidiarity and federalism in governance are both longstanding and consistent with current insights.[7] Local governance is an important component of

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ficials through which Chile acts is the responsibility of Chile, not of the investor.").

6. For instance, Vicki Been's descriptions of the pressures that *Metalclad* implies for U.S. delegation of land use regulation is accurate, even if there has been little follow-up attention to actually shifting loci of land-use decision-making. Vicki Been, *NAFTA's Investment Protections and the Divisions of Authority for Land Use and Environmental Controls*, 20 PACE ENVTL. L. REV. 19, 48–61 (2002) (describing potential federal responses to the risk of liability from local decision-making under NAFTA).

7. *See, e.g.*, George A. Berrman, *Taking Subsidiarity Seriously: Federalism in the European Community and the United States*, 94 COLUM. L. REV. 331 (1994); Steven G. Calabresi & Lucy D. Bickford, *Federalism and Subsidiarity: Perspectives from U.S. Constitutional Law* (Nw. Law & Econ. Research, Paper No. 12, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1902971; ROBERT COOTER, THE STRATEGIC CONSTITUTION (2000); *see also* Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1059 (1980) (arguing that liberalism informed a historical effort to strip cities of legal power and status and noting the tensions between this history and the ideal of democratic self-governance). Throughout this paper, the term local government is used

good governance, and uniformity is not uniformly good. Tribunals can and should recognize and accommodate these realities.

This contribution differs in focus from previous literature on federalism and investor-State dispute settlement, which addresses the mismatch created by forcing central governments to pay awards based on the misconduct of their states or provinces.[8] Rather than addressing mismatched liability, it deals with the normative context against which underlying policy mismatches are defensible.

Part II of this Note will demonstrate that aspects of international investment law do not accommodate the desirable inconsistencies that often accompany the divisions of authority in federal governments. Part III will draw on political science and economics-of-federalism literature to demonstrate why delegating certain types of decisions to different levels of government, and allowing space for some competition between different governments about the scope of their jurisdiction, can help maintain a healthy State. Part IV will investigate how investment treaty jurisprudence should digest these insights. It will survey arguments in favor of the status quo and describe possibilities for reform. Ultimately, this Note will argue that national governments are better placed to determine appropriate internal divisions of power than international tribunals. Therefore, the best way to incorporate insights from economics and political science is for tribunals to simply respect existing internal subdivisions and allow some room for internal flexibility and competition. In practical terms, this will limit

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broadly to encompass subnational authorities, including cities, provinces, and lower-case "s" states. However, there is significant divergence in the literature about the appropriate respective functions of cities and provinces. *See, e.g.*, Frug, *supra* note 7. This paper will trace these distinctions where they have implications for its argument. However, there are many reasons to delegate authority to subnational entities that apply generally, and these, by and large, support the jurisprudential changes this paper advocates. Similarly, terms such as localism, federalism, and subsidiarity are used interchangeably to refer generally to States with partially autonomous subnational governments. Though political economists are increasingly cognizant of the importance of different institutional designs to the effectiveness of decentralized States, for my purposes all of these terms point in the same direction.

8. For the most recent contribution to this literature, see Timothy Meyer, *Local Liability*, 95 N.C.L. Rev. (forthcoming 2017), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2801113.

the ability of governments to make commitments that can create "legitimate expectations" concerning the conduct of other governments within a State, and place responsibility on investors to identify and assess the views of relevant decision-makers. While this will place greater initial burdens on investors, it will also encourage them to lay the groundwork for a sustainable project by engaging in earnest with both local communities and larger-scale authorities. The expectation that an investor know the law of the host State is widely recognized.[9] But the law is more than a set of rules on paper. It is a structure, and allowing investors to ignore it by ignoring the views of jurisdictions implicated in their projects can put that structure at risk.

II. Good Governance and Fair and Equitable Treatment in Investor-State Arbitration

Investor-State dispute settlement is provided for in thousands of bilateral and multilateral investment treaties.[10] Generally, these investment treaties require that signatory States treat each other's investors at least as well as they treat their own investors and investors from third States.[11] Signatories agree not to expropriate the investments of other signatories' investors unless pursuing a public purpose, on a non-discriminatory basis, subject to due process of law, and on pay-

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9. *See, e.g.*, Saluka Investments B.V. v. Czech, UNCITRAL, Partial Award, ¶ 301 (March 17, 2006), http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf ("An investor's decision to invest is based on an assessment of the state of the law and the totality of the business environment at the time of the investment."); *MTD Equity Sdn. Bdh*, ICSID Case No. ARB/01/7, Award, ¶ 164 ("[It is the responsibility of the investor to assure itself that it is properly advised, particularly when investing abroad in an unfamiliar environment.").

10. UNCTAD's Investment Policy Hub shows more than 2,000 bilateral investment treaties currently in force, and hundreds more agreements providing for investment arbitration, though other estimates place the number of agreements in force much higher. U.N. Conference on Trade and Development, *International Investment Agreements Navigator*, http://investmentpolicyhub.unctad.org/IIA (last visited Oct. 22, 2016). For a general overview of international investment law, see Rudolf Dolzer & Christoph Schreuer, Principles of International Investment Law (2d ed. 2012).

11. *See, e.g.*, U.S. Dep't of State & U.S. Trade Rep., U.S. Model Bilateral Investment Treaty art. 3–6 (2012) [hereinafter 2012 U.S. Model BIT].

ment of prompt, adequate, and effective compensation.[12] Expropriation may be direct or indirect, although the scope of the indirect expropriation is subject to significant uncertainty. Recent case law seems to cabin its reach.[13]

Subject to varying threshold requirements such as a "cooling-off" period or a requirement to litigate in domestic courts for 18 months, these treaties often give investors the right to bring claims of treaty violations against host States directly, with three arbitrators being appointed and proceedings following rules provided by the International Center for the Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL), treaty-based institutions for administering investor-State arbitration.[14]

This system is best seen as a tool of global governance.[15] In order to improve economic relations between treaty signa-

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12. *Id.* art. 6.

13. *See* Krzysztof Pelc, *Does the International Investment Regime Induce Frivolous Litigation?* (May 10, 2016) (unpublished article), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2778056 (observing the increasing use and decreasing success rates of indirect expropriation claims); DOLZER & SCHREUER, *supra* note 10, at 101 ("The contours of the definition of an indirect expropriation are not precisely drawn. An increasing number of arbitral cases and a growing body of literature on the subject have shed some light on the issue but the debate goes on. In some recent decisions by [ICSID], tribunals have interpreted the concept . . . narrowly.").

14. The appointees tend to be a familiar cast of characters, often including attorneys who represent litigants in other parties, and far too often consisting of a disproportionate number of white men. *See* Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45, 54 (2013); *The Pledge*, EQUAL REPRESENTATION IN ARBITRATION, http://www.arbitrationpledge.com/ (last updated Jan. 9, 2017) (encouraging arbitration firms and lawyers to pledge to work towards equal representation of women as arbitrators).

15. *See* Benedict Kingsbury & Stephan Schill, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law*, (N.Y. Univ. Sch. of Law, Pub. Law & Legal Theory Research Paper Series, Paper No. 09-46, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1466980; *see also* Gus Van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L. 121 (2006); Daphne Barak-Erez & Oren Perez, *Whose Administrative Law is it Anyway? How Global Norms Reshape the Administrative State*, 46 CORNELL INT'L L.J. 455, 471 (2013); Thomas Kleinlein, *Judicial Lawmaking by Judicial Restraint? The Potential of Balancing in International Economic Law*, 12 GERMAN L.J. 1141 (2011) (assessing proportionality as a tool for harmoniz-

tories, it allows international lawyers to develop doctrines of due process and property rights through a jurisprudence evolving towards universal standards of protection for investors.[16] Often, tribunals review domestic laws before the courts of respondent States do. Their judgment as to whether domestic laws and obligations comply with international law are often functionally unreviewable.[17] Investor-State arbitration continues to develop its own doctrines of necessity, indirect expropriation, and fair and equitable treatment, with rationales converging, sometimes on multiple standards, but almost always in dialogue with previous arbitral decisions.[18]

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ing investment tribunals' approaches to reviewing the scope of national regulatory approaches). *But see* José E. Alvarez, *Is Investor-State Arbitration Public?* (Inst. Int'l Law & Justice, Working Paper No. 2016/6, 2016), http://www.iilj.org/publications/is-investor-state-arbitration-public (arguing that the regime imports private law considerations beyond procedural components and should properly be viewed as a public-private hybrid regime). *See generally* Roberts, *supra* note 14 (discussing the various analogies to commercial arbitration, international trade law, and other fields informing investment treaty arbitration and influencing competing conceptualizations of its character).

16. Barak-Erez & Perez, *supra* note 15 (addressing the nascent "international due process" evolving in investment tribunals). *See also* Julian Arato, *The Margin of Appreciation in International Investment Law*, 54 VA. J. INT'L L. 545, 553 (arguing that a better response to inconsistent interpretation of BIT standards by tribunals is the development of a consistent jurisprudence through dialogue over the medium term); 2012 U.S. Model BIT, *supra* note 11, pmbl. ("Recognizing that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties; Agreeing that a stable framework for investment will maximize effective utilization of economic resources and improve living standards").

17. *See* International Centre for the Settlement of Investment Disputes Convention art. 52(2), March 18, 1965, 17 U.S.T. 1270, T.I.A.S. 6090, 575 U.N.T.S 159 (setting out grounds for annulment of an award).

18. Arato, *supra* note 16; Brian King & Rahim Moloo, *International Arbitrators as Lawmakers*, 46 N.Y.U. J. INT'L L. & POL. 875, 883 (2014) ("[T]here is growing evidence that arbitral tribunals do indeed feel influenced by prior decisions."); STEPHAN SCHILL, THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW 278 (2009) ("Unlike their bilateral form suggests, arbitral tribunals do not predominantly interpret and construe BITs according to methods characteristic of the interpretation of bilateral treaties that contain quid pro quo bargains, but employ rationales and argumentative structures that suggest the existence of an overarching body of international investment law that has merely found its expression in bilateral treaty relationships."); Patrick M. Norton, *The Use of Precedents in Investment Treaty Arbitration Awards*, 25 AM. REV. INT'L ARB. 167 (2014).

The standards these tribunals have developed emerged from vague treaty language, interpreted in light of treaties' purposes of promoting economic cooperation and providing stable legal frameworks for investors.[19] The logic of this hortatory preambular language suggests that the treaties intend for tribunals to have a role in developing standards of good governance.[20] The idea of a stable legal framework implies that tribunals will take a view on the permissibility of different executive or administrative decisions, judicial interventions, or legislative changes. The increasing use of precedent implies an attempt to develop consensus about the range of appropriate governmental action, and, presumably, to encourage sustainable regulatory processes. Against an interpretive background of public international law and a procedural background drawn from private commercial arbitration, tribunals are essentially providing public law review. Tribunals largely use this role to promote transparent, inclusive, and deliberative procedures, and consistent regulatory frameworks.[21]

One particularly thorny treaty right for federal States is the investor's right to "fair and equitable treatment" (FET).

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19. *See* 2012 U.S. Model BIT, *supra* note 11, pmbl.; MTD Equity Sdn. Bdh. v. Rep. of Chile, ICSID Case No. ARB/01/7, Award, ¶ 113, (May 25, 2004), http://www.italaw.com/sites/default/files/case-documents/ita0544.pdf (noting that interpreting "fair and equitable treatment" in light of the Chile-Malaysia BIT's preamble meant interpreting it as requiring treatment "conducive to fostering the promotion of foreign investment."); Saluka Investments B.V. v. Czech, UNCITRAL, Partial Award, ¶ 299 (March 17, 2006), http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf.

