

INVESTOR-STATE CONTRACTS, HOST-STATE “COMMITMENTS” AND THE  
MYTH OF STABILITY IN INTERNATIONAL LAW

Lise Johnson & Oleksandr Volkov\*

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\* Lise Johnson is the Senior Legal Researcher on Investment Law and Policy at the Vale Columbia Center on Sustainable International Investment.

- Oleksandr Volkov is currently an Associate with Egorov Puginsky Afanasiev & Partners Kiev. He thanks The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the law firm.

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## I. INTRODUCTION

A new de facto rule has emerged in international investment law that emphasizes and prioritizes stability for foreign investors. This rule imposes liability on host governments for measures of general applicability when (a) the measures cause a shift in the legal framework that (b) is inconsistent with a commitment or undertaking previously made to a foreign investor. The practical impact of this new rule is difficult to overstate. Indeed, due to the very nature of government *measures*, which necessarily alter the legal framework, and the types of “commitments” or “undertakings” that tribunals have considered to be protected, the scope of potential liability under this new rule is extremely vast.

The legitimacy of this new rule giving primacy to stability – and the question of whether it is in fact an international law norm of treaty, custom, or principle – are issues that have received little if any analysis in academic literature, and should be the focus of further study. An important and related question is how this new and potent principle in the international law realm compares with domestic law norms governing the same factual circumstances. This paper takes a first step to examining that question by comparing pronouncements in international investment law disputes regarding the stability and enforceability of government “commitments” to foreign investors with doctrines that have been developed in the United States’ domestic law relating to the nature and scope of enforceable “commitments” and the government’s ability to interfere with those commitments through changes to the general legal framework.

This paper uncovers a significant gap between the international law cases and U.S. domestic law principles. The stability that international investment tribunals deem part of international law is largely a myth in the U.S. cases. In the international law realm, tribunals have been taking a wide view of enforceable “commitments” or “undertakings” and have been imposing liability for a broad range of government measures (even measures of general applicability taken in the public interest) that interfere with those obligations. In contrast, U.S. courts apply a number of principles that result in their adopting a much more deferential stance to the actions of other branches of government, taking both a narrow view of enforceable “commitments” and the types of interferences with those commitments that can give rise to governmental liability.

These issues of enforceable “commitments” and guarantees of stability are explored through the lens of investor-state contracts – which this paper defines broadly to include any specific agreement between an investor and a state, such as agreements for the purchase of services, concessions, permits, licenses and leases. Investor-state contracts are an old and persistent phenomenon. Indeed, indications show that the practice of governments contracting with domestic or foreign private entities for a diverse range of objectives is on the rise, driven by cash- and technology-strapped governments striving to meet the needs of their populations and private firms looking to expand business opportunities.<sup>1</sup>

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<sup>1</sup> See, e.g., David W. Gaffey, *Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships in the United States*, 39 PUBLIC CONTRACT L. J. 351 (2010); Don Wallace, *UNCITRAL Draft Legislative Guide on Privately Financed Infrastructure: Achievement and Prospects*, 8 TULANE J. INT’L & COMP. L. 283 (2000).

Investor-state contracts explored in this paper commonly share certain key features. For one, such contracts are often long-term, with deals usually envisioning a life of 10 to 30 years.<sup>2</sup> Furthermore, the contracts are frequently either in industries that have traditionally been considered “public services,” such as the provision of water and electricity, or relate to natural resources, such as contracts for exploration and exploitation of oil, gas and minerals. The long-term nature of the agreements, the differing interests of the public and private sector contracting parties, and a range of uncertainties and changing circumstances affecting the expected costs and benefits of the relevant transaction put well-documented stresses on the contractual relationship between investors and states. Some of those are resolved informally, while others lead to formal litigation and/or arbitration.

A number of the disputes arise from contexts when the state entity breaches the contract and does so through means available to a traditional contracting party (*e.g.*, the state or state-owned or controlled entity does not make payments due under the contract). At times, however, the dispute will not be one of traditional contract breach. Rather, the dispute will involve a situation in which the government, through its exercise of governmental powers, has impacted, interfered with or terminated a contract. This may happen through issuance of an executive decree or passage of legislation modifying the government’s performance required under a contract or cancelling it outright. The government may also issue a measure of general application that negatively affects performance of, or expected profits under, the contract.

If a measure of general applicability negatively impacts performance of an investor-state contract, the question arises of who should bear the burden of those losses; and the answer to that question has crucial implications for governmental policy design and implementation. Domestic legal systems have long been dealing with that question as disputes arising out of investor-state contracts have traditionally been adjudicated in domestic courts; in such cases, courts apply domestic contract, administrative and/or constitutional law.<sup>3</sup> Accordingly, for nearly 200 years, U.S. courts have been struggling with how to address tensions between, on the one hand, protecting investors’ rights and the government’s reputation as a stable contracting party and, on the other hand, ensuring that the government retains the ability to implement measures in the public interest, respond to constituents, and adjust to changing circumstances. The balance that they have come up with recognizes contract-, statutory- and constitutional law-based investor protections but maintains a rather powerful protective shield around sovereign authority.

As this paper describes, however, this balance struck in the U.S. domestic context stands in rather stark contrast to the approach taken in the international arena by tribunals in treaty-based investor-state arbitrations. A majority of cases brought by foreign investors against host states alleging that the host state has violated an investment treaty appear to relate to disputes regarding performance of investor-state contracts. For instance, twenty-five percent of the investor-state arbitrations administered by the

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<sup>2</sup> *See, e.g.*, *Impregilo v. Argentina*, ICSID Case No. ARB/07/17, para. 15 (citing Article 1.7 of the relevant concession contract which states that the relevant concession contract between the Province of Argentina and the company engaged to provide for water and sewerage services was to have a term of 30 years); WOLFGANG PETER, *ARBITRATION AND RENEGOTIATION OF INTERNATIONAL INVESTMENT AGREEMENT* 13 (1995).

<sup>3</sup> *See* IVAR ALVIK, *CONTRACTING WITH SOVEREIGNTY* (2011).

International Centre for the Settlement of Investment Disputes (“ICSID”) have involved investments to explore for and/or extract oil, gas, and minerals. Twenty-four percent of ICSID arbitrations have arisen out of investments in the operation and maintenance of traditional public services such as electricity generation and transmission, water and sanitation services, and telecommunications.<sup>4</sup> Another eleven percent have arisen out of investments in the transportation sector.<sup>5</sup> At the heart of many of the disputes are contracts between the investor and a government entity governing the parties’ respective rights and obligations to build, upgrade, operate, and/or maintain infrastructure, or explore and/or exploit natural resources.

Awards in published cases indicate that investor-state arbitral tribunals are holding governments to stricter standards of non-interference (whether direct or incidental) with investor-state contracts than their domestic law counterparts in the U.S. More specifically, tribunals often proclaim that state liability under international law is triggered when a law of general application modifies or interferes with a commitment made to the investor; and, crucially, they have taken wide views of the types of “commitments” that can insulate contracts from legal change.<sup>6</sup> The violations found have generally been based on tribunals’ interpretation of the minimum standard of treatment under customary international law (“MST”), related and potentially coextensive “fair and equitable treatment” (“FET”) requirements, and the “umbrella clause” provision.

This comparative law analysis serves several aims. For one, it illustrates how standards pronounced and approaches used in the relatively new field of investment treaty arbitration differ from those developed over a longer period of time under U.S. law. To the extent that investment treaties are meant to serve as international *floors* of conduct common to legal systems worldwide and below which individual states are not to fall, a finding that arbitral decisions seem instead to be creating and enforcing relatively strong property rights protections underlines the importance of ongoing debates regarding the legitimacy and desirability of the process by which these new rules have been developed, the soundness of the substantive principles being pronounced, and the strategies for better calibrating and tying the standards to desired levels.

In addition to helping assess whether tribunals are identifying and requiring adherence to the proper floor or minimum level of internationally acceptable treatment, this comparative law exercise also provides a gauge to evaluate whether tribunals’ decisions are exceeding maximum thresholds of private protections and restraints on state conduct.<sup>7</sup> If investment treaties are viewed as embodying an “updated Calvo Doctrine” that enables investors from relatively well developed and stable legal systems with robust property rights protections to be able to carry their rights and expectations with them when investing abroad in countries with more unpredictable and less protective frameworks, this paper’s finding that investment treaty arbitration has developed

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<sup>4</sup> ICSID, *The ICSID Caseload – Statistics* (Issue 201e-1), 12. These figures include claims that are based on treaty and/or contract, or other mode of establishing consent to ICSID jurisdiction.

<sup>5</sup> *Id.*

<sup>6</sup> *See infra* Part II.

<sup>7</sup> STEPHAN SCHILL, *International Investment Law and Comparative Public Law – an Introduction*, in *INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW* 34 (2010).

principles of “super-protection” that jump beyond domestic legal principles in the United States is notable in that it suggests foreign investors are not merely able to maintain and rely on developed home country safeguards when investing in foreign territories, but are also able to draw from a set of stronger protections newly created by ad hoc arbitral tribunals.<sup>8</sup> In this way, the scope of investors’ rights becomes untethered from domestic systems, enabling firms with global operations to benefit from heightened standards and rights offered by private arbitrators’ interpretations of treaty provisions, while bypassing the balances struck through domestic lawmaking processes.

This paper’s focus on the domestic law of one jurisdiction of course cannot enable a pronouncement on whether and to what extent arbitral tribunals have developed new standards of protection that give private property rights and interests a level of primacy not reflected in state practice or general principles of law more broadly. Yet an in depth examination of the law of one domestic jurisdiction does provide a foundation for additional comparative law research to help ascertain and clarify, through an inductive approach, the general and customary international law principles governing this area of sovereign power and investor-state contracts. Examination of one legal order can also suffice to suggest “new” approaches in investor-state arbitrations that draw on “different, or more nuanced, solutions” already developed in public law systems to deal with analogous issues.<sup>9</sup> In this context, U.S. law can serve as a particularly relevant guidepost. Its history of engaging with private entities in order to accomplish domestic policy goals such as construction of infrastructure, provision of public services, and development of natural resources has produced a long line of cases delving into the question of how the law should treat investor-state contracts. These cases evidence challenges courts have faced and options they have identified for accommodating the potentially competing legal and policy considerations that also underlie many investment disputes, including governments’ duties to respect contract and property rights, needs to encourage private firms to contract with government entities, and responsibilities to act in the public interest and respond to changing needs and priorities.

Structurally, the paper proceeds as follows: Section II provides a historical overview of state liability for interference with investor-state contracts in international law, and discusses investment tribunals’ recent decisions on that issue under theories of breach of treaties’ MST/FET, umbrella clause, and expropriation provisions. Section III discusses the development and current status of U.S. case law governing state liability for harm to investor-state contracts, examining liability under theories of contract breach, unconstitutional takings, and due process violations. Section IV then highlights key areas of divergence between the investment treaty cases and national law approaches; and Section V concludes with a summary and remarks regarding ways forward.

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<sup>8</sup> Santiago Montt proposes and develops this theory of the updated Calvo Doctrine, and also critiques tribunals’ grants of “super-protections” in his book. SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION 21-22 (2009) (“The [updated Calvo] Doctrine states that BIT jurisprudence should not crystallize rules of protection of investments that are more demanding than those which *developed* countries’ courts apply in favour of their own national investors.” (emphasis in original)).

<sup>9</sup> SCHILL, *supra* note 7, at 26. *See also id.* at 27 (“In order to suggest legal reform ... a single legal order may suffice. When suggesting, however, that certain principles constitute general principles of law, a more exacting methodology must be followed.”).

## II. INVESTOR-STATE CONTRACTS, SOVEREIGN POWER, AND INTERNATIONAL LAW

### A. *State Interference with Investor-State Contracts under International Law: An Overview*

It is an uncontroversial rule that if a state breaches a contract with a foreign investor in its capacity as a traditional contracting party (*e.g.*, the state does not make payments due under the contract), the issue is one of contract breach that will be resolved in accordance with the law and forum specified in the contract (and/or as may be provided, supplemented or modified by principles of applicable law).<sup>10</sup> There is not considered to be “state action,” so the state’s conduct does not amount to an expropriation or other breach of international law.<sup>11</sup> Yet if the state exercises its governmental authority, acting in its sovereign rather than commercial capacity in order to directly interfere with or terminate the contract (*e.g.*, it issues a decree canceling the contract or concession), such conduct might give rise to state liability for breach of customary international law and/or treaty norms against arbitrary and uncompensated expropriations, violations of due process, and breach of the MST/FET obligation.<sup>12</sup>

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<sup>10</sup> “As a general rule, a violation of a contract is not a violation of international law.” *Impregilo S.p.A. v. Argentina*, ICSID Case No. ARB/07/17, (Danelius, Brower, Stern), Award, June 21, 2011, para. 177. Similarly, half a century ago Garcia Amador expressed the prevailing view that “in traditional practice and doctrine ... the mere non-performance [of the contract by a State] gives rise to state responsibility only if it involves an act or omission contrary to international law.” F.V. Garcia-Amador, *The Fourth Report on State Responsibility*, II Y.B. INT’L L. COMM’N A/CN.4/119 para. 121 (1959). *See also* International Law Commission, *Draft Articles on Responsibilities of States for Internationally Wrongful Acts, with Commentaries*, in REPORT OF INTERNATIONAL LAW COMMISSION, Supplement No. 10 (A/56/10) at 41 (Aug. 10 2001).

<sup>11</sup> *See, e.g.*, F.A. Mann, *State Contracts and State Responsibility*, 54 AM. J. INT’L. L. 572, 574 (1960). The *Bureau Veritas* tribunal also recently reaffirmed these principles, stating that to establish a breach of an international obligation arising out of the treaty “something more than mere breach of contract is needed. This might occur, for example, if the State agreed to the jurisdiction of its national courts for the resolution of a contractual dispute and then acted to limit effective access to such courts.” *Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. The Republic of Paraguay*, ICSID Case No. ARB/07/9, (Knieper, Fortier, Sands), Further Decision on Objections to Jurisdiction, Oct. 9, 2012, para. 246.

<sup>12</sup> The impact of the measure on the contract rights will likely impact the issue of whether it is expropriatory. Yet, even if not expropriatory, the act may violate international law principles of non-discrimination, and fair and equitable treatment. *See, e.g.*, Mann, *supra* note 11, at 575 (“The breach of contract is alleged to result from the fact that the dependant state whose law governs the contract, has in the exercise of its legislative or executive powers, taken measures specifically designed to terminate or interfere with the particular contract in issue. Here the international tort consists in the confiscatory, discriminatory or arbitrary character of the exercise of the defendant state’s sovereignty

The rule, however, is different when the state's sovereign measure is not a measure taken in order to interfere with or cancel the investor-state contract or concession, but is a measure of general applicability taken for a public purpose. In those cases, there is "no ground for an allegation of discrimination, *abus de droit*, denial of justice, or any other international tort of the traditional type."<sup>13</sup> Consequently, the position of most states on the legal consequences of such measures has traditionally been that international law does not hold a state liable for harms done to the private parties to investor-state contracts, if the state's interference with the contract was a result of a change in the law of general applicability.<sup>14</sup> In a long line of cases, international tribunals

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or, in short, in the *abus de droit* of which it is guilty and which is sufficient to attract its liability."). See also Expropriation Claim of Ponderosa Assets, L.P. (Argentina, Contract of Insurance No. D733), OPIC Memorandum of Determinations, Aug. 2, 2005, at 11 (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES) § 712 (1987), Note 8 (stating that "international law is not implicated if a state repudiates or breaches a commercial contract with a foreign national for commercial reasons as a private contractor might, e.g. due to inability of the state to pay or otherwise perform, or because performance has become uneconomical...").

<sup>13</sup> Mann, *supra* note 11, at 577. See also Oscar Chinn Case, PCIJ Series A/B No 63, at 88 (1934) ("Favourable business conditions and good will are transient circumstances, subject to inevitable changes; the interest of transport undertakings may well have suffered as a result of the general trade depression and the measures taken to combat it. No enterprise – least of all a commercial or transport enterprise, the success of which is dependent on the fluctuating level of prices and rates – can escape from the chances and hazards resulting from general economic conditions."); see Todd Weiler, *Saving Oscar Chin: Non-Discrimination in International Investment Law*, in ARBITRATING FOREIGN INVESTMENT DISPUTES, N. HORN AND S.M. KROLL EDS., PP.159-192, (2004).

<sup>14</sup> Mann, *supra* note 11, at 578 ("No other state seems to have adopted the Swiss-French doctrine [providing for state liability when general changes in the law affected a private party's rights in a contract with the state]"). Mann noted that two exceptions are Switzerland and France, which made contrary arguments in cases in which changes of law of general applicability in the former Yugoslavia and Norway, respectively, impacted the contract rights of Swiss and French nationals. In one case, *Certain Norwegian Loans*, I.C.J. Rep. 9 (1957), 51 A.J.I.L. 777 (1957), Norway had in the early twentieth century issued bonds, many of which were held by French nationals and that had a gold clause. Norway subsequently passed legislation that abrogated the gold clause. France argued on behalf of its bondholders that the Norwegian legislation abrogating the gold clause violated international law. The Court did not decide the issue as it upheld a jurisdictional objection advanced by Norway and therefore did not reach the merits. . The other dispute was the *Losinger & Co Case*, P.C.I.J., Series C, No. 78 (1936). In that case, a Swiss company had entered into a contract with Yugoslavia to construct a railway. The contract, concluded in 1929, contained an arbitration clause. While arbitration proceedings between the parties were pending, legislation was enacted in Yugoslavia that made arbitration clauses to which the Yugoslav state was a party null and void. Based on that legislation, Yugoslavia refused to participate further in the ongoing arbitration proceedings. Switzerland then intervened, asking the Permanent Court of International Justice to declare that Yugoslavia's position was unlawful. Like the *Norwegian Loans*



have similarly rejected the contention that governmental acts of general applicability can give rise to state liability for expropriation<sup>15</sup> or other international law violations, when those acts only incidentally interfere with a contract between a foreign investor and a state.<sup>16</sup> The general rule could thus be stated as one holding that a state will not be responsible under international law as a result of enacting or taking a measure of general applicability for a public purpose that has the consequence of interfering with a foreign investor's rights under a contract with that State (unless other circumstances are present such as an abuse of law, lack of due process, or discriminatory intent).<sup>17</sup>

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case, this dispute did reach the merits as it was discontinued after the governments reached a settlement.

<sup>15</sup> If, however, the degree of interference with contractual rights is to such an extent that it severely interferes with or wholly eviscerates them, there may be arguments that those rights have been expropriated, even if the relevant measure causing the interference was a good faith measure of general application taken for a public purpose. *See* OECD, "Indirect Expropriation" and the "Right to Regulate," in INTERNATIONAL INVESTMENT LAW (2004) (providing an overview of treaty texts, scholarly writings, state practice, and jurisprudence examining the line between expropriations and non-compensable regulations); *Compañía Del Desarrollo De Santa Elena, S.A. v. Costa Rica*, Case No. ARB/96/1, (Fortier, Lauterpacht, Weil), Final Award, Feb. 17, 2000, ¶ 72.

<sup>16</sup> Mann, *supra* note 11, at 580; Professor Jennings expressed similar principles, explaining that "there can be no 'breach' of contract unless there is a breach in the proper law (and there is clearly none where the contracting State has ended the contract by a change in the proper law through constitutional means). There cannot therefore, the argument proceeds, be any international law remedy for breach of contract because there is no breach of contract. Thus, the only possible international remedy is, therefore, one founded in a distinct international delict, such as, for instance, denial of justice. It cannot be a remedy for breach of contract because breach of contract there is none." (emphasis in original) R. Y. Jennings, *State Contracts In International Law*, 37 BRIT. Y.B. INT'L L. 156, 161-62 (1961).

<sup>17</sup> IAN BROWLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 547 (7th ed. 2008) ("[A] government acting in good faith may enact exchange control legislation or impose trade restrictions which incidentally (and without discrimination) lead to the annulment or non-enforcement of contractual rights. It is difficult to treat such action as illegal on the international plane."); *see also id.* at 509 ("[S]tate measures, prima facie a lawful exercise of powers of governments, may affect foreign interests considerably without amounting to expropriation. Thus, foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas, or measures of devaluation. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation."); M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 283 (1994). *Cf.* Rosalyn Higgins, *Taking of Property by the State: Recent Developments in International Law*, in RECUEIL DES COURS III (1982), 338-39 ("In my view the right distinctions are here being drawn: governments may indeed need to be able to act qua governments and in the public interest. That fact will prevent specific performance (including restitution) from being granted against them. But that is not to liberate them from the obligation to compensate those with whom it has entered into specific arrangements. That is the reasonable place to strike the balance between the expectations

This, some have stated, is merely a reflection of the fundamental principle of private international law that law “not merely sustains but, because it sustains, may also modify or dissolve the contractual bond.”<sup>18</sup> In other words, a contract is subject to the governing law, and if that law is the law of the host state, then the host state retains the power to change that law.<sup>19</sup> Contracts between private parties are subject to the same treatment and same changes in the law as contracts between investors and states. This principle also reflects (and protects) governments’ traditional rights to regulate within their borders.

Foreign investors, however, have developed and implemented various strategies to mitigate the risk to their investments from that traditional protective bubble over host governments’ policy space, rights to regulate, or other changes in government treatment of a foreign investor.<sup>20</sup> Some of these strategies operate in the context of specific relations between investors and host states. One of these micro-level approaches is for investors to insert stabilization provisions in the contracts or concessions with the host state.<sup>21</sup> By doing this, they effectively make changes in the relevant governing legal

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of foreign investors and the bona fide needs of governments to act in the public interest.”); *see also* Total S.A. v. Argentina, ICSID Case No. ARB/04/01, Decision on Liability, (Sacerdoti, Alvarez, Marcano), Dec. 27, 2010, ¶ 309.

<sup>18</sup> Mann, *supra* note 8, at 581 (quoting Kahler v. Midland Bank, A.C. 24, at 56 (1950)).

<sup>19</sup> In his well-known Separate Opinion in *Certain Norwegian Loans*, however, Judge Lauterpacht states that “an ‘international’ contract must be subject to some national law ... However, this does not mean that that national law is a matter which is wholly outside the orbit of international law. The question of conformity of national legislation with international law is a matter of international law... The notion that if a matter is governed by national law it is for that reason at the same time outside the sphere of international law is both novel and, if accepted, subversive of international law. It is not enough for a State to bring a matter under the protective umbrella of its legislation, possibly of a predatory character, in order to shelter it effectively from any control by international law. There may be little difference between a Government breaking unlawfully a contract with an alien and a Government causing legislation to be enacted which makes it impossible for it to comply with the contract.” Available at <http://www.icj-cij.org/docket/files/29/4781.pdf>, at 37.

<sup>20</sup> Based on an empirical survey, Rodolphe Desbordes and Julien Vauday investigated the impact of foreign firms on the host governments’ decision-making processes. Their results show that in some instances multinational enterprises’ arsenal of tools to influence foreign governments is far more diversified and powerful than that of the local enterprises. This is especially true with respect to foreign direct investments and government regulation. In some instances this impact is achieved through legitimate means such as lobbying and higher leverage in negotiations, while in other situations, it is achieved through illegitimate tools like bribery. *See* Rodolphe Desbordes & Julien Vauday, *The Political Influence of Foreign Firms in Developing Countries*, 19 *ECON. & POL.* 421 (2007); *see also* NATHAN M. JENSEN, *POLITICS AND FOREIGN DIRECT INVESTMENT* (2012).

<sup>21</sup> The effectiveness of these provisions, however, should not be a foregone conclusion. As Mann states, a host state may be able to enact a general change to its regulatory

framework a breach of the contract that could be remedied by specific performance or compensation.<sup>22</sup>

Another strategy is for investors to contract for agreements providing that the law governing the contract or concession is or includes municipal law *other* than the law of the host state, or law of the host state as supplemented or modified by international law. The former approach can, but will not necessarily, insulate the project from the impact of changes in the host state's legal framework. It can protect against changes in the host state law that directly interfere with the parties' rights and obligations under the contract itself; the investment or project may nevertheless still be affected by general changes in the host state's regulatory framework that impact issues not governed exclusively by the contract. The latter approach, entailing the "internationalization" of contracts,<sup>23</sup> subjects the underlying contract to international law, filling in gaps and elevating standards to ensure applicable law is tied to an international plane.<sup>24</sup>

Other efforts aimed at protecting investor-state contracts from being affected by modifications in the host state's legal framework have looked at a more macro-level approach that would extend beyond a particular investor-state relationship. For one, states have inserted in investment treaties clauses requiring host states to comply with any commitment made or obligation owed to foreign investors. Although the meaning of such "umbrella" clauses is a subject of controversy, investors, states, and commentators have argued that the provisions elevate state entities' contractual obligations owed to investors

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framework impacting a contract "even if the parties had expressly agreed upon the application of the proper law as existing at the time when the contract was made, and had thus excluded the application of subsequent changes, unforeseen and unforeseeable by the parties. The validity and effect of such a clause is doubtful in many respects." Mann, *supra* note 11, at 581.

<sup>22</sup> See DOLZER & SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 76 (2008). *Ulysseas, Inc. v. Ecuador*, UNCITRAL Ad Hoc, (Bernardini, Pryles, Stern), Final Award, June 12, 2012, ¶¶ 229 & 258. See also *Kuwait v. The American Independent Oil Company (AMINOIL)*, 21 ILM 976 (1982).