20. This has become clearer as recent treaties have developed more State-protective language; thus the 2004 Canada Model BIT refers in its preamble to a desire to stimulate "mutually beneficial business activity," but also "sustainable development," and includes a "General Exceptions" article referring to the need to balance investment protection against other regulatory goals. Yet even the more investment-protective 1994 US-Argentina BIT refers in its preamble to goals including "developing agreement on the treatment of investors," suggesting a governance-oriented framework for even first-generation investment treaties. Treaty Between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, Arg.–U.S., pmbl., November 14, 1991, 31 I.L.M. 124 (1992) [hereinafter U.S.-Argentina BIT].

21. Kingsbury & Schill, *supra* note 15, at 2 ("[T]ribunals implement broadly phrased international standards . . . so that they increasingly define for the majority of States of the world standards of good governance and of the rule of law that are enforceable against them by foreign investors.").

Often seen as a catch-all, this right "came into fashion" as a basis for claiming a treaty breach when investment tribunals began to narrow the standard for what qualified as an indirect expropriation.[22] Although FET only recently became a meaningful, enforceable standard, FET violations have been the most successful grounds for investor challenges to host State actions to date.[23] This is in part due to the standard's function as a gap-filler in treaties.[24]

Definitions of FET vary from treaty to treaty. For instance, the 1994 U.S.-Argentina Bilateral Investment Treaty provides that "investment shall at all times be accorded fair and equitable treatment . . . *and* shall in no case be accorded treatment less than that required by international law."[25] However, the investment chapter of the 2007 Korea-U.S. Free Trade Agreement provides that "each Party shall accord to covered investments treatment in accordance with customary international law, *including* fair and equitable treatment and full protection and security."[26] This difference in language implies different views about the relationship between the FET obligation and the minimum standard of treatment (MST) required under customary international law. The fact that the language in both these treaties tracks the language of the then-current U.S. Model BIT, with the Argentine agreement tracking the 1987 Model BIT and the Korea investment chapter tracking the revised 2004 Model BIT, could imply that the United States' view of the meaning of the FET obligation has changed, or at least that at present the United States often views it as coterminous with the international minimum stan-

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22. *See* Lucy Reed & Daina Bray, *Fair and Equitable Treatment: Fairly and Equitably Applied in Lieu of Unlawful Indirect Expropriation?*, *in* CONTEMPORARY ISSUES IN ARBITRATION AND MEDIATION 13, 25 (Arthur W. Rovine ed., 2007) (quoting Mark Friedman, *International Arbitration*, 41 INT'L LAW 251, 280–81 (2007)) (noting that FET claims seemed to become more prominent in response to a series of failed indirect expropriation claims, noting that "expropriation is out of fashion.").

23. DOLZER & SCHREUER, *supra* note 10, at 130.

24. *Id.* at 132.

25. U.S.-Argentina BIT, *supra* note 20, art. 2(a) (emphasis added).

26. Free Trade Agreement Between the Republic of Korea and the United States of America, Kor.–U.S., art. 11.5 §1, Jun. 30, 2007, *modified*, Dec. 5, 2010, https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text (emphasis added).

dard of treatment.[27] Yet, the Argentina-U.S. BIT is still in force.

Furthermore, the FET doctrine's relation to the minimum standard of treatment sheds little light on either obligation's actual content, in part because the minimum standard of treatment itself is subject to its own vagaries.[28] In a 1926 case before the U.S.-Mexico Claims Tribunal, MST was defined as prohibiting conduct amounting to "an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."[29] Yet subsequent tribunals have noted both that the customary minimum standard may have evolved since 1926, and that the international community's understanding of what constitutes "an outrage" may have as well.[30]

Further complicating these questions is the International Court of Justice's 1989 interpretation of the term "arbitrary measures" to mean measures which shock, or at least surprise, a sense of judicial propriety.[31] This standard is broader stan-

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27. *See* José E. Alvarez, *Is the Trans-Pacific Partnership's Investment Chapter the New 'Gold Standard'?* 16–25 (Inst. for Int'l Law & Justice, Working Paper No. 2016/3, 2016) (describing the U.S. role in expanding and then contracting the provisions of FET clauses in investment treaties); Clayton v. Gov. of Can., NAFTA/UNCITRAL, Submission of the United States of America ¶ 4, (April 19, 2013), http://www.italaw.com/sites/default/files/case-documents/italaw1430_0.pdf (emphasizing that FET in the NAFTA context refers only to the MST though acknowledging that it may provide an autonomous standard in other treaty contexts).

28. *See* Meg Kinnear, *The Continuing Development of the Fair and Equitable Treatment Standard*, *in* Remedies in International Investment Law 1 (Andrea K. Bjorklund et al. eds., 2009) ("[N]otwithstanding its frequent invocation . . . the FET standard continues to defy precise definition.").

29. Neer v. Mex., 4 R.I.A.A. 60, 61–62 (U.S.–Mex. Claims Comm'n, 1926).

30. *See, e.g.*, Merrill & Ring Forestry, L.P. v. Gov. of Can., NAFTA/UNCITRAL, Award, ¶ 213 (Mar. 31, 2010), http://www.italaw.com/sites/default/files/case-documents/ita0504.pdf (finding that the international minimum standard has evolved since *Neer*); Glamis Gold, Ltd. v. U.S., NAFTA/UNCITRAL, Award, ¶¶ 612–13 (June 8, 2009), http://www.italaw.com/sites/default/files/case-documents/ita0378.pdf (agreeing that what is now seen as "outrageous" may cover more conduct than would have been covered in 1926).

31. Elettronica Sicula S.p.A.(ELSI), U.S. v. It., Judgment, 1989 I.C.J. 15, ¶ 128 (1989). The phrase "arbitrary measures" was a protection granted by a U.S.-Italy Friendship, Commerce and Navigation (FCN) Treaty. FCN treaties

dard than the 1926 MST standard but narrower than the FET definition provided by most investment tribunals, and its relation to both standards is unclear.

The evolution of both the FET and MST standards speak to the complex interplay between States, investors, and international courts. It is exceedingly difficult to give stable and predictable meanings to the very legal standards which demand that States provide stable and predictable legal frameworks. There are too many moving parts, too many contesting interests, and too many broad formulations that, interpreting already broad treaty language, fail to provide a clearer sense of the concrete scope of its application. Those clear trends that have emerged from arbitral jurisprudence should be seen against this backdrop of systemic uncertainty, and the corresponding scope for interpretive flexibility.

The facts of cases where investors have prevailed on FET claims provides more clarity about what circumstances might breach the obligation. Among the specific obligations that the FET standard has been read to encompass, three relatively consistent requirements are transparency of the host State's proceedings, transparency of the legal framework governing the investment, and consistency of representations.[32]

One of the clearer formulations of FET is found in *Tecmed v. Mexico*. In that case, the tribunal wrote that:

> [T]he foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.[33]

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operate in many cases as precursors to contemporary BITs. Of further interest in this ruling is the fact that the ICJ reached this formulation in rejecting a claim of treaty breach related to the temporary occupation of a factory. The ICJ additionally clarified that measures illegal under municipal law are not automatically egregious enough to qualify as "arbitrary" under international law. *Id.* ¶¶ 129–30.

32. *See generally* DOLZER & SCHREUER, *supra* note 10, ch. VII.

33. Tecnicas Medioambientales Tecmed, S.A. v. United Mex. States, ICSID Case No. ARB(AF)/00/2, Award, ¶ 154 (May 29, 2003), http://www.italaw.com/documents/Tecnicas_001.pdf.

Such a requirement is almost impossibly rigorous. While elements of it remain relevant to tribunals' interpretations of the FET obligation, many adhere more closely to the line sketched in *Saluka v. Czech Republic*, where the tribunal noted that investors cannot reasonably expect a total freeze on regulations, and that "the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well."[34]

Related to and in part deriving from *Tecmed* is the notion of an investor's "legitimate expectations."[35] Claims based on legitimate expectations resemble a common-law "promissory estoppel" claim—tribunals often look for a representation made to an investor that it was reasonable to rely upon, and that the investor did rely upon in making an investment.[36] While tribunals diverge on whether a representation giving rise to legitimate expectations must be specific or whether a generally applicable regulation may suffice,[37] many are permissive about what constitutes a specific representation.

Particularly relevant is *SPP v. Egypt*, where a tribunal found that a presidential decree made without any legal au-

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34. Saluka Investments B.V. v. Czech, UNCITRAL, Partial Award, ¶ 305 (March 17, 2006), http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf. *See also* CMS Gas Transmission Co. v. Rep. of Arg., ICSID Case No. ARB/01/8, Award, ¶ 277 (May 12, 2005), http://www.italaw.com/sites/default/files/case-documents/ita0184.pdf (noting that regulations can change, but that a wholesale alteration of the framework under which an investment was made is unlikely to be compliant with treaty obligations); Parkerings-Compagniet AS v. Rep. of Lith., ICSID Case No. ARB/05/8, Award, ¶¶ 332, 337 (Sept. 11, 2007), http://www.italaw.com/sites/default/files/case-documents/ita0619.pdf ("Any businessman or investor knows that laws will evolve over time. What is prohibited however is for a state to act unfairly, unreasonably or inequitably in the exercise of its legislative power.").

35. *See Tecnicas Medioambientales Tecmed, S.A.*, ICSID Case No. ARB(AF)/00/2, Award, ¶ 157 (referring to the "fair expectations" of the Claimant at the time their investment was made).

36. *See, e.g.*, OKO Pankkii Ojy v. Rep. of Est., ICSID Case No. ARB/04/6, Award, ¶ 248 (Nov. 19, 2007), http://www.italaw.com/sites/default/files/case-documents/ita0583.pdf. *See generally* DOLZER & SCHREUER, *supra* note 10, at 145.

37. *Compare* Lemire v. Ukr., ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, ¶ 284 (Jan. 24, 2010), http://www.italaw.com/sites/default/files/case-documents/ita0454.pdf (requiring a specific representation), *with CMS Gas Transmission Co.*, ICSID Case No. ARB/01/8, Award, ¶¶ 274–76 (finding reliance on a regulatory framework).

thority was nevertheless "cloaked with the mantle of Government authority" and so "created expectations protected by established principles of international law."[38] Though some tribunals have found that political statements cannot give rise to legitimate expectations,[39] many continue to follow *SPP* in giving primacy to the conduct of government officials. This seems to be the case regardless of the legal background against which these representations are made.[40] For instance, in *OKO Pankki Oyj v. Estonia*, the Tribunal referred to a letter from the government stating their intention to repay a bank loan that a State-owned entity had defaulted on.[41] The Tribunal determined that while the letter "was not a guarantee, nor an indemnity, nor a near-guarantee, nor indeed of any contractual significance," it nevertheless "constituted an unequivocal representation by the Respondent to the Banks."[42]

In theory, requiring a specific representation from a government to an investor as a predicate for finding a breach of the investor's "legitimate expectations" may seem more even-handed than subjecting any regulatory change to some sort of fairness review. It gives a State greater notice about what obligations it is under, and what changes it can make to its legal framework consistent with its treaty obligations. However, in practice, the breadth of what may constitute a specific representation extends beyond what, say, contract law provides for, and beyond a presumption that the law of the host State will

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38. Southern Pacific Properties Ltd. v. Arab Rep. of Egypt, ICSID Case No. ARB/84/3, Award, ¶ 82 (May 20, 1992), 32 I.L.M. 933 (1993).