<sup>23</sup> Professor Sornarajah called this process "a transmogrification which enables it to move [an investor-State contract] out of the sphere of the domestic law of the host State onto a higher plane of supranational law, variously identified as transnational law, general principles of law and international law." M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 288-89 (3rd ed. 2010); Richard B. Lillich, *The Law Governing Disputes Under Economic Development Agreements: Reexamining the Concept of Internationalization*, in RICHARD B. LILICH R. & CHARLES N. BROWER, INTERNATIONAL ARBITRATION IN THE 21<sup>ST</sup> CENTURY 68-69 (1994); Derek William Bowett, *State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach*, 1998 B.Y.I.L.49, 59. See also George W. Haight, *The Internationalization of Development Contracts*, 3 PUB. L. FORUM 69, 78 (1983).

<sup>24</sup> As one scholar has contended, "Although contracts can be lawfully nationalized upon the payment of adequate compensation, governments in the exercise of their sovereignty can ... divest themselves of the right to nationalize their contracts. If despite such divestment the government nevertheless purports to nationalize, the principle of *restitutio integrum* would apply ... and a tribunal could order specific performance or damages which would include loss of profits." Haight, *supra* note 20, at 78.

to obligations protected and enforceable under the treaty, thereby providing another legal barrier against host states' ability to modify their performance of the contract, and providing investors expanded avenues through which to pursue claims for breach.<sup>25</sup> To the extent that the scope and nature of the underlying "commitment" or "obligation" protected by the treaty is defined by the domestic law of the host state, there are arguments that the host state's ability to shape that commitment or obligation through subsequent legislation remains intact. Furthermore, as noted above, the host state's law, with the power to sustain the contract, also can impact its performance. On that basis, an "umbrella" clause is not an international treaty obligation equivalent to a contractual stabilization clause.<sup>26</sup> Yet, as is described more fully below, and akin to the process of contract internationalization referred to above, tribunals have rather frequently determined that the scope and meaning of "commitments" made by the host state are not strictly bounded by the scope of the obligation under domestic law, but can be expanded (or, more particularly, stabilized) through reference to international law.<sup>27</sup>

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<sup>25</sup> The origin of the concept that "[a] treaty can be used effectively to elevate a contract between an investor and host state to the level of an inter-state obligation between the host state and the national state of investor" can be traced to Sir Elihu Lauterpacht. Anthony Sinclair, *The Origins of the Umbrella Clause in the International Law of Investment Protection*, 20 ARB. INT'L 411, 412 (2004). See also Alexandrov A. Stanimir, *Breaches of Contract and Breaches of Treaty: The Jurisdiction of Treaty-based Arbitration Tribunals to Decide Breach of Contract Claims in SGS v. Pakistan and SGS v. Philippines*, 5 JWIT 555 (2004); Thomas Wälde, *The "Umbrella Clause" in Investment Arbitration – A Comment on Original Intentions and Recent Cases*, 6 JWIT 183 (2005); Katia Yannaca-Small, *What About this 'Umbrella Clause'?*, in ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES 479, 483 (Katia Yannaca-Small ed., 2010); Michael Feit, *Attribution and the Umbrella Clause – Is there a Way out of the Deadlock?*, 21 MINN. J. INT'L L. 21 (2012). See Jean-Christophe Honlet & Guillaume Borg, *The Decision of the ICSID Ad Hoc Committee in CMS v. Argentina Regarding the Conditions of Application of an Umbrella Clause: SGS v. Philippines Revisited*, 7 LAW & PRAC. OF INT'L CTS. & TRIBUNALS 1 (2008).

<sup>26</sup> The distinction between umbrella clauses and stabilization clauses is evident. While the latter are created to establish a contractual remedy for a party to the contract in case the state-counterparty modifies its own law, umbrella clauses are treaty provision, "creat[ed] to establish] an inter-state obligation to observe investment agreements that investors may enforce when the BIT confers a direct right of recourse to arbitration." Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches Of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEORGE MASON L. REV. 135, 143 (2006).

<sup>27</sup> The *SGS (Paraguay)* and *Al-Bahloul* tribunals, for example, each found a breach of the umbrella clause due to the host state's failure to adhere to contractual obligations without finding it was necessary to make any recourse to the municipal law or to limit scrutiny only to municipal law. Thus tribunals based their findings of treaty breach on international law grounds. Mohammad Ammar Al-Bahloul v. Republic of Tajikistan, SCC Case No. V064/2008, Partial Award on Jurisdiction and Liability, (Hertzfeld, Happ, Zyklin), Sept. 2, 2009, ¶¶ 265-68; *SGS Société Générale de Surveillance S.A. v. Republic of Paraguay*, ICSID Case No. ARB/07/29, Award, (Alexandrov, Donovan, Mexía) Feb.

Another macro-level approach that has been pursued has been to argue for a principle of international law that would serve this stabilization function. In his 1960 article on *State Contracts and State Responsibility*, for instance, F.A. Mann examined the precise issue of state liability for government measures of general applicability that interfered with foreign investors' rights under contracts with the government. He surveyed the state of relevant customary international law existing at that time and determined that *no* rule of liability under international law for those types of measures had come into force. Nevertheless, he stated, there were continued calls for the development of a principle that would expand the circumstances under which host states would be liable for changes in their domestic law if and to the extent those changes interfered with the state's performance of a contract with a foreign investor to the detriment of that investor. The extreme end of this position, he noted, would hold that any sovereign measure infringing upon the rights of the other contracting party would result in liability for the host country.<sup>28</sup>

Although unconvinced of the need for a new rule on the matter,<sup>29</sup> Mann suggested an intermediate approach expressed in the following principle:

[W]ithout prejudice to its liability for any other tort (such as denial of justice, discrimination, expropriation), the state shall be responsible for the injuries caused to an alien by the non-performance of its obligations stipulated in a contract with that alien if and insofar as such non-performance results from the application of the state's law enacted after the date of the contract; this shall not apply where the law so enacted is required for the protection of public safety, health, morality or welfare in general.<sup>30</sup>

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10, 2012, ¶¶ 167-68, 170, 173. In contrast, in *Duke Energy* the tribunal found that Ecuador violated provisions of the municipal law governing the relevant contract, and subsequently found a breach of the treaty's umbrella clause. *See Duke Energy Electroquil Partners and Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, (Kaufmann-Kohler, Pinzón, van den Berg) Aug. 18, 2008, ¶ 325. Some scholars have defined the effect of the umbrella clause as providing an investor the opportunity "[t]o require the state to honor its original bargain irrespective of subsequent changes in the law [thus] giv[ing] the clause an independent and additional sphere of operation on the plane of international law." CAMPBELL MCLACHLAN, LAURENCE SHORE & MATTHEW WEINIGER, *INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES* 116 (2007).

<sup>28</sup> *See supra* note 11. As is discussed in the text, *infra*, the hypothetical raised by Professor Mann is analogous to the contemporary practice of investment tribunals. *See, e.g.,* ROLAND KLÄGER, *FAIR AND EQUITABLE TREATMENT IN INTERNATIONAL INVESTMENT LAW* 164-65(2011); *Total S.A. v. Argentina*, *supra* note 17.

<sup>29</sup> As one reason why expansion of state liability in this area may not be warranted, Mann stated that "[i]f an alien who contracts with a foreign state desires to be protected against legislative encroachments by that state upon his contractual rights, he must insist upon the submission of the contract to a legal system other than that of the contracting foreign state." Mann, *supra* note 11, at 588.

<sup>30</sup> *Id.* at 591.

This proposal aimed to find a middle ground between, on the one hand, the default rule that there was no state liability under international law for post-contractual modifications of the law through measures of general applicability and, on the other hand, calls for expanding state liability such that states would be responsible for *any* changes in the legal framework that impacted the investor's rights under the contract. The proposal would hold states liable for governmental acts that interfered with private contract rights but would maintain carve-outs for situations when *required* for legitimate public purposes.

It would be a worthwhile endeavor to explore the fate of that proposal, and investigate whether and, if so, how, custom or general principles of law have moved from the position Mann identified in 1960.<sup>31</sup> That, however, is not the main focus of this paper.<sup>32</sup> This paper recognizes that in a growing number of investor-state arbitrations,

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<sup>31</sup> In this context, Article 38 of the Statute of the International Court of Justice is relevant. It states that application of international law requires application of (a) treaties; (b) "international custom, as evidence of a general practice accepted as law;" (c) "general principles of law recognized by civilized nations; and, (d) "judicial decisions and the teachings of the most highly qualified publicists of the various nations, *as subsidiary means for determining the rules of law.*" Art. 38(1), 59 Stat. 1055, T.S. No. 933 (1945) (emphasis added). With respect to the issue of establishing custom, *see, e.g.*, Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v. United States) (Merits), 1986 I.C.J. 14, ¶ 207 (June 27, 1986) ("[F]or a new customary rule to be formed, not only must the acts concerned amount to a settled practice, but they must be accompanied by the *opinio juris sive necessitatis*. Either the States taking such action or other States in a position to react to it, must have behaved so that their conduct is evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it.") (internal quotation marks and citations omitted); Continental Shelf case (Libyan Arab Jamahiriya v. Malta), Judgement, June 3, 1985, ICJ Reports 29–30, 27 (1985); North Sea Continental Shelf cases, Judgement, Feb. 20 1969, ICJ Reports 3 (1969).

<sup>32</sup> A number of arbitrations have addressed the issue of whether and how the content of international law regarding treatment of aliens has evolved and, more specifically, how to establish that evolution. *See, e.g.*, Glamis v. United States, UNCITRAL Ad Hoc Award, (Young, Caron, Hubbard), June 8, 2009, ¶ 21 ("The Parties disagree, however, as to how that customary standard has in fact, if at all, evolved since that time. As an evidentiary matter, the evolution of a custom is a proposition to be established. The Tribunal acknowledges that the proof of change in a custom is not an easy matter to establish. In some cases, the evolution of custom may be so clear as to be found by the tribunal itself. In most cases, however, the burden of doing so falls clearly on the party asserting the change"). Further, once a tribunal issues an award incorporating its assessment of applicable law, the award and that determination of applicable law could face scrutiny by national courts if enforcement is resisted by the respondent state. National courts have therefore likewise pronounced on rules for establishing custom; and their decisions can have fatal implications for the legal force of awards. *See, e.g.*, United Mexican States v. Metalclad Corp., 2001 BCSC 664, ¶ 68 (May 2, 2001) ("On my reading of the Award, the Tribunal did not simply interpret Article 1105 to include a minimum standard of transparency. No authority was cited or evidence introduced to establish that transparency has become part of customary international law."); *see also* Jack J. Coe, Jr., *Domestic*

tribunals have declared that there has *in fact* been a shift, and that state liability is triggered when a law of general application modifies or interferes with a specific contractual commitment.<sup>33</sup> While tribunals, in their decisions, have not engaged in the exercise of tracing the evolution of that principle from sources of customary international law,<sup>34</sup> they have given life to it by reference to hortatory language in investment treaty preambles referring to the “stability” and/or “predictability” of host states’ legal regimes<sup>35</sup> and conclusions of other tribunals in investor-state disputes.<sup>36</sup> Consequently, the statement that a measure of general applicability is permissible<sup>37</sup> unless it contravenes a commitment made by the state to investor is now a common refrain in many awards in investor-state disputes.<sup>38</sup> This next section explores the content of those pronouncements.

## B. *Investment Law Disputes*

The first investment treaty dispute, *Asian Agriculture Products v. Republic of Sri Lanka*, was filed in 1987. By 2000, nearly 140 investment treaty disputes had been initiated. And as of December 2012, that number had exceeded 500.<sup>39</sup> The growth in the

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*Court Control of Investment Awards: Necessary Evil or Achilles Heel within NAFTA and the Proposed FTAA*, 19(3) J. INT’L ARB. 185, 197-98 (2002).

<sup>33</sup> See cases discussed *infra*, Part II.B.1 and II.B.2. . . See also ROLAND KLÄGER, *FAIR AND EQUITABLE TREATMENT IN INTERNATIONAL INVESTMENT LAW* 154-186 (2011). See also IOANA TUDOR, *THE FAIR AND EQUITABLE TREATMENT STANDARD IN INTERNATIONAL LAW OF FOREIGN INVESTMENT* (Oxford Univ. Press, 2008). See also *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, (de Maekelt, Rezek, van den Berg), Oct. 3, 2006, ¶ 123 & n.29.

<sup>34</sup> But see *Total S.A. v. Argentina*, *supra* note 17, ¶¶ 114-184.

<sup>35</sup> See, e.g., *LG&E v. Argentina*, *supra* note 33, ¶¶ 123-24; *Continental Casualty Company v. Argentina*, ICSID Case No. ARB/03/9, Award, ¶ 258; *Occidental Exploration and Production Company v. Ecuador*, LCIA Case No. UN 3467, Final Award, July 1, 2004. As a general rule, the approach of looking to a treaty’s preamble to inform meaning of the agreement’s substantive standards is consistent with the Vienna Convention on the Law of Treaties (VCLT). See VCLT, Art. 31(1), 1155 U.N.T.S. 331, *opened for signature* May 23, 1969 (“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”).

<sup>36</sup> See, e.g., *LG&E v. Argentina*, *supra* note 33, ¶¶ 124-25.

<sup>37</sup> In this sense, a “permissible” measure is one that does not violate the treaty and does not require compensation or other remedy. It thus is in contrast to a legal expropriation, which is also permissible under the treaty, but requires payment of compensation.

<sup>38</sup> See, e.g., *Total S.A. v. Argentina*, *supra* note 17, ¶¶ 119-20; *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision on Jurisdiction, (Orrego Vicuña, Lalonde, Rezek) July 17, 2003, ¶ 27. See also cases discussed *infra* in Part II.B.1. and II.B.2. and accompanying notes.

<sup>39</sup> *Latest Developments in Investor–State Dispute Settlement*, UNCTAD IIA ISSUES NOTE NO. 1, (Apr. 2012), available at [http://www.unctad.org/en/PublicationsLibrary/webdiaeia2012d10\\_en.pdf](http://www.unctad.org/en/PublicationsLibrary/webdiaeia2012d10_en.pdf) (last visited

cases has thus been dramatic. And as the cases have come forward, so has an emerging body of case law in which tribunals often refer to and rely on other decisions by investor-state arbitration tribunals to support their rulings. As noted above, many treaty-based investor-state arbitrations have arisen from investor-state contracts such as concession agreements, permits and licenses which govern long-term investments in areas of state and public concern including infrastructure construction and operation and the extractive industries. Indeed, the majority of investor-state disputes that have arisen to date appear to fall into this category and are too numerous to list.<sup>40</sup>

This microcosm of law has generated a number of de facto rules on the legal consequences of regulatory impacts on investor-state contracts. There are two notable features of these decisions. The first is the breadth of “promises” or “commitments” they commonly find as forming part of the binding obligations governing the investment. These have been found not only to arise from within the four corners of a contract, but also from statements made by government officials and provisions in general laws and regulations. The second is the broad scope of liability for subsequent legislation and measures of general applicability that impact or interfere with those “commitments.”

#### 1. *Forms of Commitments on Stability*

Turning to the first issue, there have been a wide variety of “promises” or “commitments” that have been interpreted to restrict governments’ abilities to modify their legal frameworks to the detriment of investors. Some decisions have taken the view that only a *specific* commitment by a state to an investor regarding the stability of the state’s legal framework can give rise to liability for subsequent changes to that framework. In *EDF v. Romania*, for instance, the tribunal explicitly acknowledged that an investor “may not rely on a bilateral investment treaty as a kind of insurance against the risk of any changes in the host State’s legal and economic framework ... except where specific promises or representations are made by the State.”<sup>41</sup> Respondent states have also supported the contention that liability can exist for changes in the regulatory framework, but only where a specific commitment had been given to refrain from (or indemnify for) changes in that framework.<sup>42</sup>

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January 2013); *see also* The ICSID Caseload – Overview in the Presentation of Meg Kinnear during Kiev Arbitration Days (Nov. 15, 2012).

<sup>40</sup> *See* ICSID, The ICSID Caseload – Statistics (Issue 2012-2) (Jun. 30, 2012), <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English32> (last visited Feb. 17, 2013).

<sup>41</sup> *EDF v. Romania*, ICSID Case No. ARB/05/13, Award, (Bernardini, Rovine, Derains), Oct. 8, 2009, ¶ 217.

<sup>42</sup> *See, e.g., EDFI v. Argentina*, ICSID Case No. ARB/03/23 Award (Park, Kaufmann-Kohler, Remón), June 11, 2012, ¶ 360 (“In Respondent’s view, legitimate expectations do not demand that the host state refrain from modifying its legislation unless there has been an assumption of specific commitment to the investor”); *Electrabel v. Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, (Kaufmann-Kohler, Stern, Veeder), Nov. 20, 2012, ¶ 7.76 (“Hungary asserts that legitimate expectations must be based on affirmative governmental representations...”).



There are variations, however, regarding how “specific” tribunals have required that commitment to be, and in what form they have determined it needs to be made. In *Total v. Argentina*, the tribunal summarized other investment arbitration decisions and came to the conclusion that “[t]he expectation of the investor is undoubtedly ‘legitimate’ ... if the host State has explicitly assumed a specific legal obligation for the future, such as by contracts, concessions or stabilization clauses on which the investor is therefore entitled to rely as a matter of law.”<sup>43</sup> This suggests that the commitment must be expressly contained in a legal instrument tailored to the particular deal between the investor and state.

Yet explicit promises set forth in a contract are not uniformly required by tribunals.<sup>44</sup> In *Glamis Gold v. United States*,<sup>45</sup> the tribunal suggested that promises of stability could be “quasi-contractual,” made through “specific assurances”<sup>46</sup> by the government that were “definitive, unambiguous and repeated.”<sup>47</sup> Taking a more relaxed approach, the tribunal in *Electrabel v. Hungary* stated that while “specific assurances made by the host state” were relevant, they were not “always indispensable,” and cited three other decisions for that proposition:<sup>48</sup> *MTD v. Chile*,<sup>49</sup> *GAMI Investment v. Mexico*,<sup>50</sup> and *SD Myers v. Canada*.<sup>51</sup> In *Parkerings v. Lithuania*, the tribunal similarly stated that both “explicit” promises and “implicit[] assurance[s] or representation[s]” could support an enforceable commitment regarding the stability of the legal framework.<sup>52</sup>

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<sup>43</sup> *Total S.A. v. Argentina*, *supra* note 17, ¶ 117.

<sup>44</sup> In *Saluka* the tribunal determined that “Claimant’s reasonable expectations to be entitled to protection under the Treaty need not be based on the explicit assurances from Czech Governments.” *Saluka Investments v. Czech Republic*, UNCITRAL, Partial Award, (Watts, Fortier, Behrens) Mar. 17, 2006, ¶ 329.

<sup>45</sup> *Glamis v. United States*, UNCITRAL Ad Hoc, Award, (Young, Caron, Hubbard), June 8, 2009.

<sup>46</sup> *Id.* ¶¶ 799-801.

<sup>47</sup> *Id.* ¶¶ 799-802.

<sup>48</sup> *Electrabel v. Hungary*, ICSID Case, No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, (Kaufmann-Kohler, Stern, Veeder), Nov. 30, 2012 ¶ 7.78. The tribunal thus seems to have rejected the claimant’s contention that its “expectation that its contractual rights [would] not be affected by governmental measures without compensation [was] legitimate in and of itself, without further affirmative governmental representations or assurances.” *Id.* ¶ 7.76.

<sup>49</sup> *MTD v. Chile*, ICSID Case No. ARB/01/7, Award, (Sureda, Lalonde, Blanco), May 25, 2004.

<sup>50</sup> *GAMI Investment v. Mexico*, Ad Hoc, UNCITRAL, Final Award, (Reisman, Muró, Paulsson), Nov. 15, 2004.

<sup>51</sup> *SD Myers v. Canada*, Ad Hoc, UNCITRAL, Second Partial Award, (Hunter, Schwartz, Chiasson), Oct. 21, 2002.

<sup>52</sup> *Parkerings v. Lithuania*, ICSID Case No. ARB/05/8, Award, (Lévy, Lalonde, Lew), Sept. 11, 2007, ¶ 331. The tribunal further stated that “[s]ave for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.” *Id.* ¶ 332.

“Representations” and “assurances” that have been found to imply a promise of stability include both written and oral statements by government officials.<sup>53</sup> And, although some tribunals have stated that such promises must be legally binding in order to establish an enforceable commitment,<sup>54</sup> tribunals in a number of cases have used a less exacting “totality of the circumstances” approach when assessing whether such promises have been made, citing a variety of non-binding statements by public officials in support of their findings that governments have guaranteed regulatory stability.<sup>55</sup>

Tribunals have also inferred commitments of stability based on extrapolations from alleged statements of representatives of state-owned enterprises. One notable example is the 2012 decision *Occidental v. Ecuador*.<sup>56</sup> There, the tribunal found that the oil participation contract between the claimant Occidental and Ecuador’s state-owned oil company, PetroEcuador, contained an implied promise barring Ecuador from subsequently enacting a new law (“Law 42”) taxing revenues generated from oil production governed by the contract.<sup>57</sup> The tribunal acknowledged that the contract itself did not have any revenue guarantees. The tribunal also noted that the contract specifically contemplated providing the investor compensation for certain changes in the governing

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<sup>53</sup> See, e.g., *Técnicas Medioambientales Tecmed v. Mexico*, ICSID Case No. ARB (AF)/00/2, Award, (Grigera Naon, Fernandez Rozas, Bernal Vereza), May 29, 2003, ¶¶ 158-74; *Metalclad v. Mexico*, Reasons for Judgment of the Honorable Mr. Justice Tysoe, ¶¶ 28-29 (S.C. B.C. May 2, 2001) (“The Tribunal found that Metalclad had been led to believe by federal authorities that the federal and state permits issued to COTERIN allowed for the construction and operation of the landfill, and it made reference to Metalclad’s position (which the Tribunal appeared to have implicitly accepted) that it was also told by federal officials that if it submitted an application for a municipal construction permit, the Municipality would have no legal basis for denying the permit.”). At least one case has found that a general offering memorandum issued by the host government designed to encourage investment in the host country supported a promise of future regulatory stability; overall, however, such promotional materials do not seem to carry much weight as constituting non-derogable undertakings. *LG&E v. Argentina*, *supra* note 33, ¶ 175. When discussing whether there had been a breach of the umbrella clause, the tribunal noted that the Offering Memorandum was among the guarantees that had been offered to foreign investors. It did not appear, however, to place similar weight on the Memorandum in terms of deciding whether there was a breach of the FET obligation. In contrast to *LG&E*, other tribunals have determined that such offering memoranda do not support enforceable commitments. In *PSEG v. Turkey*, for instance, the tribunal stated, “True enough, the whole BOT policy was built on the premise that foreign investments would be needed, encouraged and welcome, but this was a matter of general policy that did not entail a promise made specifically to the Claimants about the success of their proposed project.” *PSEG v. Turkey*, ICSID Case No. ARB/02/5, Award, (Orrego Vicuña, Fortier, Kaufmann-Kohler), Jan. 19, 2007, ¶ 243.

<sup>54</sup> *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award, (Orrego Vicuña, Lalonde, Rezek) May 12, 2005, ¶ 124.

<sup>55</sup> See cases cited *supra*, note 53. See also *id.* ¶¶ 134-35.

<sup>56</sup> *Occidental Petroleum Corp. v. Ecuador*, ICSID Case No. ARB/06/11, Award, (Fortier, Williams, Stern), Oct. 5, 2012, ¶¶ 467-547.

<sup>57</sup> *Id.* ¶¶ 512-530.

legal framework impacting the economics of the deal, and found that Law 42 was not one of the measures covered by that provision. Yet despite finding no explicit promise of stability, or express commitment to compensate for the legal change effected by Law 42, the tribunal highlighted that in contract negotiations between the claimant and PetroEcuador, PetroEcuador's representatives indicated that Occidental would bear the risk of low oil prices, but would be able to fully capture the benefits of its allotted levels of production in times of high prices for the commodity.<sup>58</sup> According to the tribunal, Occidental "was justified in expecting" that bargain of risks and rewards struck by the contracting parties "would be respected and certainly not modified unilaterally by the Respondent" through enactment of legislation impacting the value of the deal.<sup>59</sup>

Some tribunals have also inferred the existence of promises from an examination of the relevant contract and its relationship to the general regulatory framework. In *EDFI v. Argentina*, the dispute arose out of a concession for the provision of electricity transmission and distribution services, and centered largely on the impact that measures taken by Argentina in response to its 1999-2002 financial crisis had on the investors' investment in that concession. One of the measures Argentina took was to repeal its "Convertibility Law," which had pegged the peso to the dollar at a one-to-one ratio.<sup>60</sup> The investors argued that the contract had implied that the regime based on the Convertibility Law would remain in place, and that the government consequently committed to bear the risk and indemnify the investors in the case that that law was repealed. Argentina, in contrast, contended that no such promise had been made in the concession contract and that the risk remained with the investors. The tribunal sided with the investor claimants.<sup>61</sup> In doing so, it placed the burden on Argentina to disclaim the assumption of such commitments, noting that if the contract had not intended to compensate for repeal of the Convertibility Law, it "could have said so."<sup>62</sup>

A number of cases have gone further and determined that when states contract with foreign investors, the *existence* of the regulatory framework gives rise to an *implied* promise that the investment will not be impacted by subsequent regulatory change.<sup>63</sup> In *Enron v. Argentina*, for instance, the tribunal determined that the regulatory framework in place at the time the investment was made was a part of the "conditions ... offered by the State to the investor at the time of the investment,"<sup>64</sup> and that under the "emerging standard of fair and equitable treatment in international law,"<sup>65</sup> the investor had a right to

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<sup>58</sup> *Id.* ¶¶ 517, 526

<sup>59</sup> *Id.* ¶¶ 522, 526, 541.