39. Continental Casualty Co. v. Argentine Republic, ICSID Case No. ARB/03/9, Award ¶ 261 (Sept. 5, 2008); El Paso Energy Int'l Co. v. Argentine Republic, ICSID Case No. ARB/03/15, Award, ¶ 378 (Oct. 31, 2011), http://www.italaw.com/sites/default/files/case-documents/ita0228.pdf.

40. Clayton v. Gov. of Can., Case No. 2009-04, Dissenting Opinion of Professor Donald McRae, ¶ 5 (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4213.pdf (disagreeing with the majority and suggesting that "[a]ssurances and encouragement by provincial officials have nothing to do with the expectation that an investor will have Canadian law applied properly to it"). *See also Lemire*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, ¶ 284 (looking, inter alia, to whether a State has made specific representations to an investor, and whether any actions of the State can be labeled inconsistent to identify relevant expectations).

41. *OKO Pankki Oyj*, ICSID Case No. ARB/04/6, Award.

42. *Id.* ¶¶ 262–63.

be followed.[43] Puffery, salesmanship, insufficient coordination across different governments within a State, or good faith errors about the scope of legal authority might be actionable under the standard as applied.[44]

This standard creates particular headaches for States with multiple governments with distinct powers. It complicates the contestation of jurisdiction inherent in federal States by promulgating a broad standard for protecting reliance interests. Nearly half of NAFTA cases have been challenges to actions by local, not national governments.[45] Many of these cases involve claims of breach of the FET obligation, and many have been instrumental in defining and extending the scope of what constitutes an investor's "legitimate expectations."[46]

Metalclad v. Mexico, *Bilcon v. Canada* and *Copper Mesa v. Ecuador* all provide examples of how different signals from different levels of government can risk exposing a State to liability under international investment law.

A. Metalclad

Metalclad involved an American company's purchase of hazardous waste landfill operator COTERIN, which intended to construct a facility near the town of Guadalcazar in the state of San Luis Potosí and had already obtained a necessary federal permit.[47] In 1993, shortly after Metalclad acquired an option to purchase COTERIN, the company also obtained a per-

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43. On the potential insights of contract law theory to international investment law, see generally Alan O. Sykes, *Economic Necessity in International Law*, 109 AM. J. INT'L L. 296; Julian Arato, *The Logic of Contract in the World of Investment Treaties*, 58 WM. & MARY L. REV. (forthcoming 2016).

44. *See Metalclad* discussion *infra* Section II.A; *cf.* Tecnicas Medioambientales Tecmed, S.A. v. United Mex. States, ICSID Case No. ARB(AF)/00/2, Award, ¶ 154 (May 29, 2003), http://www.italaw.com/documents/Tecnicas_001.pdf.

45. Meyer, *supra* note 8.

46. Clayton v. Gov. of Can., NAFTA/UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4212.pdf; Metalclad Corp. v. United Mex. States, ICSID Case No. ARB(AF)/97/1, Award, (Aug. 30, 2000), 16 ICSID Rev. 165 (2001); Copper Mesa Mining Corp. v. Rep. of Ecuador, UNCITRAL, PCA Case No. 2012-2, Award, (Perm. Ct. Arb. 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7443.pdf.

47. *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1, Award.

mit from San Luis Potosí, subject to the condition that the project conform to the requirements of other implicated authorities.[48]

At this point, Metalclad was informed by officials from a federal agency that it had obtained all the necessary permits, except for a single federal one.[49] Metalclad was allegedly also told that the federal government would "obtain project support" from the state and local government.[50] Metalclad went ahead with the purchase. Though Metalclad alleges it had obtained the prior support of the governor of San Luis Potosí, he began to campaign against the project.[51] Before the Tribunal, Mexico denied the governor had ever supported the project.[52]

Construction began in May 1994, but the municipality of Guadalcazar ordered the company to cease activities that October, on the grounds that it had not obtained a municipal construction permit.[53] Nevertheless, federal officials continued to tell Metalclad that it had already obtained all of the necessary permits.[54]

This back-and-forth continued, with the federal government continuing to renew Metalclad's federal permits, and the state and municipal government continuing to oppose the continued construction and operation of the landfill.[55] Metalclad ultimately applied for a municipal construction permit, continuing its work in the meantime, and its application was denied.[56] Finally, the Governor issued an ecological decree protecting the area in which the landfill was to be operated, which was purportedly the habitat of a rare desert cactus.[57] The parties disputed whether Metalclad had known that municipal permits might be required.[58]

The Tribunal found a breach of NAFTA's FET obligation. In part this was on the grounds that Mexico failed to establish

48. *Id.* ¶ 31.
49. *Id.* ¶ 33.
50. *Id.* ¶¶ 33, 34.
51. *Id.* ¶¶ 32, 37.
52. *Id.* ¶ 32.
53. *Id.* ¶ 40.
54. *Id.* ¶¶ 38, 40–41.
55. *Id.* ¶¶ 48, 50.
56. *Id.* ¶¶ 45, 50.
57. *Id.* ¶ 59.
58. *Id.* ¶ 53.

"transparency."[59] The Tribunal interpreted transparency to require that "all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors . . . . There should be no room for doubt or uncertainty on such matters."[60]

The Tribunal also determined that because Mexican law vests the federal government with authority over decisions concerning the regulation of hazardous waste, the municipality exceeded its powers in considering environmental factors when deciding whether to grant a construction permit.[61]

Perhaps most critical for present purposes was the Tribunal's determination that "Metalclad was entitled to rely on the representations of federal officials."[62] This determination arose in part from the Tribunal's finding that there was no transparency—in the absence of certainty about the scope of state and municipal powers, the representations of individuals within the federal government were deemed controlling.[63]

What makes this determination so interesting is that the municipality used creative legal practices to assert a voice for itself. In addition to requiring that Metalclad obtain a construction permit, it also sought to challenge some of the company's federal permits through federal administrative agencies and Mexican courts.[64] Though the investment tribunal arrived at its own interpretations of Mexican law, there was clearly gray area concerning the scope of municipal authority.[65] Guadal-

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59. *Id.* ¶ 99.

60. *Id.* ¶ 76. Although Canadian courts found that the tribunal exceeded its jurisdiction in reading a transparency requirement into the FET obligation, subsequent tribunals have followed suit and *Metalclad* generally remains good law among arbitrators. Mex. v. Metalclad, (2001) 89 B.C.L.R. 3d 359, ¶ 68 (Can. B.C. Sup. Ct.); *see, e.g.*, Micula v. Rom., ICSID Case No. ARB/05/20, Award, ¶ 533 (Dec. 11, 2013), http://www.italaw.com/sites/default/files/case-documents/italaw3036.pdf (expressing agreement with the *Metalclad* tribunal's reasoning).

61. *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1, Award, ¶ 86.

62. *Id.* ¶ 89.

63. *Id.* ¶¶ 89, 99.

64. *Id.* ¶ 94–95.

65. *Id.* ("The Tribunal infers from this that the Municipality lacked confidence in its right to deny permission for the landfill solely on the basis of the absence of a municipal construction permit.").

cazar, faced with an unwanted hazardous waste landfill, sought to exert all available legal authority.

Reacting flexibly to urgent challenges and attempting to expand regulatory reach are regular habits of government. While they may not be desirable tendencies in every instance, they are also not inherently unfair. Yet in *Metalclad*, where there was ambiguity concerning the relative balance of authority, the Tribunal determined that the affirmations of officials within one of the governments competing for power in Mexico's federal system settled the question.

There was significant waste in this case and it is not obvious that the Tribunal reached the wrong result. But the implications of its findings regarding the content of Mexican law, the impermissibility of ambiguity in the scope of municipal authority, and the overriding significance of representations by federal officials, all display insensitivity to issues of federalism and the possible need for flexibility. Mexican law, by contrast, may have already incorporated these concerns. It may be significant that when Guadalcazar brought its case to Mexican courts, it successfully obtained a temporary injunction on construction of the landfill.[66]

The *Metalclad* award was issued in August 2000, but by July 2001 the NAFTA parties had issued a joint Interpretive Statement equating the FET standard with the customary international minimum standard of treatment.[67] Yet *Metalclad* remains widely cited.[68] And recently a NAFTA tribunal's decision in *Bilcon v. Canda* has indicated that this FTC interpretation may not have obviated all federalism concerns.

B. Bilcon

Bilcon complicates the conventional pattern of a federal government inducing investments that local actors oppose.[69] At its core, the *Bilcon* award is less concerned with the different

66. *Id.* ¶ 95.

67. NAFTA Free Trade Comm'n, Notice of Interpretation of Certain Chapter 11 Provisions (2001), http://www.state.gov/documents/organization/38790.pdf.

68. *See, e.g.*, sources cited *supra* note 64.

69. Clayton v. Gov. of Can., NAFTA/UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4212.pdf.

positions of federal and provincial governments vis-à-vis a proposed quarry than it is with an administrative review panel's use of arbitrary standards in assessing the investor's permit application.[70] Yet although these were sufficient grounds for the Tribunal to find liability, it went out of its way to address the significance of Nova Scotian encouragement of the project in context of the investor's legitimate expectations.[71]

In this case, provincial authorities had published literature indicating provincial support for mineral exploitation in Nova Scotia, and encouraged a foreign investor to pursue quarrying operations on the province's coast when the federal Department of Fisheries and Oceans (DFO) intervened.[72] Federal authorities determined that because the proposed quarry site could potentially affect fisheries in navigable waters, and because it was geographically associated with a project for harbor construction, federal regulations were implicated in oversight of the proposal.[73] As the DFO's role grew, the investor alleged that Canadian officials misled them about the scope of the review to which their proposal would be subject. The investor further alleged that the DFO exceeded its authority in intervening in the first place, doing so only because the minister heading the department represented the electoral district where the quarry would be constructed.[74] Ultimately, provincial and federal officials agreed to subject the project to an exceptional and exhaustive Joint Review Panel (JRP).[75]

Following open hearings by the joint federal-provincial review panel, where community members expressed intense opposition to the project, the panel determined that the proposed quarry was incompatible with "core community values"

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70. *Cf. id.* ¶¶ 534, 601.

71. For sharp criticism of this approach, see Clayton v. Gov. of Can., Case No. 2009-04, Dissenting Opinion of Professor Donald McRae (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4213.pdf.

72. *Clayton*, NAFTA/UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability, ¶¶ 122–26 (describing the increasing role of the Department of Fisheries & Oceans in the permitting process); *id.* ¶¶ 132, 455–66 (describing alleged support by Nova Scotia official for the project).

73. *Id.* ¶¶ 152, 154–55.

74. *Id.* ¶¶ 159–60, 165, 169.

75. *Id.* ¶ 157.

and recommended that Nova Scotian and federal officials reject it.[76]

The investment tribunal determined that, though the panel had authority to assess the project's likely effect on the "human environment," it gave the investors no notice that it would consider "core community values," and no opportunity to revise their proposals.[77] Its finding of a breach of NAFTA's FET obligation depended heavily on this deviation.[78]

While the tribunal's decision for the investors emphasized that the JRP had exceeded its powers, it also noted that "the reasonable expectations of the investor are a factor to be taken into account in assessing whether the host State breached the international minimum standard of fair treatment under Article 1105 of NAFTA."[79] In assessing those expectations, it found that:

> A series of encouragements by Nova Scotia in policy pronouncements and directly by elected officials and civil servants . . . created the expectation in the Investors, on which they could reasonably rely, that an environmental impact assessment of a coastal quarry and marine terminal project in the Whites Point area would be carried out fairly and impartially within the legislative framework provided by federal Canada and Nova Scotia . . . . Viewing the actions of Canada as a whole, it was unjust for officials to encourage coastal mining projects in general and specifically encourage the pursuit of the project at the Whites Point site, and then, after a massive expenditure of effort and resources by Bilcon on that basis, have other officials effectively determine that the area was a "no go" zone for this kind of development . . . . Canada is one entity for the purposes of NAFTA responsibility. There is a saying that sometimes "the left hand does not know what the right hand is doing." For the purposes of State responsibility the combined impact of its left hand and right hand can be determinative

76. *Id.* ¶ 20.
77. *Id.* ¶¶ 534–35.
78. *Id.* ¶ 601.
79. *Id.* ¶ 455.

> even if the actions of either in isolation do not rise to the level of a breach.[80]

While the Tribunal emphasized that the different Canadian governments were communicating with each other and could have coordinated, it did not find that the possibility of such coordination was a prerequisite for finding that Canada had frustrated the investors' expectations.[81] Furthermore, the Tribunal's reasoning seems to imply that the extensive environmental inquiry required by a JRP was no longer compatible with Canada's FET obligations once Nova Scotian officials had expressed support.[82]

While the JRP process was admittedly highly unusual, and while the decision ultimately turned on other factors, the Tribunal's reasoning nevertheless suggests that the values of federalism and contesting jurisdictions are still viewed as subordinate to international investment law's requirements of transparency and consistency. The implication is that federalism itself will continue contributing to international liability where governments at different levels within a State maintain different views about foreign investment projects. Most recently, and most tragically, this tension again arose in an arbitration against Ecuador.

C. Copper Mesa

The arbitration in *Copper Mesa* arose out of a gold mining company's acquisition of a concession in the remote Junin area of Ecuador.[83] The region had almost no police presence.[84] It was governed by six local parish councils.[85]

Copper Mesa understood the magnitude of opposition to mining in the area when it acquired its concessions in 2002.[86] In 1997, anti-mining activists burned down the camp of a Japanese entity that had conducted local exploratory work.[87] The

80. *Id.* ¶¶ 470, 592–93. *See also id.* ¶ 589.
81. *Cf. id.* ¶ 592.
82. *Id.*
83. Copper Mesa Mining Corp. v. Rep. of Ecuador, UNCITRAL, PCA Case No. 2012-2, Award, (Perm. Ct. Arb. 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7443.pdf.
84. *Id.* ¶ 4.10.
85. *Id.* ¶ 4.11.
86. *Id.* ¶ 4.36.
87. *Id.* ¶ 4.33.

company left the region shortly thereafter due to local hostility.[88] Local governments banded together to demand a consultative role in any prospective mining development, and to declare Cotacachi, part of the Junin area, an "ecological canton."[89] As of 1998, the Ecuadorian Constitution mandated a role for local governments in decisions on matters that could affect their environment.[90] Copper Mesa's concessions in particular were governed by regulations which required that local communities be given a consultative role prior to any issuance of environmental permits by the central government.[91] Immediately upon Copper Mesa's acquisition of the concessions,[92] several local parishes sent the Ministry of Energy and Mines a letter expressing their irrevocable opposition to any mining in the area.[93] In sum, Copper Mesa acquired its concessions knowing that local communities and parishes both opposed local mining and had some authority to determine whether any mining activities would proceed.

While Copper Mesa benefitted from the support of the central government and from at least some community members and local parishes, many of the latter continued to express strong opposition to its efforts.[94] In the face of this opposition, Copper Mesa's escalating campaign for support led to increasingly violent altercations. Local, unsupervised agents of Copper Mesa held the anti-mining mayor of Cotacachi hostage.[95] Anti-mining activists began blocking company officials from accessing their concession.[96] As tensions steadily escalated between 2004 and 2007, the company hired armed security contractors to support their local operations.[97] Anti-mining activists also escalated their tactics: Copper Mesa found its own employees taken hostage.[98]

88. *Id.* ¶ 4.35.
89. *Id.* ¶¶ 4.30–4.31.
90. *Id.* ¶ 4.39.
91. *Id.* ¶¶ 4.55, 4.232.
92. *Copper Mesa* relied on an agent to acquire the concessions in 2002; ultimately its predecessor-in-interest took control in 2004. *Id.* ¶¶ 4.53, 4.64.
93. *Id.* ¶ 4.52.
94. *Id.* ¶¶ 4.93, 4.108, 4.115.
95. *Id.* ¶ 4.123.
96. *Id.* ¶ 4.131.
97. *Id.* ¶ 4.179.
98. *Id.* ¶ 4.209.

From at least 2006, Copper Mesa agents used violence and intimidation to both gain access and cow opposition to their projects. Documentary footage shows armed, uniformed men teargassing Junin locals at a roadblock.[99] The Tribunal itself, while observing that both pro- and anti-mining factions among local communities had resorted to violence, condemned Copper Mesa:

> [T]he reckless escalation of violence which [Copper Mesa] . . . introduced into the Junín area . . . particularly with the employment of organized armed men in uniform using tear gas canisters and firing weapons at local villagers and officials. It was miraculous that no-one had been killed during one or more of these violent incidents. Certain of the anti-miners were certainly not angels, as already noted; but Mr Pérez [a leader of a local parish council] . . . appears to have done his best to restrain his supporters during these incidents. That could not be said of AE. As a result, AE and Ascendant Copper had now acquired, irrevocably, a malign reputation for intimidation, threats, deception, mendacity and violence amongst members of the local communities in the Junín area. It was a place from which there could be no easy return.[100]

By July 2007, tensions were so pitched that the Ministry of Mines and Petroleum (successor to the Ministry of Energy and Mines) requested Copper Mesa to cease all activities in the Junin region.[101] By September this had crystallized into an order.[102] By January 2008, Copper Mesa's concessions were nullified, and by April, concessions of all Ecuadorian mining developers who had not submitted a current environmental application were nullified.[103]

Doctrinally, the *Copper Mesa* award is distinct from the cases surveyed above. The Tribunal found that Ecuador had failed to provide Copper Mesa fair and equitable treatment.[104]

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99. *Id.* ¶¶ 4.245, 4.251.
100. *Id.* ¶ 4.265.
101. *Id.* ¶ 4.293.
102. *Id.* ¶ 4.300.
103. *Id.* ¶¶ 4.307, 4.310.
104. *Id.* ¶ 6.85.

However, the trigger for this finding was not the inconsistency between Ecuador's support of the project and the Junin communities' opposition. Rather, the tribunal found that by blocking Copper Mesa from consulting communities in the Junin area, and then stripping concession rights from miners who had not submitted environmental permit applications, Ecuador had forced Copper Mesa into an impossible dilemma: it had blocked them from carrying out the very consultations they needed to conduct in order to retain their concession.[105]

In assessing whether FET (as well as "full protection and security" obligations) were breached, the tribunal asked:

> Should the Respondent have imposed its will on the anti-miners, acting with all the powers and forces available to a sovereign State, so as to ensure that the Claimant, as the concessionaire under concessions granted by the Respondent, could gain access to the Junín concessions in order to carry out the required consultations and other activities required for its EIS?[106]

The answer, it appears, was yes.

> [R]ather than giving legal force to the factual effect of the anti-miners' physical blockade of the Junín concessions, the Respondent should have attempted something to assist the Claimant in completing its consultations and other requirements for the EIS. It is of course difficult to say now what it should have done to resolve all the Claimant' difficulties and, still more so, whether what anything it could have done would have changed the Claimant's position for the better. Plainly, the Government in Quito could hardly have declared war on its own people. Yet, in the Tribunal's view, it could not do nothing.[107]

Doctrinally, the tribunal's view of FET is unremarkable, even innocuous: a host State cannot specifically block an investor from seeking to meet legal requirements necessary to implementing their project. Yet politically, its implications are much broader: a central government's duties to a foreign in-

105. *Id.* ¶ 6.84.
106. *Id.* ¶ 6.82.
107. *Id.* ¶ 6.83.

vestor extend, in this case, not only to ignoring local government opposition, but to actively seeking to override them. Against the factual context of this case, the Tribunal's views of the role of local government, the function of community consultation, and the nature of governance in general are remarkable.

The anti-miners, for the Tribunal, were simply not part of the State. They were an obstacle to the miners' efforts to obtain an environmental permit. Junin governments and governmental associations repeatedly undertook their own formal initiatives to reject mining.[108] For the Tribunal, local governments had no mantle of legitimacy. The respondent was simply the government in Quito, beholden to its obligations under the investment treaty, notwithstanding the role granted to local communities under the constitution and relevant mining regulations. Local governments, notwithstanding their clearly expressed views, had no official role to play.

Junin communities had a formal role in the central government's permitting process in approving proposed mining investments.[109] While the Tribunal did not analyze in detail the precise nature of this role in its various manifestations,[110] their reading of FET deprives it of all salience. Was the central government obliged to force these communities to keep listening to Copper Mesa's attempts at consultation until they acceded?[111] The Tribunal did not go so far as to say that the

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108. *See, e.g.*, *id.* ¶¶ 4.48, 4.111, 4.115.

109. *Cf. id.* ¶ 4.232.

110. For instance, various local governments apparently had legal rights to be consulted under the constitution, under general mining regulations, and under the terms of Copper Mesa's concessions in particular. Yet it is not clear from the Tribunal's analysis whether any of these amounted to veto rights, or whether there were any precise procedural referenda requirements. *See supra* notes 93, 94, and accompanying text.

111. The Tribunal had noted the regrettable fact that the blanket opposition to mining by local communities was based on "misinformation" that spread while Japanese entities surveyed the region. *Copper Mesa Mining Corp.*, UNCITRAL, PCA Case No. 2012-2, Award, ¶ 4.45. It is thus possible that the Tribunal perceived that "local consultation" amounted to Copper Mesa's right to set the record straight. While the Tribunal did not clearly express this view, and it may be overly speculative to impute it to them, it is worth stating that such a position effectively denies local groups the autonomy to arrive at their own decisions, and also neglects the asymmetries inherent in forcing a group with limited access to credible information to accept the

communities had no power to prevent the mining operations from proceeding, but it declined to consider the possibility that, for purposes of permitting requirements, interested communities had already made their views clear.

This view of the relationship between central and local governments raises questions about the Tribunal's view of the nature of a State. While central governments may sometimes be forced to compel the allegiance of subnational governments, the latter nonetheless have some authority and the former have independent obligations to all their citizens. "It is of course difficult to say now what [the central government] should have done," the Tribunal observed, as though hindsight in this case made such decisions harder.[112] But by 2007, for both the government in Quito and the local governments in Junin, their positions and obligations were clear. The communities and their local governments had soundly rejected mining in the area. The central government had its own obligations to keep its community safe, which made it difficult to justify allowing Copper Mesa access to the area. The very thing it needed access for, community consultations, were mooted by the fact that community *opposition* made them impossible to carry out.

As mentioned above, the Tribunal's legal reasoning here is not the obvious problem. What is missing is an understanding of the authority of subnational entities—a recognition of their autonomous role as part of the State and appropriate role in the regulation of investment.