<sup>60</sup> For more on the convertibility regime and its fate, *see, e.g.*, Steve Hanke & Kurt Schuler, *What Went Wrong in Argentina?*, 7 *CENTRAL BANKING J.* 42 (2002).

<sup>61</sup> *See, e.g.*, *EDFI v. Argentina*, *supra* note 42, ¶¶ 951-69.

<sup>62</sup> *Id.* ¶ 960.

<sup>63</sup> *See, e.g.*, *Enron v. Argentina*, ICSID Case No. ARB/01/3, Award, (Orrego Vicuña, van den Berg, Tschanz), May 22, 2007; *LG&E v. Argentina*, *supra* note 33; *CMS Gas Transmission Company v. Argentina*, *supra* note 54; *EDFI v. Argentina*, *supra* note 42; *National Grid v. Argentina*, Ad Hoc, UNCITRAL, Award, (Sureda, Kessler, Garro), Nov. 3, 2008; *BG Group v. Argentina*, Ad Hoc, UNCITRAL, Final Award, (Alvarez, van den Berg, Garro), Dec. 24, 2007.

<sup>64</sup> *Enron v. Argentina*, *supra* note 63, ¶ 262.

<sup>65</sup> *Id.* ¶ 260.

expect that those conditions would not change. The tribunal noted that the underlying concession contract between the investor and state did not contain explicit promises that the legal and regulatory framework would remain unchanged,<sup>66</sup> but declared that the burden was on the government to make clear at the time of the investment that no such promises of stability were being made, stating that “the tariff regime approved was devised as a permanent feature of the privatization, not a transitory one, and if it was intended to be transitory it should have also been clearly advised to prospective investors, but again nothing of the sort was done.”<sup>67</sup>

The tribunal in *LG&E v. Argentina* likewise proclaimed that although there was “no binding contractual agreement” containing “stabilization clauses [to protect the investor] in the event of changes in circumstances,”<sup>68</sup> the laws and regulations in place at the time when the investor made its investment established a “guarantee” the government had the obligation under the FET requirement to maintain.<sup>69</sup>

In another, earlier dispute between Occidental and Ecuador, *Occidental v. Ecuador (2004)*,<sup>70</sup> the tribunal inferred the existence of a promise by the government to the investor that the investor would not be impacted by shifts in *interpretations* of the laws by administrative or judicial decision-makers. In 1999, Occidental had entered into a contract with PetroEcuador providing for Occidental’s exploration and exploitation of hydrocarbons in Ecuador. Around that same time, Ecuador adopted a new tax law to which Occidental was subject. Beginning in 2001, Ecuador’s regulatory tax authority issued a series of resolutions determining that it had been incorrectly applying that 1999 tax law for roughly the previous year and that Occidental was not entitled to certain tax refunds that it had been claiming and receiving. Occidental filed an investor-state claim arguing that the shift in interpretation and application of the tax law required it to pay more than it had anticipated and relied upon when it made its investment, and that such a shift violated its “legitimate expectations” in breach of the FET standard. The tribunal agreed, stating that “there is certainly an obligation [under customary international law] not to alter the legal and business environment in which the investment has been made.”<sup>71</sup>

In a final example, the tribunal in *Frontier v. Czech Republic* also took a broad view of enforceable promises by stating that investors are entitled to rely on representations or undertakings made “explicitly or implicitly” by the host state through “legislation, treaties, decrees, licenses, and contracts.”<sup>72</sup>

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<sup>66</sup> Based on that ambiguity, the tribunal looked outside the language of the contract to determine whether it had guaranteed maintenance of the tariff regime that had been in place at the time of the investment, examining, for example, deliberations of the Privatization Committee in Argentina. It noted that one interpretation of the deliberations in the Privatization Committee supported Argentina’s contentions, but that other readings were also “justified.” *Id.* ¶¶ 138-39.

<sup>67</sup> *Id.* ¶ 137.

<sup>68</sup> *LG&E v. Argentina*, *supra* note 33, ¶ 98.

<sup>69</sup> *LG&E v. Argentina*, *supra* note 33, ¶ 134.

<sup>70</sup> *Occidental v. Ecuador (2004)*, *supra* note 35.

<sup>71</sup> *Occidental v. Ecuador (2004)*, *supra* note 35, ¶ 191

<sup>72</sup> *Frontier v. Czech Republic*, Award, (Williams, Alvarez, Schreuer), Nov. 12, 2010, ¶ 285.

## 2. *Liability for Legal and Regulatory Change*

In the cases cited above, where a promise of stability was found to have been offered to the investor relating to an investor-state contract, and the regulatory framework governing that contract later changed, the tribunals found the host government liable and required the payment of damages which, in several cases, rose above \$ 100 million<sup>73</sup> and, in *Occidental v. Ecuador (2012)*, contributed to an award of over \$ 1.7 billion plus interest.<sup>74</sup> The tribunals based their findings of liability on a breach of the FET requirement which, in some cases like *Occidental v. Ecuador (2004)*, was equated with the minimum standard of treatment under customary international law;<sup>75</sup> and, in others such as *LG&E v. Argentina*, was interpreted as being an autonomous treaty standard more demanding of governments.<sup>76</sup> According to those tribunals, modifications to the general legal framework that interfere with “commitments” given to investors can upset investors’ “legitimate expectations” in breach of the guarantees of stability and predictability enshrined in the FET standard.

In some cases where the claimant added a claim for a breach of the umbrella clause, tribunals also found breaches of those obligations alongside the FET violations.<sup>77</sup> In *LG&E v. Argentina*, for instance, the tribunal determined that elements of the statutory framework in place at the time the investor made its investment represented commitments by the government, the abrogation of which violated the FET standard and the umbrella clause in the governing treaty.<sup>78</sup> Likewise, the tribunal in *EDFI v. Argentina* concluded that changes to the applicable legal framework were inconsistent with contractual commitments made to the investor, and thus violated both the FET and umbrella clause obligations.<sup>79</sup>

Generally, tribunals have *not* deemed changes in the legal and regulatory frameworks interfering with or abrogating prior government commitments to constitute expropriations of the investors’ investments.<sup>80</sup> Instead, expropriation claims based on changes in the applicable legal framework that impact or interfere with specific commitments seem to have largely failed, and have done so because the degree of impact or interference on the investment has been inadequately severe.<sup>81</sup>

Via treaty-based investor-state arbitrations, therefore, the rule of international law that F.A. Mann concluded did not exist in 1960 has been given de facto force through the FET obligation (whether viewed as an autonomous standard or the equivalent of the MST) and, in certain cases, the umbrella clause; and tribunals have found that new FET-based rule largely based on treaty preambles and other tribunals’ similar conclusions.

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<sup>73</sup> *LG&E v. Argentina*, *supra* note 33; *CMS Gas Transmission Company v. Argentina*, *supra* note 54; *EDFI v. Argentina*, *supra* note 42; *National Grid v. Argentina*, *supra* note 63; *BG Group v. Argentina*, *supra* note 63.

<sup>74</sup> *Occidental v. Ecuador (2012)*, *supra* note 56, ¶¶ 467-547, 876.

<sup>75</sup> *Occidental v. Ecuador (2004)*, *supra* note 35, ¶ 188.

<sup>76</sup> *LG&E v. Argentina*, *supra* note 33, ¶ 123.

<sup>77</sup> *LG&E v. Argentina*, *supra* note 33; *EDFI v. Argentina*, *supra* note 42.

<sup>78</sup> *LG&E v. Argentina*, *supra* note 33, ¶ 175.

<sup>79</sup> *EDFI v. Argentina*, *supra* note 42, ¶¶ 221-40.

<sup>80</sup> *LG&E v. Argentina*, *supra* note 33, ¶¶ 198-200.

<sup>81</sup> *See, e.g., id.* ¶¶ 198-200.

Due to the range of “commitments” that have been deemed to constitute enforceable promises, and the similar range of measures that can potentially interfere with those commitments, this is a significant shift in the scope of actual or potential liability for states. And, as discussed below, the shift goes farther than at least some domestic law systems, which, like investment tribunals, have encountered questions of how to reconcile public and private interests, and the goals of stability, predictability, and flexibility, in investor-state contracts.

### III. INVESTOR-STATE CONTRACTS, SOVEREIGN POWER, AND DOMESTIC LAW – THE U.S. CONTEXT

The U.S. has a long history of contracting with private entities for the provision of public goods and services, with various levels of government using diverse contracting forms to allocate rights and responsibilities in connection with activities such as banking, and construction, operation, and maintenance of transport, water, energy, and communications infrastructure.<sup>82</sup> Performance of these agreements, like those giving rise to some of the international arbitrations cited above, are often impacted by judicial, legislative, or executive changes in the legal framework governing the project over its term; and not surprisingly, investors often challenge these measures in formal litigation alleging breach of contract, a violation of due process, and/or an unconstitutional taking. Consequently, and as is described more fully below, there is substantial U.S. case law considering whether, when, and through what remedies private parties can secure relief from harms that legal shifts allegedly caused to their government contracts. This case law provides insight into how one domestic jurisdiction with relatively strong property rights protections has sought to balance and resolve tensions between the various public and private interests at stake in the disputes. This insight, in turn, serves several purposes, including contributing to the inductive exercise of identifying general principles of law, providing a point of reference against which to measure the weight tribunals are assigning to property rights protections relative to other interests, and suggesting options for new decision-making approaches in investor-state arbitrations.<sup>83</sup>

#### A. Breach of Contract: “Sovereign Acts” and “Unmistakability”

Two key doctrines in U.S. law governing state liability for government measures of general applicability that impact investor-state contracts are those of “sovereign acts” and “unmistakability.”

The sovereign acts doctrine is an underlying fundamental rule broadly shielding the government from liability for changes to the legal framework. It is based on the principle that any “contractual arrangements, including those to which a sovereign itself is a party, ‘remain subject to subsequent legislation’ by the sovereign.”<sup>84</sup> Pursuant to this

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<sup>82</sup> See cases discussed *infra*, Part III(A)(1). See also Dominique Custos & John Reitz, *Public-Private Partnerships*, 58 AM. J. COMP. L. 555, 564-70(2010); Jacques Cook, *Modern Enhancements for PPP Concession Agreements*, 28 CONSTRUCTION LAWYER 24 (2008).

<sup>83</sup> See *supra* Part I and *infra* Part IV.

<sup>84</sup> *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52-53 (1986) (citation omitted).

doctrine, a government will not be held liable for breach of a contract as a result of acts taken in its sovereign capacity and for the public good.<sup>85</sup>

But this does not mean that a government can avoid contractual liability simply by exercising its sovereign authority to modify or escape its obligations to specific contracting parties, even if doing so for a laudatory goal or the public good.<sup>86</sup> If such unilateral contractual escape routes were allowed, every government contract would arguably be illusory.<sup>87</sup> A fundamental limitation on the sovereign acts defense therefore exists which provides that the defense only applies when a government takes a measure of general application, rather than one that is specifically aimed at the affected contract or the party to it.<sup>88</sup> The sovereign acts rule is thus that “[w]hatever acts the government may do, be they legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons.”<sup>89</sup>

A further refinement of the sovereign acts principle and additional restraint on government liability for contract breach is the doctrine of unmistakability. According to the U.S. Supreme Court, “[s]overeign power governs all contracts subject to the sovereign jurisdiction, and will remain intact unless surrendered in *unmistakable terms*.”<sup>90</sup> This rule provides that a government can be contractually liable for a sovereign measure of general applicability (e.g., the enactment of legislation), but only if the government has given an “unmistakable” commitment not to take that specific action.<sup>91</sup> It can therefore be seen as a “rule of strict construction that presumes that the government, in making an agreement regarding its regulation of a private party, has not promised to restrain future use of its sovereign power, unless the intent to do so appears unmistakably clear in the agreement.”<sup>92</sup> As the Supreme Court explained in 1837, “In grants by the public, nothing passes by implication.”<sup>93</sup>

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<sup>85</sup> *Atlas Corp. v. United States*, 895 F.2d 745, 754 (Fed.Cir.1990).

<sup>86</sup> *Cienega Gardens v. United States*, 33 Fed. Cl. 196, 211-12 (Fed. Cl. 1995), vacated, 194 F.3d 1231 (Fed. Cir. 1998).

<sup>87</sup> *Temple-Inland, Inc. v. United States*, 59 Fed. Cl. 550 (Fed. Cl. 2004); *Centex Corp. v. United States*, 49 Fed. Cl. 691 (Fed. Cl. 2000).

<sup>88</sup> *United States v. Winstar Corp.*, 518 U.S. 839, 904 (1996); *Klamath Irr. Dist. v. United States*, 635 F.3d 505, 521 (Fed. Cir. 2011); *Stockton East Water Dist. v. United States*, 583 F.3d 1344, 1366 (Fed.Cir.2009).

<sup>89</sup> *Winstar*, 518 U.S. at 891 (quoting *Horowitz v. United States*, 267 U.S. 458, 461 (1925) & *Jones v. United States*, 1 Ct.Cl. 383, 384 (Cl. Ct. 1865)).