Unintentionally, *Copper Mesa* also highlights a key benefit of an FET jurisprudence that would require investors to deal with different implicated jurisdictions on their own terms. If investment tribunals took local consultative roles more seriously, it would provide strong incentive for the next Copper Mesa to do the same. Knowing that investment tribunals would respect local government autonomy to reject investments might discourage the sort of escalation of pressure that even the Tribunal in this case called reckless.[113]

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views of international miners with potentially conflicting values and interests.

112. *Id.* ¶ 6.83.

113. *Id.* ¶ 4.265.

The elements of the FET obligation putting the most pressure on federal systems have emerged as individual arbitrators faced aggrieved claimants seeking vindication for wasted efforts. These elements are shaped in part by vague and hortatory preambular language in investment treaties. This treaty language also exhorts the importance of good governance by empowering tribunals to promote best practices for fostering economically vibrant States. The following part of this Note will address how federalism contributes to those goals.

III. The Political Economy of Federalism

Most of the world's wealthiest countries have federal constitutional structures.[114] Federal States, more than centralized ones, are better able to implement the axiom that decisions should be taken at the lowest level that internalizes all externalities.[115] The desirability of local decision-making is not limited to the national constitutional context either. The European Union's constituent treaty enshrines a commitment to the principal of subsidiarity, and municipalities are taking on an increasing prominence in international law.[116]

The popularity of some form of localism is not new. Alexis de Tocqueville's reverence for the role of the American municipality remains widely cited.[117] More cosmopolitan scholars have noted the captivation with which Enlightenment thinkers regarded federal political organization, whether looking to history for examples of model political communities[118] or en-

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114. *See* Calabresi & Bickford, *supra* note 7, at 2.

115. Cooter, *supra* note 14; *see also* Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. Econ. Lit. 1120, 1122 (1999) ("[T]he provision of public services should be located at the lowest level of government encompassing, in a spatial sense, the relevant benefits and costs.").

116. Berrman, *supra* note 7; Yishai Blank, *The City and the World*, 44 Colum. J. Transnat'l L. 875 (2006); *see also* Luis Eslava, Local Space, Global Life: The Everyday Operation of International Law and Development (2015) (providing a critical perspective on the motives of international development interests in promoting decentralization).

117. *See, e.g.*, A.E. Dick Howard, *The Values of Federalism*, 1 New Eur. L. Rev. 143, 147 (1993).

118. *See, e.g.*, Richard Whatmore, Against War and Empire 13 (2012) (addressing, in part, the intellectual efforts of disillusioned 18th-century Genevans "to make the modern world of commerce and empire, dominated

visioning a broader global project.[119] Historians of empire note the critical importance of delegating real authority to different geographical regions to remain united.[120] While the importance of international investment law in some sense reflects the growth of global institutions, localizing government functions continues to prove its usefulness—and in some cases, localities are demonstrating that they are better able to adapt to global changes and implement global public goods than are States.[121]

Against the backdrop of federalism's enduring prominence, this part will address three issues: the political economy arguments in favor of subdividing certain State functions; the capacity of local governments to play a "gatekeeping" role concerning some incoming investments; and the inevitability of contestation for authority in federal systems.

A. *The Case for Federalism*

There is a trade-off in scaling governmental decision-making. Larger governments are likely to be structurally accountable to a wider range of constituencies than smaller governments. Yet this increase in the breadth of structural accountability may go hand-in-hand with a decrease in the depth of a government's concern.[122] Legislatures living in the city or province whose laws they are writing may be more immediately familiar with its concerns, cultural values, and subjective preferences. This trade-off helps explain the continuing relevance of sub-national entities in governmental decision-making. Giving local governments a say—or even primary authority—in certain decisions can help mitigate disregard of these interests.

This capacity of local governments forms the core case for delegating authority. In George Berrman's classic case for sub-

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by the commercial monarchies of Britain and France, safe for small republics.").

119. Robert Howse, *Montesquieu on Commerce, Conquest, War and Peace*, 31 BROOK. J. INT'L L. 1 (2006) (positing an interpretation of Montesquieu premised on the notion of a global federalism).

120. *See generally* JANE BURBANK & FREDERICK COOPER, EMPIRES IN WORLD HISTORY (2011).

121. Timothy Meyer, *How Local Discrimination Can Promote Global Public Goods*, 95 B.U. L. REV. 1937 (2015).

122. *See generally* Paul Seabright, *Accountability and Decentralisation in Government: An Incomplete Contracts Model*, 40 EUR. ECON. REV. 61 (1996).

sidiarity in the European Union, he argued that decentralized government had five clear, general advantages over centralized government.[123] First, he argued, in a democracy, people are more effectively represented at lower levels of government.[124] Their vote literally counts more, increasing legislative accountability and the influence of citizens on their government and its policies. Second, this improves the flexibility of local governments; more attuned to "the unique combination of circumstances . . . that obtain at a given moment," they can better offer the most appropriate solution.[125] Third, centralizing power creates a "winner-take-all" effect.[126] There is no effective check on a centralized government once a given faction takes control. Decentralized power thus creates greater insurance against factionalism. Fourth, federal structures can preserve identities associated with distinct localities.[127] Finally, allowing different governments to implement different policies creates natural experiments.[128] This final argument was most famously made, in a slightly different form, by Charles Tiebout, who noted that, given mobile citizens and a local supply of public goods, "fiscal federalism" creates a quasi-market pressure on government policy.[129]

Many scholars have echoed these views.[130] The contrary case has been made as well; scholars note that decentralization also leaves States vulnerable to clear vices. For instance, it may be easier to take power in smaller governments, meaning ma-

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123. Berrman, *supra* note 7, 340–45. Berrman actually makes six arguments, although the sixth may be somewhat particular to the context of European integration. Many of these themes can be found elsewhere, for example in Calabresi & Bickford, *supra* note 7, or in John D. Donahue & Mark A. Pollack, *Centralization and its Discontents: The Rhythms of Federalism in the United States and the European Union*, *in* THE FEDERAL VISION: LEGITIMACY AND LEVELS OF GOVERNANCE IN THE UNITED STATES AND THE EUROPEAN UNION 73 (Kalypso Nicolaidis & Robert Howse eds., 2001).

124. Berrman, *supra* note 7, at 340.

125. *Id.* at 341.

126. *Id.*

127. *Id.*

128. *Id.*; *see also* Donahue & Pollack, *supra* note 123, at 75.

129. Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POLIT. ECON. 416 (1956).

130. *See, e.g.*, Howard, *supra* note 117; Jonathan Rodden, *Federalism*, *in* OXFORD HANDBOOK OF POLITICAL ECONOMY (2006); Calabresi & Bickford, *supra* note 7; Donahue & Pollack, *supra* note 123; Susan Rose-Ackerman, *The Economics and Politics of Federalism*, 11 APSA-CP NEWSLETTER 16 (2000).

jorities may be more extreme as they need not moderate their message to expand their appeal.[131] This may mean that policies for the protection of regional and national minorities are best made at the highest level. (Of course, in the context of the United States, the history of strong advocacy for states' rights has an unsavory association with pro-slavery and pro-segregation constituencies.)[132] Furthermore, differing policies mean that different laws will apply to different people within one political community; enhancing a sense of local community may come at the price of a sense of national community.[133] Economies of scale may also militate in favor of uniformity.[134] For instance, health and safety regulations targeting products sold nationally ought to be set nationally. Broad national concerns about matters ranging from income inequality to infrastructural investment may implicate an important federal role. These are the rationales underlying the protection of foreign investors' rights through treaties made at the highest levels. The more likely a decision by a unit of government is to affect that government's neighbors, the more cooperation—in the form of larger-scale decisionmaking—will be needed.

There are also internal tensions in the case for federalism.[135] The idea that local government decisions will better reflect community preferences may be in tension with the notion that variant local policies can operate as natural experiments.[136] If there are significant differences between different communities, policies adopted in one community may be of little relevance for another.[137] Furthermore, Tiebout's implicit

131. *See* Calabresi & Bickford, *supra* note 7, at 16.

132. *See, e.g.*, Richard Simeon & Beryl A. Radin, *Reflections on Comparing Federalisms: Canada and the United States*, 40 PUBLIUS 357, 362 (2010) ("In the United States . . . social justice for African Americans was to be found in a call for federal action to challenge racist southern state regimes.").

133. Howard, *supra* note 117. *See generally* BENEDICT ANDERSON, IMAGINED COMMUNITIES (1983).

134. Howard, *supra* note 117; Calabresi & Bickford, *supra* note 7.

135. *See* Rose-Ackerman, *supra* note 130.

136. *Id.* at 18 ("[A]s a general argument for decentralization, the innovation claim is weak and in conflict with other claims. Thus if a nation is very deeply divided along ethnic or religious lines, it seems unlikely that new programs in one community will have much to teach those in other communities with very different values.").

137. *Id.* at 17.

suggestion that there is an optimal policy mix that federalism helps us identify bears little relation to the idea that local governance is better because it better captures local community preferences.[138] Tiebout's argument also understates the actual practical difficulties of moving somewhere new, and the importance people place on living near friends and family.[139]

These criticisms have demonstrated the need for specificity on the part of federalism's proponents, but do not rebut the claims. For instance, differences in restrictions on the ownership of firearms between New York City and a small town in Wisconsin will not give either municipality insights into whether one policy or the other is better. However, allowing them to adopt different policies is still desirable due to different local conditions and community values. Differences in subsidized housing policies between New York and Boston, by contrast, may reflect community preferences (willingness to experiment with ensuring affordable housing) and provide insights relevant to both cities' decision-makers. Furthermore, the particular institutions of different federal States matter in their own right, and should be examined on their own terms.[140]

These critiques have not, however, posed a serious challenge to the basic insight that local governments are more responsive to what their voters want; that local supply of local public goods is best unless there are clear economies of scale or spillover effects; and that local institutions might better reflect local values and preferences, even if minority rights are better protected at higher levels. They have reaffirmed the insight that different types of problems are best resolved at different levels.[141] Decisions whose primary effects will be felt locally are likely best made locally.

At a basic level, this insight supports the evolution of international norms for the protection of aliens as a redress against local majoritarianism. But it also suggests that, for many problems, different jurisdictions have different interests which need to be taken into account—for instance, local interests in maintaining a certain way of life. This Note contends

138. *Id.*
139. *Id.*
140. *Rodden*, *supra* note 132, at 364.
141. Seabright, *supra* note 122.

that many of the fact patterns examined implicate the latter concern as much as or more than the former.

B. *Gatekeeping*

Local governments may operate as the best gatekeepers of a community. Charles Tiebout's seminal model of optimal sorting, and the literature of "fiscal federalism" that it generated, developed the idea that competition, rather than accountability, might help different cities do best by their residents' wishes.[142] Those not offering the right mix of taxes and spending on local public goods suffer a loss of residents to more attractive municipalities, losing their tax base, capacity, and influence.[143]

Tiebout's assumption of cost-free mobility is, of course, an oversimplified description of humans. Network effects make residency sticky, as indicated above, since we prefer to live near people we know, and prefer to stay where our jobs are.[144] Furthermore, mobility can interact with accountability; the threat of exit can improve governments' responsiveness to what their constituents want, as can the prospect of exercising voice through voting.