<sup>90</sup> *Winstar*, 518 U.S. at 872 (quoting *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 148 (1982)) (emphasis added); see also *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569, 1578 (Fed.Cir.1997), cert. denied, 524 U.S. 951 (1998).

<sup>91</sup> *Centex Corp. v. United States*, 395 F.3d 1283, 1307 (Fed. Cir. 2005) (“A prerequisite for invoking the unmistakability doctrine is that a sovereign act must be implicated”).

<sup>92</sup> Alan R. Burch, *Purchasing the Right to Govern: Winstar and the Need to Reconceptualize the Law of Regulatory Agreements*, 88 KY. L.J. 245, 248 (2000).

<sup>93</sup> *Charles River Bridge Co. v. Warren Bridge Co.*, 36 U.S. (11 Pet.) 420, 421 (1837).

1. *Narrowly Viewing Commitments of Stability – the Unmistakability Rule*

Several early cases in the development of the unmistakability doctrine arose in connection with private entry into the financial services sector and governments' regulation of those private entrants. One such case was the 1830 Supreme Court decision in *Providence Bank v. Billings*.<sup>94</sup> In that dispute, a U.S. state had granted Providence Bank and other institutions bank charters.<sup>95</sup> In the Providence Bank charter, the government had *not* expressly reserved the power to repeal or modify that charter or the law impacting it. In contrast, in its subsequent charters with other entities the government did include clauses stating that the banks would be subject to “acts which may be passed by the general assembly, in amendment or repeal thereof, or in any way affecting the same.”<sup>96</sup>

Roughly thirty years after granting Providence Bank its charter, the state enacted a new tax on the bank that diminished the charter's value. In response, the bank brought an action seeking an injunction to bar imposition of the tax. In a unanimous decision, the Supreme Court determined that, absent an explicit exclusion, the government retained its legislative and taxation authority. No express reservation to allow for future regulatory change had to be taken because “[t]he power of legislation ... resides in government as part of itself, and need not be reserved when property of any description, or the right to use it in any manner, is granted to individuals or corporate bodies.”<sup>97</sup> The Court determined that the government had not specifically promised to refrain from imposing additional taxes and that, therefore, the measures could stand.

“Unmistakability,” however, is not an impossibly high barrier that renders government contract liability illusory. In another case arising out of taxation of financial institutions, *Jefferson Branch Bank v. Skelly*,<sup>98</sup> the Court reached a different conclusion regarding the enforceability of government commitments in light of subsequent changes to the relevant legal framework. In 1845, a state legislature passed an act granting a charter to a private entity to establish and operate a bank. Among its provisions, the charter specified that the bank had to pay six percent of its profits to the state and that such charges would be in lieu of all other taxes on the bank. Roughly seven years later, the legislature passed another act subjecting the bank to additional taxes; the government followed by taking steps to collect the new assessments, and by amending the state constitution in an effort to affirm its right to take those actions.

A bank branch challenged the state law and constitutional amendment imposing the new taxes, arguing that those measures could not legitimately modify the tax arrangement set forth in the bank's 1845 charter. According to the bank, the state's measures violated the provision in the U.S. Constitution barring states from passing “any law impairing the obligation of contracts.”<sup>99</sup>

Reviewing the case, the Supreme Court first affirmed that, although granted by means of a legislative act, the bank charter represented a contract and that that contract

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<sup>94</sup> 29 U.S. (4 Pet.) 514 (1830).

<sup>95</sup> The court equated the charter to a contract between the government and the investor.

<sup>96</sup> *Providence Bank*, 29 U.S. at 521.

<sup>97</sup> *Id.* 29 U.S. at 563.

<sup>98</sup> *Jefferson Branch Bank v. Skelly*, 66 U.S. (1 Black) 436 (1861).

<sup>99</sup> *Id.* at 443-44.



was protected by the U.S. Constitution from state interference.<sup>100</sup> The Court also affirmed that a state does have the power to contract away its taxing power, and that subsequent government actions interfering with such contractual commitments would give rise to a breach of contract.<sup>101</sup> It added, however, that “[t]he rule of construction in such a case is that the grant of privileges and exemptions to a corporation are to be strictly construed against the incorporators and in favor of the public, that nothing passes but what has been granted in clear and explicit terms, and that neither the right of taxation nor any other power of sovereignty will be held ... to have been surrendered unless such surrender has been expressed in terms too plain to be mistaken.”<sup>102</sup> Applying that standard of construction, the Court determined that the state had committed via the charter to restrict its power to tax the bank, and that its subsequent legislative act and constitutional amendment breached that commitment in violation of the U.S. Constitution.<sup>103</sup>

*Providence Bank* illustrates that a reservation of rights to modify the legal framework is not necessary, and that although the U.S. Constitution bars U.S. states from “impairing the obligations of contracts,” a contractual promise to refrain from exercising sovereign authority must be *unmistakable* in order to be effective. While *Providence Bank* suggests the difficulty of establishing unmistakability, *Jefferson Branch* is evidence that it can be done. Nevertheless, as the Supreme Court’s 1899 ruling in *Covington v. Kentucky* subsequently affirmed, the unmistakability doctrine serves as a strong guardian of sovereign power.<sup>104</sup>

*Covington v. Kentucky* involved a contract for the construction and operation of a municipal water supply system.<sup>105</sup> The state legislature granted the “contract”<sup>106</sup> at issue in 1886 through legislation, and specified in that law that the relevant “reservoir or reservoirs, machinery, pipes, mains and appurtenances, with the land upon which they are situated, shall be and remain forever exempt from state, county and city tax.”<sup>107</sup> Roughly ten years after passage of the legislation/grant of the contract, the legislature enacted a constitutional provision and complementary law subjecting the water supply system to taxes. The municipality did not pay the taxes assessed under those new legal provisions; the state took ownership of the water company’s property,<sup>108</sup> and the municipality followed by bringing suit to recover that property, arguing that the new tax impaired its contract with the state and therefore breached the U.S. Constitution.<sup>109</sup>

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<sup>100</sup> *Id.* at 445-50.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 446.

<sup>103</sup> *Id.* at 443-44.

<sup>104</sup> 173 U.S. 231 (1899).

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* The Kentucky court from which the case was appealed had treated the relevant state law as a contract. That issue was not on appeal before the Supreme Court so it likewise treated the law as a contract. *Id.* at 231. The contract was a grant to a municipality, not a private entity. *Id.*

<sup>107</sup> *Id.* at 233, 236 (quoting Acts Ky. 1885-86, p. 317, c. 897) (emphasis added).

<sup>108</sup> *Id.* at 236. The property was sold at an auction at which the state was the only bidder. It purchased the property for roughly \$2000.

<sup>109</sup> *Id.* at 236.

On review, the Supreme Court stated that *if* the state had entered into a contract with the municipality exempting it from those new taxes, then, under the U.S. Constitution, no state constitutional provision or piece of legislation enacted could affect that contract.<sup>110</sup> Nevertheless, the Court upheld the tax against the constitutional challenge. Crucial to the Court’s decision was the fact that prior to granting the water supply contract, the legislature had enacted a separate law stating:

[A]ll charter and grants of or to corporations, or amendments thereof, and all other statutes, shall be subject to amendment or repeal at the will of the legislature, unless a contrary intent be therein plainly expressed: provided, that whilst privileges and franchises so granted may be changed or repealed, no amendment or repeal shall impair other rights previously, vested.<sup>111</sup>

According to the Court, the language in the contract for the supply of water services purporting to free that property from tax liability did not sufficiently constitute a plain or unmistakable promise to keep that property free from tax assessments in perpetuity. The Court took the view that “the exemption from taxation embodied in that act [constituting the contract] did not tie the hands of the [state government], so that it could not, by legislation, withdraw such exemption, and subject the property in question to taxation. The act of 1886 was passed subject to the provision in a general statute expressly protecting the government’s ability to amend or repeal statutes “at the will of the legislature.”<sup>112</sup> The Court further elaborated on its view of the inadequate plainness of the purported promise to keep the property “forever” free from taxation. It stated:

[Such promise] falls short of a plain expression by the legislature that at no time would it exercise the reserved power of amending or repealing the act under which the property was acquired. The utmost that can be said is that it may be inferred from the terms in which the exemption was declared that the legislature had no purpose, at the time the act of 1886 was passed, to withdraw the exemption from taxation; not that the power reserved would never be exerted, so far as taxation was concerned, if in the judgment of the legislature the public interests required that to be done. The power expressly reserved to amend or repeal a statute should not be frittered away by any construction of subsequent statutes based upon mere inference. Before a statute—particularly one relating to taxation—should be held to be irrepealable, or not subject to amendment, an intent not to repeal or amend must be so directly and unmistakably expressed as to leave no room for doubt; otherwise, the intent is not plainly expressed. It is not so expressed when the existence of the intent arises only from inference or conjecture.<sup>113</sup>

Another case relating to water utilities is *Rogers Park Water Co. v. Fergus*.<sup>114</sup> Here, as in *Covington*, the Supreme Court was particularly protective of state regulatory power and took a narrow view of unmistakability. In that case, the state had passed laws in 1872 granting cities the power to enter long-term contracts (up to 30 years) with

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<sup>110</sup> *Id.* at 237.

<sup>111</sup> *Id.* at 234.

<sup>112</sup> *Id.* at 238.

<sup>113</sup> *Id.* at 238-39.

<sup>114</sup> 180 U.S. 624 (1901).

private entities to supply water for public use.<sup>115</sup> Pursuant to that authority, in 1888 the city of Rogers Park entered into such a contract. Among its provisions, the terms of that deal set forth the rates to be charged for the water provided.<sup>116</sup> Subsequently, however, the city sought to modify the rates, prompting a challenge by the investor that the deal it had secured did not allow those modifications. The Court sided with the government. It reasoned that although it may have been necessary for the city to have promised the water supplier monopoly rights in order to induce it to invest, “no such inducement was given for an unalterable rate.”<sup>117</sup> According to the Court, there was again a lack of unmistakability:

There is no stipulation that it will be the only instance of regulation; that the power to do so is bartered away, and that the conditions which determined and justified it in 1888 would remain standing, and continue to justify it through the changes of thirty years. It would require clearer language to authorize us in so holding.<sup>118</sup>

Other cases have arisen out of disputes regarding contracts for transportation infrastructure and services. One early Supreme Court decision involving these types of contracts is *City of Saint Louis v. United Railways Company*.<sup>119</sup> There, the city had granted street railway companies contracts to construct, operate, maintain, and reconstruct its tracks and railways.<sup>120</sup> The contracts were long-term, with some of them running up to 50 years. At the time the contracts were granted through city ordinances, the city’s code specified that a license fee of \$25 would be due for each and every street railway car used by the licensees to transport passengers. Subsequently, the city imposed an additional tax based on the number of passengers transported. The street railway companies challenged that second tax. When the case reached the Supreme Court, it rejected the plaintiffs’ claim and used the opportunity to further elaborate upon the principle that sovereigns should be presumed to retain their sovereign authority when entering into contracts with private parties:

The principles involved in this case have been the subject of frequent consideration in this court, and while it can be no longer doubted that a state or municipal corporation, acting under its authority, may deprive itself by contract of the power to exercise a right conferred by law to collect taxes or license fees, at the same time the principle has been established that such deprivation can only follow when the state or city has concluded itself by the use of clear and unequivocal terms. The existence of doubt in the interpretation of the alleged contract is fatal to the claim of exemption. The section of the Missouri Constitution, and the laws to which we have referred, clearly show that while the franchise of the corporation essential to its existence is derived from the state, the city retains the control of its streets, and the use of them must be acquired from the municipal authorities upon terms and conditions which they shall fix. An examination of the cases in this court shows that it is not sufficient that a street

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<sup>115</sup> *Id.* at 628-29.

<sup>116</sup> *Id.* at 629-30.

<sup>117</sup> *Id.* at 630.

<sup>118</sup> *Id.* at 630.

<sup>119</sup> 210 U.S. 266 (1908).

<sup>120</sup> *Id.* at 270.

railway company has agreed to pay for the privilege of using the streets for a given term, either in a lump sum, or by payments in installments, or percentages of the receipts, to thereby conclude the municipality from exercising a statutory authority to impose license fees or taxes. This right still exists unless there is a distinct agreement, clearly expressed, that the sums to be paid are in lieu of all such exactions.<sup>121</sup>

Each of the cases discussed above relates to actions taken by state or local entity. One reason for this is that the express constitutional bar against impairment of contracts is only directed to U.S. states,<sup>122</sup> and, pursuant to the doctrine of sovereign immunity, federal liability for contract breach was largely circumscribed until laws began narrowing the scope of that protection in the latter half of the nineteenth century.<sup>123</sup> As that broad sovereign immunity defense has been chipped away, however, the sovereign acts and unmistakability doctrines have been interpreted to provide some cover from new exposure. Cases decided to date thus have applied those doctrines to any sovereign act – whether taken by local, state, federal,<sup>124</sup> or Native American governments.<sup>125</sup>

*Merrion v. Jicarilla Apache Tribe*,<sup>126</sup> a case assessing the legitimacy of changes in the fiscal regime governing long-term agreements for oil and gas production, illustrates this for conduct by Native American governments. Beginning in the 1950s, the Jicarilla Apache Tribe entered into lease agreements with various private entities granting them exclusive rights to develop and produce oil and gas from tribal lands. In exchange for those rights, the lease agreements required, subject to certain exceptions, the oil and gas companies to provide the tribe cash bonuses, royalties and rents.<sup>127</sup> In 1976, and pursuant to a revised constitution adopted by the tribe, a new ordinance was adopted imposing a tax on oil and gas removed from tribal lands. In response, the oil and gas producers brought an action to challenge the tax on, among other grounds, the argument that the tribe had waived its right to impose the tax by entering into the lease agreements where royalties, rents and bonuses – not taxes – formed the consideration given in exchange for the production rights.

The Court readily dismissed those arguments. In doing so, it noted wide applicability of the sovereign acts and unmistakability doctrines. It clarified that the same protections for sovereign acts including, in particular, the right to tax,<sup>128</sup> and the same

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<sup>121</sup> *Id.* at 274. *See also* *Vicksburg, S. & P. R. Co. v. Dennis*, 116 U. S. 665, 668 (1886).

<sup>122</sup> *See Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 732 & n.9 (1984).

<sup>123</sup> The Tucker Act, 24 Stat. 505, enacted on March 3, 1887; 28 U.S.C. § 1491.

<sup>124</sup> *See, e.g., Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986).

<sup>125</sup> *See, e.g., Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982).

<sup>126</sup> 455 U.S. 130 (1982).

<sup>127</sup> *Id.* at 135-36.

<sup>128</sup> The Court elaborated on the significance of this power for the sovereign and the benefits it considered to be received by the taxed. It stated, for instance:

The power to tax is an essential attribute of Indian sovereignty, because it is a necessary instrument of self-government and territorial management. This power enables a tribal government to raise revenues for its essential services. The power does not derive solely from the Indian tribe's power to exclude non-Indians from tribal lands. Instead, it derives from the tribe's general authority, as sovereign, to

requirements for the unmistakability of purported surrenders of those rights, were principles that applied to sovereign tribes just as they applied to other government entities at the federal, state or local level. It determined that although the leases at issue – which the Court considered were documents entered into by the tribe in its commercial capacity<sup>129</sup> – made no mention of taxes, that omission in no way constituted the “unmistakable” commitment necessary to constitute a waiver of the right to impose those charges in the future.<sup>130</sup>

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control economic activity within its jurisdiction, and to defray the cost of providing governmental services by requiring contributions from persons or enterprises engaged in economic activities within that jurisdiction. ... The petitioners avail themselves of the ‘substantial privilege of carrying on business’ on the reservation. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U. S. 425, 445 U. S. 437 (1980); *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 311 U. S. 444-445 (1940). They benefit from the provision of police protection and other governmental services, as well as from ‘the advantages of a civilized society’ that are assured by the existence of tribal government.

*Id.* at 137-38.

<sup>129</sup> The nature of the two types of charges (royalties, rents and bonuses, on the one hand, and taxes, on the other) and the arguable commercial/sovereign distinction between the two, seems to have been relevant to the Court’s analysis. The Court stated that “[t]he mere fact that the government imposing the tax also enjoys rents and royalties as the lessor of the mineral lands does not undermine the government’s authority to impose the tax. .... The royalty payments from the mineral leases are paid to the Tribe in its role as partner in petitioners’ commercial venture. The severance tax, in contrast, is petitioners’ contribution ‘to the general cost of providing governmental services.’” *Id.* at 138 (citing *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623 (1981)). It similarly added that while “[i]t is one thing to find that the Tribe has agreed to sell the right to use the land and take from it valuable minerals; it is quite another to find that the Tribe has abandoned its sovereign powers simply because it has not expressly reserved them through a contract.” *Id.* at 146. The Court also noted, however, that the initial *sovereign act* of allowing non-Indians to *enter* tribal lands for the purpose of engaging in oil and gas production did not shape and then bind the terms of the relationship between the sovereign and non-Indian entities going forward. According to the Court, “[t]he fact that the tribe chooses not to exercise its power to tax when it initially grants a non-Indian entry onto the reservation does not permanently divest the tribe of its authority to impose such a tax.” *Id.* at 145.

<sup>130</sup> *Id.* at 148. The Court stated that “[e]ven where the contract at issue requires payment of a royalty for a license or franchise issued by the governmental entity, the government’s power to tax remains unless it ‘has been specifically surrendered in terms which admit of no other reasonable interpretation.’” *Id.* at 148 (quoting *St. Louis v. United R. Co.*, 210 U. S. 266, 280 (1908)). The Court then applied that standard to the facts before it, explaining:

We could find a waiver of the Tribe’s taxing power only if we inferred it from silence in the leases. To presume that a sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to

These early cases developing the sovereign acts and unmistakability doctrines demonstrate a judicial willingness to protect legal evolution, and to construe narrowly claims that agreements between governments and private entities could freeze the law impacting the performance of those deals. This treatment by the courts gave relatively new government entities in a young country latitude to put in place infrastructure and essential public services during a period of rapid development and expansion in U.S. history; judicial decisions left lawmakers room to refine the regulatory frameworks governing long-term investor-state agreements based on changing circumstances and policies.<sup>131</sup> Flexibility of the legal framework, rather than stability of precise contractual terms, was the dominant guiding principle.

Yet, as the nature of government and its contracts with private entities has evolved, expanded and diversified,<sup>132</sup> one might wonder whether those developments would prompt courts to view tensions between investor-state contracts and legal change through a different lens. Judicial scrutiny of government actions impacting economic rights has notoriously gone through various phases of intensity;<sup>133</sup> and there are signs that the degree of protection courts will provide economic interests and rights arising from investor-state agreements may also evolve. The 1996 decision in *U.S. v. Winstar Corp.*<sup>134</sup> and cases that have followed illustrate such potential shifts, and reactions to them.

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exercise that power in a commercial agreement turns the concept of sovereignty on its head, and we do not adopt this analysis.

*Id.*

<sup>131</sup> The Supreme Court has stated:

The impetus for the modern unmistakability doctrine was thus Chief Justice Marshall's application of the Contract Clause to public contracts. Although that Clause made it possible for state legislatures to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments. Later decisions were accordingly less willing to recognize contractual restraints upon legislative freedom of action, and two distinct limitations developed to protect state regulatory powers. One came to be known as the "reserved powers" doctrine, which held that certain substantive powers of sovereignty could not be contracted away. ... The other, which surfaced somewhat earlier in *Providence Bank v. Billings*, 4 Pet. 514, 7 L.Ed. 939 (1830), and *Proprietors of Charles River Bridge v. Proprietors of Warren Bridge*, 11 Pet. 420, 9 L.Ed. 773 (1837), was a canon of construction disfavoring implied governmental obligations in public contracts.

*United States v. Winstar Corp.*, 518 U.S. 839, 874 (1996).

<sup>132</sup> David W. Gaffey, *Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships in the United States*, 39 PUBLIC CONTRACT L. J. 351 (2010); Dominique Custos & John Reitz, *Public-Private Partnerships*, 58 AM. J. COMP. L. 555, 564-70 (2010); Jacques Cook, *Modern Enhancements for PPP Concession Agreements*, 28 CONSTRUCTION LAWYER 24 (2008).

<sup>133</sup> See *infra*, Part III.B.2.

<sup>134</sup> 518 U.S. 839 (1996).

2. *Relaxing the Requirements of the “Unmistakability” Test in U.S. v. Winstar Corp.?*

A string of more recent cases elaborating upon the sovereign acts and unmistakability doctrines arose out of reform triggered by the collapse of the savings and loan industry in the United States. In the late 1970s and early 1980s, soaring interest rates and inflation wreaked havoc on thrifts. Over 400 declared bankruptcy in the short window between 1981 and 1983, and many more were teetering on the brink of insolvency. Fears rose that the Federal Savings and Loan Insurance Corporation, a government entity responsible for insuring consumer deposits in the institutions, would run out of funds.

To address the crisis, the Federal Home Loan Bank Board, the federal regulatory agency responsible for overseeing federally chartered savings and loans, took steps to encourage and induce healthy thrifts and other investors to purchase the insolvent thrifts in what were deemed “supervisory mergers.”<sup>135</sup> Among the inducements were certain financial incentives, including accounting methods that (1) made it easier for thrifts to satisfy reserve capital requirements (through “purchase accounting”), and (2) made thrifts appear more profitable than they were (through “amortization of goodwill”).<sup>136</sup> Due to both the attractiveness of these accounting methods for “supervisory mergers” and the risks of such deviations from Generally Accepted Accounting Principles (“GAAP”), regulators and the entities acquiring the insolvent thrifts entered into express agreements to reflect the arrangements.<sup>137</sup>

Yet despite these measures, the health of the savings and loan industry remained in danger of collapse and there were charges that the accounting tricks approved by the government exacerbated the problem by increasing the risk of the thrifts’ failure.<sup>138</sup> In response, in 1989, Congress stepped in and enacted the Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”). Among FIRREA’s changes, it denied thrifts the ability to use the previously approved accounting practices that had been allowed in order to incentivize the purchase of the failing institutions. Without the ability to use those relaxed accounting rules, many thrifts collapsed and were subsequently seized by government regulators. These developments gave rise to a slew of lawsuits against the United States in which the acquiring entities in the “supervisory mergers” alleged that, through its enactment of FIRREA, the United States had breached its contracts with the thrifts to provide those institutions with specific regulatory treatment.

Eventually, the Supreme Court took up the issue of whether the government’s enactment of FIRREA breached its contractual obligations. The case involved three thrifts that had concluded supervisory mergers. After the passage of FIRREA, two of the thrifts fell out of compliance with the capital requirements imposed by new federal

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<sup>135</sup> *Id.* at 847-48.

<sup>136</sup> *Id.* at 848-53.

<sup>137</sup> *Id.* at 839, 853.

<sup>138</sup> *Id.* at 857 (“According to the House Report, these tougher capital requirements reflected a congressional judgment that “[t]o a considerable extent, the size of the thrift crisis resulted from the utilization of capital gimmicks that masked the inadequate capitalization of thrifts.” (quoting House Report No. 101-54(I), 101st Cong. 1st Sess. at 310, U.S.Code Cong. & Admin. News 1989, pp. 86, 106)).

regulations and were seized by the government; the third survived, but only after “a massive private recapitalization.”<sup>139</sup> The three brought suit, seeking monetary relief on the grounds that the government’s passage of FIRREA breached contractual commitments to permit purchase accounting and amortization of goodwill.<sup>140</sup>

The issue of whether the underlying terms and approvals of the supervisory mergers were *contracts* was not squarely before the Court;<sup>141</sup> nevertheless, it considered that it had to address the question in connection with its legal analysis of the claim, and thus considered whether the government’s authorizations of purchase accounting and amortization of goodwill were, as the failed thrifts contended, contractual commitments for present and future treatment under the law, or, as the government asserted, merely statements of government policy.<sup>142</sup> Based on the specific circumstances and documents related to the supervisory mergers at issue in *Winstar*, the Supreme Court concluded that the documents executed by government regulators and the acquiring thrifts in connection with the supervisory mergers at issue and allowing purchase accounting and amortization of goodwill did constitute enforceable contractual agreements.<sup>143</sup>

Finding that the underlying contracts existed, the Court turned to whether the sovereign acts doctrine applied to preclude liability for impacts that enactment of FIRREA had on those agreements. In a highly fragmented outcome, the Court determined that the sovereign acts defense did not apply because the law was not sufficiently public and general in application. Justice Souter, who wrote the opinion for the Court, looked to statements by legislators when debating the enactment of FIRREA and reasoned that, as those statements seemed to evidence, one intent behind the law was specifically to undo and abandon the “accounting gimmicks” that had approved by the government for the supervisory thrifts. He concluded that the “self-interested” and targeted nature of the law thus disqualified it from the sovereign acts defense shielding public and general laws.<sup>144</sup> The opinion further likened the scenario to a violation of the rule of law, where the government used the powers uniquely available to it to seek relief from commitments it had entered into, but later determined were no longer in the public interest.<sup>145</sup> That the law did not specifically target the three contracts at issue and was general on its face was deemed inconsequential as “[l]egislation can almost always be written in a formally general way” to mask its more specific targets.<sup>146</sup>

Evidencing discontent with that conclusion, however, only three of the nine Justices joined in this part of the Court’s discussion on the nature of the “public and general” requirement and the FIRREA’s apparent failure to satisfy it.<sup>147</sup>

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<sup>139</sup> *Id.* at 858.

<sup>140</sup> *Id.* at 858-59.

<sup>141</sup> *Id.* at 860-61.

<sup>142</sup> *Id.* at 862-6.