Yet competition in government policies clearly exists. It seems most pronounced in contexts where barriers to moving are low—commercial contexts. Perhaps the most obvious example of this is in the internal U.S. market for corporate legal regimes. Delaware's well-drafted code and its provision of a business-savvy specialized Court of Chancery has put it in charge of the majority of U.S. publicly-traded companies.[145] As another example, the magnitude of tax breaks and corporate incentives designed to lure investment at the state and local level in the United States suggest that competition in some cases has become a collective action problem, as cities race to

142. Tiebout, *supra* note 129.

143. *Id.*

144. *See* Rose-Ackerman, *supra* note 130, at 14.

145. *See* Dep't of State, Div. of Corps., *About Agency*, STATE OF DEL., http://www.corp.delaware.gov/aboutagency.shtml (last visited Oct. 1, 2016) (observing that 64% of Fortune 500 companies are incorporated in Delaware).

the bottom in terms of revenue extraction to attract the most investment.[146]

While certain mechanisms to attract investors may require a national backstop, this competition indicates that municipalities often desire investment and make efforts to try to attract it. Indeed, in both *Bilcon* and *Copper Mesa*, significant local constituencies supported the proposed investments.[147]

Foreign investors can exert pressure on governments through the threat of capital flight, vitiating some of the concern that local governments will disregard their interests. However, these examples also suggest that for many types of investment, local governments will internalize many of the benefits. Investment may bring economic revitalization, employment opportunities, an increased tax base, and expanded regional influence, all of which may matter more at local levels, where constituents will be more dramatically affected.

This suggests that when local governments decide whether to let investments in, they are often balancing significant economic gains against other non-economic values, not as easily ascertainable at higher levels.[148] Thus, they should not simply be compelled to let investors enter.

This does not mean that there are never supervening national or international concerns. Where a project has serious positive externalities, it may be undervalued. For instance, in *Metalclad*, Guadalcazar likely perceived (rightly or wrongly) that it was taking on an environmental risk by hosting a hazardous waste landfill in order to remedy a national shortage of safe disposal sites.[149] It is easy to imagine other cases, where, for instance, a proposed investment would not provide many

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146. *See* Louise Story, *As Companies Seek Tax Deals, Government Pays High Price*, N.Y. TIMES (Dec. 1, 2012), http://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html?pagewanted=all&_r=0.

147. Clayton v. Gov. of Can., NAFTA/UNCITRAL, PCA Case No. 2009-04, Award on Jurisdiction and Liability, ¶ 377 (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4212.pdf; Copper Mesa Mining Corp. v. Rep. of Ecuador, UNCITRAL, PCA Case No. 2012-2, Award, ¶ 4.74 (Perm. Ct. Arb. 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7443.pdf.

148. *See supra* Section III.A for a discussion of the greater flexibility and accountability that local governments can provide.

149. *Cf.* Metalclad Corp. v. United Mex. States, ICSID Case No. ARB(AF)/97/1, Award, (Aug. 30, 2000), 16 ICSID Rev. 165 (2001).

local jobs but would provide significant advantages for the international economy. These are more difficult cases.

There is a complex interplay of externalities involved in resolving all of these types of issues. How to balance the benefits of highways against, say, legitimate concerns about community cohesion, is beyond the scope of this article.[150] There are good reasons to scale such decisions, but fairness may militate against ignoring or simply overriding local concerns without any form of compensation or consultation. Yet in cases where a primarily local economic benefit is to be balanced against primarily local non-economic harm, a good case can be made for the presumptive capacity of local government.

Of course, the logic of investment treaties indicates that where decisions concerning foreign investors are being made, there are *always* externalities. Foreign investors seek to make a profit that will be enjoyed outside of the host state. They seek to operate in a community where they may not have a direct voice in governance. There are serious concerns about fair treatment of aliens at any level of government. At the local level, this is most salient in context of discrimination.[151] Where a local government can dictate that all the benefits of a given investment accrue locally, it will likely do so. Yet investment treaties address most of these potential abuses through nondiscrimination obligations.[152] Therefore, where a local government opposes a foreign investor in favor of a local one, FET obligations are not needed to force the government to internalize the externalities it imposes. However, in the context of a project proposal which would bring significant economic benefits to an area whose government may veto it, concerns about externalities are at a low ebb. The dramatically local positive impact of an investment project minimizes concerns that the locality will ignore the social value of the pro-

150. For an overview of the different strategic elements at play in these sorts of decision, see generally COOTER, *supra* note 7, ch. 5.

151. *See, e.g.*, Loewen v. United States, ICSID Case No. ARB(AF)/98/3, Award, (June 26, 2003), http://www.italaw.com/sites/default/files/case-documents/ita0470.pdf (documenting egregiously discriminatory treatment of a foreign investor though declining to find liability); *see also* Meyer, *supra* note 121 (describing the importance of domestic benefits, and hence discriminating in favor of local interests, to passing state- and municipal-level legislation).

152. *See generally* 2012 U.S. Model BIT, *supra* note 11.

ject; the fact that local governments may recognize social values that risk being ignored or misunderstood by governments at higher levels suggests that their opposition to an incoming project may not be due to their disregard of externalities, but their better ability to balance all relevant factors.

While not necessary to a doctrinal view of FET that allows different governments to take different positions, these insights provide a background against which arbitrators might feel more comfortable allowing idiosyncratic local actions with respect to a proposed investment.

C. *Contests*

Municipal governments are accountable to their municipality. This means that, in general, where a municipality opposes something, its government is unlikely to adjust its opposition based on how much the nation favors it (though the possibility of bargaining may mollify these concerns in some cases). This explains why Guadalcazar might vehemently oppose Metalclad's hazardous waste facility regardless of the need for such facilities in Mexico generally.[153]

This is a specific case of a general phenomenon that seems intrinsic to federal systems: governments within the State will compete for power. This is neither a surprising, nor seemingly tractable phenomenon. It explains why George Berrman, studying subsidiarity in the E.U. treaty, and Steven Calabresi and Lucy Bickford, studying the enforcement of federalism within U.S. constitutional law, took as their starting points the question of how to enforce against the centralizing tendencies of a federal structure.[154] In both cases, it was obvious that there would be centripetal tendencies due to the greater power of the central government.[155] This corresponded to a need for a check, at the level of the central gov-

153. One possibility is that indemnification laws may obviate this possibility in context of IIL. Whether indemnification provides a workable solution to the problems this article identifies will be explored in Part IV.

154. Berrman, *supra* note 7, at 424; Calabresi & Bickford, *supra* note 7, Part II; *see also* Steven G. Calabresi, *"A Government of Limited and Enumerated Powers": In Defense of* United States v. Lopez, 94 MICH. L. REV. 752 (1995) (arguing in favor of greater Supreme Court restrictions on federal regulatory authority).

155. Berrman, *supra* note 7, at 349; Calabresi & Bickford, *supra* note 7, at 20–21.

ernment, on its authority vis-à-vis the states.[156] Similarly, to many current political scientists, it is evident that providing too many veto powers to sub-national governments may cause its own problems.[157] Political economists, like legal theorists, have caught on that:

> [T]he prevailing view of federalism as a clean division of sovereignty between higher and lower-level governments is giving way to a notion that authority over taxation, expenditures, borrowing, and policy decisions is inherently murky, contested, and frequently renegotiated between governments, with federal constitutions analogized to the "incomplete contracts" of industrial organization theory.[158]

Disagreements and legal contests may be central to the federal arrangements in a State. While local intransigence may lead to national instability or constitute a form of free-riding strategic behavior,[159] it may also reveal preferences. In *Metalclad*, Guadalcazar's multiple and creative strategies to attempt to block the investor's landfill were probably not an attempt to rent-seek from the investor or the federal government, though the municipality was free-riding by avoiding the cost of hazardous waste disposal.[160] Yet at the same time, Guadalcazar's efforts to defeating the project communicated the intensity of its residents' opposition.

Political economists continue to explore the ramifications of these ongoing battles for primacy within federal systems, and how different incentive structures within federations can moderate potential problems of strategic behavior.[161] Meanwhile, lawyers continue to litigate these issues.[162] Some uncer-

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156. Berrman, *supra* note 7, at 336–38; Calabresi & Bickford, *supra* note 7, at 25.

157. Cooter, *supra* note 7; Rodden, *supra* note 130; Donahue & Pollack, *supra* note 123, at 80–84 (describing the failure of the American experiment with the Articles of Confederation).

158. Rodden, *supra* note 130, at 2; *see also* Seabright, *supra* note 122.

159. Rodden, *supra* note 130.

160. *See generally* Metalclad Corp. v. United Mex. States, ICSID Case No. ARB(AF)/97/1, Award, (Aug. 30, 2000), 16 ICSID Rev. 165 (2001).

161. Rodden, *supra* note 130.

162. *See, e.g.*, Nat'l Federation of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2633–40 (2012) (striking down proposed conditional Medicaid expansion as coercive of states' rights by the federal government).

tainty about the scope of delegation in a decentralized government may be desirable: political agents accountable to different constituents will fight for control where they think it is important to do so.[163] Yet even if these contests do not provide any value in helping delegate decisions flexibly, or in enhancing the voice of different constituencies, and simply constitute pure waste, they are probably a built-in cost of confederating.

This means that the consistency, transparency and predictability which investment tribunals expect across different governments within federal States is not merely impracticable, but inconsistent with their responsibilities.[164] Different governments are responsive to different constituencies which may have different interests relating to an investment. This need not create impossible tasks for the incoming investor, requiring them to second-guess every assertion of authority they receive. Rather, investors should talk to officials from implicated jurisdictions.

Decentralizing government authority is a popular, longstanding and effective means of organizing large, diverse political communities. Central to such systems are disputes about the precise allocation of decision-making authority. A responsibility of different subparts of these governments is to disagree; they represent different constituencies. The rules of attribution in international law do not require that investment tribunals be blind to these realities.

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163. In Seabright, *supra* note 122, the author assesses the principal-agent relationship between citizens and their representatives as an incomplete contract, arguing that where there is uncertainty and limited oversight decision-making authority should be given to those with proper incentives. Seabright argues a trade-off emerges between economies of scale and accountability, virtues of centralization and decentralization which this paper has seen before. Arguably the appropriate trade-off varies from question to question, and agents with properly aligned incentives will seek to represent their constituencies wishes in pushing for more of one benefit or the other in accordance with their interests.

164. On these obligations, see Tecnicas Medioambientales Tecmed, S.A. v. United Mex. States, ICSID Case No. ARB(AF)/00/2, Award, ¶ 54 (May 29, 2003), http://www.italaw.com/documents/Tecnicas_001.pdf, and discussion *supra* Part II.

IV. How to Accommodate Federalism in Investor-State Arbitration

How can principles of federalism be preserved against the pressures that FET obligations impose? This section will address possibilities going forward. First, it will survey arguments for leaving the current system in place, notwithstanding the federalism concerns it implicates. Second, it will set out the legal and pragmatic case for reform. Finally, it will suggest what a better model might look like. A better regime, it proposes, would protect investors from bad faith conduct by States, but also require that they act based on a structural understanding of a country's legal regime. In order to form protected expectations, they would need to work with federal States' dispersed sources of authority.

A. *Retaining the Status Quo*

The case for the status quo rests on the observation that it is costly for investors to assess the positions of a range of potentially implicated jurisdictions within a state, as is dealing with the fallout when those jurisdictions disagree. Why should the investor bear the brunt of such inconsistency?

Protecting investors from the conflicting goals of national and regional polities through the FET standard arguably serves the same goals as the rules of attribution in international law, a least-cost avoider approach to the risk of collusion among different State agencies.[165] States should not be able to gain the benefit of an international treaty by signing it while avoiding its costs by relying on their court system or local governments to breach. Analogously, reading investment treaties to demand consistency among different branches of government relieves an investor of the risk of a bait-and-switch scheme.

Yet this analogy is insufficient to support current practice. It plays too loosely with different types of rules. Attribution rules are constitutive meta-rules defining the nature of specific obligations; FET is one such specific obligation.[166]

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165. *See generally* Brownlie's Principles of Public International Law 542 (James R. Crawfod ed., 8th ed. 2012) (discussing rules of attribution in international law).

166. *See generally id.*

These different rules implicate different operational concerns. Attribution rules, applicable across all treaties, need to create sensible presumptions and need to be sensitive to enforcement and monitoring issues that arise across the full range of international legal contexts. Not all international treaties provide for effective means of enforcement, and monitoring treaty compliance is often costly for concerned States.[167] The attribution rules provide a normative backdrop that prevents gaming, facilitates monitoring by providing an expansive basis for liability and limiting the scope for subjective self-judging, and offers a flexible negotiating template that States can tailor to their needs in particular contexts.[168] By contrast, FET protects a group with every incentive to monitor potentially unlawful conduct and efficient mechanisms for enforcing their rights.[169] FET as a substantive standard is not the same as the attribution rules, and its application in light of the attribution rules need not flatten the State.

This is particularly true because the virtues of attribution rules still apply in context of investment treaties. They already require local governments not to discriminate against foreign investors, and oblige municipalities not to expropriate.[170] Operationally, then, current jurisprudence on the FET standard is not a logical consequence of the rules of attribution so much as a conflation of different standards. Adopting a revised view of FET in light of the structure of decision-making authority vested in different governments would not free any particular government within a State from overarching treaty obligations. Local government procedures could not be unduly abusive in their own right, and local government officials could not use their capacity as representatives of the local pol-

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167. For instance, approximately seventy States recognize the compulsory jurisdiction of the International Court of Justice—leaving over one-hundred who are only subject to formal international dispute settlement as explicitly set out in specific treaties. *Declarations Recognizing the Jurisdiction of the Court as Compulsory*, INT'L CT. JUST., http://www.icj-cij.org/jurisdiction/?p1=5&p2=1&p3=3 (last visited Oct. 1, 2016).

168. Many human rights treaties, for instance, purport to regulate private conduct within the jurisdiction of signatories. *See, e.g.*, G.A. Res. 34/180, Convention on the Elimination of All Forms of Discrimination Against Women art. 7(c) (Dec. 8, 1979).

169. *See, e.g.*, Pelc, *supra* note 13 (discussing a range of incentives investors might have for bringing claims).

170. *See, e.g.*, 2012 U.S. Model BIT, *supra* note 11, arts. 3, 4, 6.

ity to fraudulently induce investment. Similarly, because of the attribution rules, collusive efforts to fraudulently court investors across different levels of government could still give rise to a viable claim.[171] However, as will be explored below, maintaining these protections need not unduly pressure federal systems with multiple points of decision-making. Interpreting FET to require consistency among all levels of government within a State is both overbroad, because there are more focused interpretations that can deal adequately with collusion, and unnecessary, because of background attribution rules.

Another argument emphasizes that treaty practice has failed to respond to this problem. States continue to sign investment treaties that, in relevant respects, look like the treaties under which the above-referenced awards were rendered.[172] Neither Canada's most recent investment treaties nor the current U.S. Model BIT seek to specify FET definitions so as to avoid liability for inconsistency between federal and state or provincial actions.[173] Should this be construed as legitimizing the practice?

States cannot respond to all issues in investment treaty jurisprudence, and in many cases seem unsure how to proceed. For instance, they have responded narrowly by carving tobacco out from the investment protection chapter of the draft TPP.[174] They have also responded more broadly by trying to import regulatory exceptions from international trade law into investment treaty jurisprudence.[175] Commentators have been skeptical about the likely effectiveness of either development.[176] The *Copper Mesa* award, for instance, was rendered

171. Int'l Law Comm'n, *supra* note 5.

172. The Canada-Mongolia BIT, for instance, was signed on Aug. 9, 2016.

173. Agreement Between the Government of Canada and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Promotion and Protection of Investments, Can.-H.K., art. 6, Oct. 2, 2016 [hereinafter "Canada-Hong Kong BIT"]; 2012 U.S. Model BIT, *supra* note 11, art. 5.

174. U.S. Trade Representative, Draft Trans-Pacific Partnership, Ch. 29 art. 29.5, https://ustr.gov/sites/default/files/TPP-Final-Text-Exceptions-and-General-Provisions.pdf.

175. Canada-Hong Kong BIT, *supra* note 175, art. 17.

176. *See, e.g.*, Simon Lester, *More on the Tobacco Carve-Out*, Int'l Econ. L. & Policy Blog (Oct. 8, 2015, 7:01 AM), http://worldtradelaw.typepad.com/ielpblog/2015/10/more-on-the-tobacco-carveout.html; Simon Lester, *Improving Investment Treaties Through General Exceptions Provisions: The Australian*

under an investment treaty which borrowed "General Exceptions" from international trade law—they had no impact on the outcome.[177] Ultimately, treaty reform is a slow and difficult process. States are unsure which reforms will adequately protect the interests they are concerned about.[178] The vast network of treaties makes effective reform particularly difficult, especially because "Most-Favored Nation" clauses may obviate any effects of partial reform by allowing investors to borrow protections from older treaties.[179] In sum, the addition of a clause to FET articles could help, clarifying that government officials at one level of a federal State do not have the authority to bind officials from other governments vis-à-vis an investor absent a showing of bad faith. The absence of particular reforms to treaty texts by State parties, however, cannot stand as a general argument against adopting otherwise sensible jurisprudential reforms.

There are two further reasons to maintain the status quo, though they are premised on alternative empirical presumptions. On one view, if the current investment regime is not actually undermining federalist structures, then the impetus for change—and for shifting costs of decision-making onto investors—is weak. If a revised jurisprudence would not better protect principles of good governance, then investors' interests in restitution should prevail as an interpretive gloss on investment treaties. On the other view, to the extent that FET

Example, INV. TREATY NEWS (May 14, 2014), https://www.iisd.org/itn/2014/05/14/improving-investment-treaties-through-general-exceptions-provisions-the-australian-example/.

177. Copper Mesa Mining Corp. v. Rep. of Ecuador, UNCITRAL, PCA Case No. 2012-2, Award, (Perm. Ct. Arb. 2016), http://www.italaw.com/sites/default/files/case-documents/italaw7443.pdf; *see also* Jarrod Hepburn, *In-Depth: In* Copper Mesa *Case, Jurisdictional Objections Were Waved Away; Ecuador Breaches BIT Due to Failure to Protect Investors from Protestors*, INV. ARB. REP. (June 5, 2016), http://ezproxy.library.nyu.edu:8741/articles/in-depth-in-copper-mesa-case-jurisdictional-objections-were-waved-away-ecuador-breaches-bit-due-to-failure-to-protect-investor-from-protesters/ ("[T]he Copper Mesa case appears to be the first in which a state has sought to rely on a general exceptions clause, which—although relatively often found in Canada's BITs—remain otherwise rare. Nevertheless, the tribunal's swift dismissal of Ecuador's effort grants little further understanding of how such clauses might work in investment arbitration.").

178. Alvarez, *supra* note 27, addresses the reactive character of FET evolution is U.S. investment treaty practice.

179. *See, e.g.*, *id.* at 20.

interpretations *can* influence the design of governmental decision-making, they might push it towards more efficient techniques. Both of these arguments point to the conclusion that, notwithstanding legitimate and justifiable disagreements between different levels of government, investors should not bear the cost.

The first view draws strength from the absence of evidence of major changes to State operations since the growth of investment treaty claims in the 1990s.[180] No studies have emerged showing a significant "scaling-up" of formerly local competences in the United States since the adoption of NAFTA; no constitutional amendments have altered our federal structure. Early warnings of threats to American federalism now seem like overreactions, and empirical attempts to demonstrate "regulatory chill" arising from investment treaty jurisprudence often promise more than they can deliver.[181] Defenders of the system suggest that there are few cases which, properly understood, threaten States' regulatory powers.[182] They point to the difference between the average amount claimed in damages by investors, $622 million U.S. dollars (USD), and the average amount awarded by tribunals, approximately $16 million USD, to suggest that investors' ability to threaten States with insolvency is overblown.[183] While this debate largely addresses whether investment treaty arbitration unduly restricts police powers,[184] it also implicates potential threats to a State's constitutional structure.

Yet just as critics have exaggerated the perils of investment treaty arbitration, so its defenders' benign depiction of it as non-coercive is overly facile. Evidence of the use of threats

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180. *See* Charles N. Brower & Sadie Blanchard, *What's in a Meme? The Truth About Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States*, 52 COLUM. J. TRANSNAT'L L. 689, 726 ("[A] review of actual arbitral awards reveals great respect for environmental protection efforts and national policy discretion.").

181. *Cf.* Been, *supra* note 6, at 54; *cf.* Chris Hambly, *Secrets of a Global Super Court*, BUZZFEED (Aug. 28, 2016), https://www.buzzfeed.com/globalsupercourt.

182. *See* Brower & Blanchard, *supra* note 180, at 726.

183. *Id.* at 711 (arguing that rendered awards are much lower than expected); Susan D. Franck & Lindsey E. Wylie, *Predicting Outcomes in Investment Treaty Arbitration*, 65 DUKE L.J. 459, 467 (2015).

184. *See generally* Brower & Blanchard, *supra* note 180 (providing a survey of and rebuttal to standard critiques of investor-State arbitration).

of investment treaty claims to halt forestry regulations in Indonesia, plain packaging tobacco legislation in Canada and New Zealand, and to attempt to prevent the conversion of bank loans from francs to Euros in Croatia has emerged despite the significant empirical difficulties involved in demonstrating "regulatory chill."[185] Recent empirical evaluations of the types of claims brought in investor-State disputes have bolstered the theory that merely initiating them can be an effective coercive instrument for investors, particularly as even unsuccessful suits may seriously impede investment flows.[186]

Similarly, data about average damages awarded in investor-State disputes may offer cold comfort to States like Peru, currently facing pending claims for close to $2 billion (USD).[187] Its annual government expenditures run close to $20 billion (USD).[188] While any of the three suits it currently faces may be unlikely to result in damages awards at all close to what the different claimants are seeking, the risk remains massive. Damages awards in investor-State arbitration exhibit high variance.[189] Peru is significant in part because it is unexceptional. Having faced twelve investment treaty cases, is neither the most- nor the least-sued State in investment treaty arbitration. It is in a three-way tie for eighteenth place on the list of most frequent respondents, behind the United States.[190]

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185. Pelc, *supra* note 13, at 15; Jasmina Kuzmanovic, *Croatia Approves Swiss-Franc Loans Switch Over Bank Protests*, BLOOMBERG (Sept. 18, 2015), http://www.bloomberg.com/news/articles/2015-09-18/croatia-approves-swiss-franc-loan-law-after-banks-cry-foul.

186. Pelc, *supra* note 13.

187. *See* U.N. Conference on Trade and Development, *Investment Policy Hub: Investment Dispute Settlement Navigator: Peru*, http://investmentpolicyhub.unctad.org/ISDS/CountryCases/165?partyRole=2 (last visited Oct. 23, 2016) (providing a list of investment dispute decisions and cases by country).

188. Peru's annual government expenditures were estimated based on THE WORLD BANK, PUBLIC EXPENDITURE REVIEW FOR PERU: SPENDING FOR RESULTS fig. 2.4 (June 6, 2016), http://documents.worldbank.org/curated/en/225811468297875669/pdf/NonAsciiFileName0.pdf and THE WORLD BANK, DATA: GDP (CURRENT US$), http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=PE (last visited Oct. 1, 2016).

189. *See* PRICEWATERHOUSECOOPERS LLP, INTERNATIONAL ARBITRATION DAMAGES RESEARCH 6 (2015) https://www.pwc.com/sg/en/publications/assets/international-arbitation-damages-research-2015.pdf (highlighting variance in awards).

190. U.N. Conference on Trade and Development, *Investment Dispute*

Due to the magnitude of damages claimed and to persistent uncertainty in the investment regime, it seems unlikely that the pressures which investment treaty arbitration exerts on States can be neatly cabined off from its impact on their exercise of legitimate regulatory authority or their interactions with regional governments. The risk that investment treaty jurisprudence will push States away from good governance practices is high enough to warrant skepticism of the view that we can leave things as they are without real risk to federalist arrangements.

A more sophisticated variant of this argument would argue in favor of the current approach because it influences State behavior. From an ex ante perspective, existing jurisprudence encourages States to adopt cooperative joint decision-making processes, which can in theory accommodate sensitive local concerns, national policy, and investor expectations. From an ex post perspective, it encourages the adoption of indemnification laws, allocating costs efficiently and encouraging the development of clarity and certainty on federalism questions through the better-situated domestic judicial process.

The problem with this argument is that it relies on States to voluntarily implement these allegedly superior policies. While proposals for indemnification laws in Canada suggest this hope may be partially warranted,[191] the willingness of federal governments in a new generation of trade agreements to simply carve out local discriminatory measures rather than seek to rein them in suggests ex ante reforms may be a dim prospect.[192] Creating better decision-making processes may not be the path of least resistance for federal governments. In

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Settlement Navigator, http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry (last visited Oct. 1, 2016).

191. *See* Alexander Gauthier & Simon Lapointe, *Canada's Provinces and International Trade Agreements*, *in* LIBRARY OF PARLIAMENT: CURRENT & EMERGING ISSUES (2011), http://www.bdp.parl.gc.ca/content/lop/researchpublications/cei-16-e.htm ("The future agreement between Canada and the European Union may include a section on investment protection similar to the provisions of NAFTA. With the provinces participating actively in these negotiations, there may be an opportunity for them and the federal government to agree on an internal mechanism for sharing liability in the event of a dispute.").

192. U.S. TRADE REPRESENTATIVE, *supra* note 174, Annex 1.

either case, even if proposed reforms are adopted there is a risk of diminishing accountability in exchange for efficiency.

The argument for cooperative federalism is fairly straightforward from an investor's perspective. Coordinated decision-making processes allow for multiple levels of government to express their interests concerning an investment or proposed investment without unduly protracting decision-making or inducing reliance.

Yet critics charge that cooperative federalism can dilute accountability and make monitoring of government behavior more difficult for citizens.[193] They note that in the United States and Germany, which essentially delegate execution of federal policies to states (with respect to implementing certain federal policies) or *Länder* (as the State's sole executive apparatus), these approaches make it difficult for citizens to determine which policies at what level are responsible for the regulatory outcomes that occur.[194] If citizens do not know which policies resulted in an unpopular outcome, they do not know who to hold responsible, and elected officials lose a key feedback mechanism.

More importantly, cooperative federalism only works when both federal and local governments agree to it. Absent mutual consent, it is hardly federalism.[195] Thus, to the extent that current standards pressure federal governments to demand coordinated procedures, they are already eroding local government autonomy.

Furthermore, models of cooperative federalism which involve delegating authority suggest limits to its viability where there are major policy differences at different levels.[196] For instance, if an investor faces friendly national policies and hostile state policies, are they not better off having federal officials on their side, rather than facing a state government whose offi-

193. *See, e.g.*, Roderick Hills, *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Autonomy" Doesn't*, 96 MICH. L. REV. 813 (1998) (though Hills also observes these criticisms are inevitable in governments with overlapping jurisdictions); Jesse Buhlman-Pozen & Heather K. Gerken, *Uncooperative Federalism*, 118 YALE L.J. 1256 (2009); Michael S. Greve, *Against Cooperative Federalism*, 70 MISS. L.J. 557 (2000).

194. Roderick M. Hills, Jr. & Daniel Halberstam, *State Autonomy in Germany and the United States*, 572 ANNALS AM. ACAD. POL. & SOC. SCI. 173, 182 (2001).

195. *See generally* Hills, *supra* note 193.

196. *Cf. id.* at 885.

cials are responsible for implementing federal policy? More importantly, how are state officials to implement federal policies that sharply conflict with their own policy goals? Where federal and provincial policies differ significantly, efficiency gains from consolidation will be limited.

There may be many cases where federal and local policies are similar enough to yield significant efficiency gains from coordination. Cooperative federalism may not dilute accountability any more than overlapping jurisdictions, and may provide better institutional channels for cooperation between local and central governments.[197] Yet ultimately, the hope that such procedures will be adopted more widely is too attenuated a justification to support complacency.

Requiring local governments to indemnify federal governments for actions which give rise to international liability is another proposed response to, and justification for, the current approach.[198] Such a system would force local governments to internalize the costs of their decisions, rather than ignoring treaty obligations with impunity and leaving the national government to pick up the tab. Such laws could accommodate the risk of power-seeking misrepresentations by leaving liability where it lies when the federal government misstates a local government's authority.

Such indemnification processes would have little application in the context of two parallel, contesting decision-making processes which reached different results. At its worst, applying local indemnification laws to these situations would result in a race, wherein a government opposed to an investor would need to reject their proposal before a rival government expressed support in order to avoid liability. Having potentially investment-averse governments race to reject the investor seems suboptimal; cautious governments, particularly financially vulnerable, low-level governments, would be less likely to give an investor a chance.

Furthermore, assuming that two lawful, or potentially lawful regulatory processes are playing out at different levels, assigning liability seems arbitrary. In such cases, it would not be any particular government's action or inaction that triggers lia-

197. *Id.* at 828, 838.

198. *Cf.* Gauthier & Lapointe, *supra* note 191.

bility, but the interplay between them. Indemnification is unsuited to address this.

Even where indemnification could resolve problems arising from uncertain scopes of respective federal and local authority, it risks serious agency problems internal to the State. Where a federal government is arbitrating a dispute triggered by local government action, they will have little incentive to litigate fully. This puts local governments under significant pressure not to disagree with federal positions.

Finally, local governments are likely to have even fewer financial resources than national governments, and so are more likely to be subject to coercion by the threat of international liability. The threat of financial liability for opposing an investment could easily limit the local government's ability to account for the legitimate non-pecuniary interests of their constituents—the very interests which they are best placed to account for. There is a reason that U.S. takings jurisprudence does not expect the government to compensate private parties for all value diminutions resulting from regulation.[199] It stems from the initial underrepresentation of non-financial interests in government decision-making, and a desire not to stack the deck any further.[200] Local liability, like liability for governments engaged in legitimate internal regulatory exchanges, threatens this ability.

B. *Reforming FET*

There are legal, pragmatic, and jurisprudential reasons for reforming tribunals' approach to the meaning of FET rather than shifting the burdens to States to deal with these tensions internally. Pragmatically, this problem is a problem of jurisprudence; tribunals gave the term "fair and equitable treatment" the meaning that has given rise to these issues. Tribunals could easily change their practice without having to change the internal distributions of power of longstanding de-

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199. *See generally* Penn Cent. Transp. Co. v. New York City, 438 U.S. 104 (1978) (setting forth the constitutional law regarding compensation for regulatory takings in the United States).

200. *See id.* at 124 ("Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law" (quoting Pennsylvania Coal Co. v. McMahon, 260 U.S. 393 (1922))).

mocracies. Such a shift would be much easier than amending all currently operative investment treaties.

A corollary is that, from a legal perspective, States never gave their approval to this interpretation and their current practice often suggests opposition to it.[201] The uncertainty surrounding the scope "legitimate expectations," as suggested in Part II, suggests a corresponding flexibility in how it may be interpreted.

Finally, the question of where responsibility should lie raises the jurisprudential question of which principles should underlie investment treaty interpretation. As discussed in Part II, there must be a backstop to protecting investors, and good governance must be that backstop. Multi-tiered decision structures are not, in and of themselves, in tension with such a normative agenda.

What, then, should be done? How can an investor achieve certainty about a project?

Donald McRae, discussing representations of provincial officials to the claimants in his dissent in *Bilcon*, disputed that these representations could provide a basis for an investor to form "protected expectations."[202] "The Claimant's only legitimate expectation could have been that Canadian law would be properly applied," McRae asserts.[203] This view is largely consonant with the settled view discussed in Part II—that investors are expected to learn the law of the place where they go to do business.

Yet any lawyer recognizes that the law is more than a collection of written statutes. Similarly, they understand that governments are complex entities. Law is a set of discretionary rules placed within a structure of decision-making and author-

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201. *See, e.g.*, Spence Int'l Investments LLC v. Costa Rica, ICSID Case No. UNCT/13/2, Submission of the United States of America, ¶ 17, n.24 (Apr. 17, 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4249.pdf (noting that in the U.S. view "[n]either the concepts of 'good faith' nor 'legitimate expectations' are component elements of 'fair and equitable treatment' under customary international law and citing the agreement of El Salvador, Honduras, and Guatemala in context of the DR-CAFTA agreement.").

202. Clayton v. Gov. of Canada, Case No. 2009-04, Dissenting Opinion of Professor Donald McRae, at 15 (Perm. Ct. Arb. 2015), http://www.italaw.com/sites/default/files/case-documents/italaw4213.pdf.

203. *Id.* ¶ 36.

ity and intended to provide predictive guidance. It is dynamic. It must be understood in its context, and that understanding most often begins with assessing the relevant actors and sources of authority.

Investors with access to international dispute settlement understand that the projects they are developing are complicated. Municipal water concessionaries, for instance, may have to work with constructors and shippers of piping, consumer organizations and tax authorities. Quarry manufacturers will have to line up supply and shipping contracts, complicated labor agreements, and detailed supply agreements for sophisticated and complex equipment. In order to succeed, international investors need to be skilled at working collaboratively with different groups, striking satisfactory bargains in independent contexts and resolving the concerns of all relevant partners into a successful enterprise.

Different governments with jurisdiction over an investment represent different interests which need to be dealt with on their own terms. This is the nature of the federal system; it is the reason for delegating decision-making. To investors, it means that sometimes there are more parties whose approval and cooperation needs to be obtained. International investment law, in expecting that investors know the law of the place they invest, should expect them to work with the implicated authorities.

Doctrinally, this view of FET would eliminate the idea that an investor can reasonably develop expectations about how one government will act based on representations made by another, regardless of the clarity of domestic law on the point. This approach would expect some tolerance for ambiguity from investors going into States where the precise balance of federal and local authority is in contention. It would recognize the gatekeeping role that local governments are well-suited to play, and acknowledge the inevitability, and perhaps even the desirability, of occasional intra-national disagreement between governments. Such an approach would not provide financial compensation to as many aggrieved investors. It would not presume as much naivety on the part of multinational corporations. However, it would recognize that investors seek growth, and that only good governance—which often involves local governments—can provide that.