<sup>143</sup> *Id.* at 859-60.

<sup>144</sup> *Id.* at 890.

<sup>145</sup> *Id.* at 897.

<sup>146</sup> *Id.* at 903.

<sup>147</sup> This part of the discussion written by Justice Souter, contained in Parts IV-A and IV-B, was joined by Justices Stevens and Breyer. Justice O’Connor joined the Court’s opinion except as to those specific parts. Three of the Justices, Justices Scalia, Kennedy, and Thomas, also would have rejected the sovereign acts defense, but on different



The Court's opinion on unmistakability was similarly fragmented, and similarly dismissive of the government defenses. Justice Souter's treatment of the doctrine in the Court's plurality opinion was joined by three other Justices, one of which wrote a separate opinion to elaborate more fully on his view of the issues. Overall, the plurality opinion narrows the scope of the unmistakability doctrine, limiting the situations in which it will apply. As Justice Souter describes in the *Winstar* plurality opinion, the unmistakability doctrine is only triggered in cases when a government entity has purportedly offered to refrain from exercising its sovereign authority. It does not apply where it has agreed to *indemnify* its contracting party for losses suffered as a result of future regulatory change. Thus, to the extent that an investor-state agreement can be viewed as a risk-shifting agreement under which the government will provide financial cover for losses suffered as a result of an altered legal framework, the unmistakability doctrine will provide no extra restraint on the alleged scope of government promises. The strict rule of construction otherwise afforded by the requirement for an unmistakable commitment will not apply. In other words, according to the *Winstar* plurality opinion, "[s]o long as such a contract is reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of [a governmental] power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it."<sup>148</sup>

The plurality opinion then added that, in certain cases, a commitment to refrain from the exercise of sovereign authority and a duty to indemnify would effectively be the same. This would be the case, for instance, in the context of tax measures, where both the exercise of the sovereign act (collection of the tax) and indemnification (repayment of the tax collected) would be functionally equivalent.

The other five Justices criticized the plurality's interpretation. They contended that the "risk-shifting" approach was a departure from previous cases,<sup>149</sup> and that it threatened to eviscerate the unmistakability doctrine in practice as "[v]irtually every contract operates, not as a guarantee of particular future conduct, but as an assumption of liability in the event of nonperformance."<sup>150</sup> As the dissent argued, the plurality's conception of the doctrine would enable a plaintiff to avoid its application by simply repackaging its challenge to a law: rather than seeking injunctive or declaratory relief, which would trigger the strict rule of construction, the plaintiff could allege that the

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reasoning, and issued a separate concurring opinion. Justice Rehnquist filed a dissenting opinion, which Justice Ginsburg joined in part.

<sup>148</sup> *Id.* at 880.

<sup>149</sup> *Id.* at 919, 927. (Justices Scalia, Kennedy and Thomas stated in their concurring opinion that the "risk shifting" analysis "had no basis in [previous Supreme Court] cases, which have not made the availability of these sovereign defenses (as opposed to their validity on the merits) depend upon the nature of the contract at issue." Justices Rehnquist and Ginsburg, in dissent, stated that the "principal opinion drastically limit[ed] the circumstances under which the [unmistakability] doctrine will apply by drawing a distinction never before seen in our case law." *Id.* at 927.).

<sup>150</sup> *Id.* (citing Holmes, *The Path of the Law* (1897), in 3 THE COLLECTED WORKS OF JUSTICE HOLMES 391, 394 (S. Novick ed., 1995)).

government had agreed to assume the risk of legal change and had breached that agreement, and should therefore be made to pay damages.<sup>151</sup>

Given the divided Court in *Winstar* and the plurality's narrow reading of the sovereign acts and unmistakability doctrines, the case has left a wake of uncertainty, generated much commentary, and required a number of lower courts to struggle to identify the precedential power of the decision's various elements. As some of that commentary and case law have indicated, *Winstar* may not have neutered the two sovereign defenses to the extent feared by government, or to the extent hoped by the entities with which it contracts.<sup>152</sup>

### 3. *A Return to Broad Protections for Sovereign Acts and Strict Demands for Unmistakability*

*Yankee Atomic Electric Co. v. United States*<sup>153</sup> is an example of a post-*Winstar* case that has had to grapple with the question of when the sovereign acts doctrine and unmistakability rule can apply to preclude or require government liability for regulatory change that impacts preexisting contractual relations. In that case, the plaintiff was a company that generated nuclear energy and sold the resulting electricity to other utilities for sale to retail customers. To obtain the enriched uranium it needed for electricity generation, it entered into a series of supply contracts with the U.S. government. Those supply contracts governed Yankee Atomic's purchase of enriched uranium from the U.S. government from 1963 until the early 1990s, when Yankee Atomic ceased operations.<sup>154</sup>

Eight months after Yankee Atomic shut down, the U.S. Congress passed the Energy Policy Act of 1992 ("EPA"). The EPA established a fund to clean up old uranium enrichment plants, and provided that deposits would come from two sources: public funds appropriated by Congress and a special assessment to be levied on utility companies based on whether they had benefited from enriched uranium purchased from the government. Pursuant to the EPA and its special assessment, the government demanded \$3 million from Yankee Atomic. The company paid, then sought recovery of the funds in federal court.<sup>155</sup>

The district court determined that the government's special assessment was a "unilateral retroactive increase in the price previously charged by the Government for its uranium enrichment services."<sup>156</sup> According to the court, the assessment was not adequately "public and general" to fall within the sovereign acts defense and was, instead, an unlawful exaction that breached the terms of the supply contracts between the

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<sup>151</sup> *Id.* at 927.

<sup>152</sup> One study of post-*Winstar* decisions that was published in 2000 stated that the cases issued up to that time did "not suggest that *Winstar* has effected any radical change in the law respecting the liability of the United States for retroactive legislation affecting the government's contractual undertakings." Joshua I. Schwartz, *The Status of the Sovereign Acts and Unmistakability Doctrines In The Wake of Winstar: An Interim Report*, 51 ALA. L. REV. 1177, 1179 (2000)

<sup>153</sup> 112 F. 3d 1569 (1997).

<sup>154</sup> *Id.* at 1572-73.

<sup>155</sup> *Id.* at 1573.

<sup>156</sup> *Id.*

government and Yankee Atomic.<sup>157</sup> On appeal, the U.S. Court of Appeals for the Federal Circuit overturned that holding. In reaching its conclusion, the appellate court stated that the relevant test to be applied was whether the government, in taking the challenged act, was “(i) was acting for ... the benefit of the Government-as-contractor or (ii) acting for ... the benefit of the public.”<sup>158</sup> It concluded the latter. It viewed enactment of the EPA and imposition of the special assessment was not a “unilateral retroactive” price increase, but an exercise of the sovereign’s taxing power designed to address a “societal problem,” bringing the act under the protective umbrella of the sovereign acts defense.<sup>159</sup>

The appellate court then turned to the unmistakability doctrine and its application to the facts. First, it stated that it would not adopt the approach taken by the *Winstar* plurality which focused on the whether the contract could be considered a “risk shifting” contract or an agreement to waive sovereign authority. Rather, it followed the five Supreme Court Justices who “stated that the application of the [unmistakability] doctrine [was] unrelated to the nature of the underlying contracts.”<sup>160</sup> The court also noted, however, that even if it had chosen to follow the plurality’s approach, the unmistakability doctrine would apply because the damages to be awarded (i.e., a refund of the special assessment) would effectively block the exercise of the action at issue (i.e., the government’s power to tax).<sup>161</sup>

Applying the doctrine, the appellate court noted that the legislative act authorizing the contracts stated that the government’s fees in the agreements should “enable recovery of the Government’s costs over a reasonable period of time.”<sup>162</sup> Based on that congressional directive, the court further noted, one could argue that the price charged should be assumed to incorporate *all* costs, including subsequently discovered costs of environmental remediation. The appellate court held, however, that such general legislative directives and the implications that could arise therefrom did not amount to a specific commitment capable of satisfying the unmistakability doctrine. It therefore concluded that although Yankee Atomic possessed a “vested contract right” that barred the government from charging more than the fixed price set in the contract for the *supply* of enriched uranium, the contract did not preclude the “subsequent assessment” aimed at “spreading the costs of the later discovered decontamination and decommissioning problem.”<sup>163</sup>

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<sup>157</sup> *Id.* at 1573.

<sup>158</sup> *Id.* at 1575.

<sup>159</sup> *Id.* at 1577.

<sup>160</sup> *Id.* at 1579.

<sup>161</sup> *Id.* (“As explained above, the assessment at issue in the present case is a general, sovereign act. Although Yankee Atomic seeks money damages, its argument would effectively block the exercise of this sovereign power to tax, for if Yankee Atomic were to prevail, the Government would be required to refund the entire amount assessed. This is akin to a tax rebate, which even the plurality seemed to recognize as a block to the exercise of sovereign power. *See* [*Winstar*, 518 U.S. at 880] (‘Granting a rebate, like enjoining enforcement, would simply block the exercise of the taxing power.’)”) *Id.*

<sup>162</sup> 112 F.3d at 1580.

<sup>163</sup> *Id.*

Another and more recent case, *Century Exploration New Orleans v. United States*<sup>164</sup> follows *Yankee Atomic* in reasserting, post-*Winstar*, the dominance of the sovereign acts rule and narrowness of the unmistakability doctrine. That case arose in the aftermath of the Deepwater Horizon disaster, which involved a massive oil spill of the coast of the United States in the Gulf of Mexico. As part of its response to that disaster, a U.S. government agency implemented moratoria and revised the regulatory framework governing drilling for oil and gas under offshore leases. The plaintiff, a leaseholder impacted by the new regulatory regime, brought an action against the government alleging that the new measures unexpectedly changed the rules governing offshore exploration and production in breach of its contract with the government (i.e., the lease), and rendering its activities commercially impracticable.

The court rejected the plaintiff's contract breach action. It first concluded that the government's new measures did not violate the lease terms. Importantly, it then added that even if the new measures were inconsistent with the contract, the government's breach was excused under the sovereign acts doctrine. The court identified three questions as being relevant to whether the doctrine applied: (1) whether the government acted specifically aimed to abrogate its contractual obligations; (2) whether the primary effect of the action was to release the government from a duty or confer on it a benefit; and (3) whether the action was targeted at the affecting the government's contracting party or to have a broader impact.<sup>165</sup> Applying those factors, the court determined that the new measures regarding offshore leases were "sovereign acts" designed for a legitimate and broad public purpose and that any breach of the leases based on compliance with those acts was excused on the ground of legal impossibility.<sup>166</sup> While the court found that the lease did contain some express protections against future legal change, none shielded the plaintiff against any of the new regulations it was challenging. The risk of complying with those measures remained with the leaseholder.<sup>167</sup>

Overall, the sovereign acts doctrine and unmistakability rule, which are "as easily summarized as [they are] poorly delineated," have resulted in many complex, fact specific, and arguably conflicting opinions in U.S. courts regarding to the circumstances in which a sovereign entity will be deemed to have contracted away its sovereign authority (or shifted the risk of loss for regulatory change).<sup>168</sup> *Yankee Atomic* and *Century Exploration*, just two of the many post-*Winstar* cases that have applied those doctrines and tried to reconcile the various parts of the Supreme Court's ruling, are therefore not included to present a comprehensive or representative statement of the law. They do, however, illustrate the continuing (though shifting) roles of the two principles, and the complex doctrinal, factual and policy issues that courts consider when determining when and whether they apply.

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<sup>164</sup> 110 Fed.Cl. 148 (Fed. Cl. 2013).

<sup>165</sup> *Id.* at 178.

<sup>166</sup> *Id.* at 175-182.

<sup>167</sup> *Id.* at 182-183.

<sup>168</sup> *Cuyahoga Metro. Hous. Auth. v. United States*, 57 Fed. Cl. 751, 763 (Fed. Cl. 2003).

4. *Beyond “Unmistakability” – Additional Requirements for Enforceability of Government Promises*

Importantly, identifying unmistakability is not the end of the matter; the commitment itself, and the broader underlying contract, must also be otherwise enforceable. For contracts with the U.S. government, this requires satisfaction of a number of criteria, including (1) mutuality of intent to contract; (2) consideration; (3) lack of ambiguity in offer and acceptance; and (4) authority on the part of the government agent entering the contract.<sup>169</sup> While issues may arise regarding the satisfaction of any of those elements, the issue of “intent” and “authority” both appear particularly salient in the area of governmental promises to refrain from exercising sovereign authority in fiscal and other matters. Several cases have elaborated upon both issues in cases arising out of or applying *Winstar* and are worthwhile to explore for their elaboration of prerequisites for government liability.

i. *Mutuality of intent*

In one case examining the “mutuality of intent” requirement, as in *Winstar*, shareholders in an insolvent thrift brought a derivative suit against the United States for Congress’s passage and implementation of FIRREA. The United States Court of Appeals for the Federal Circuit rejected their claims on the ground that the plaintiffs had not shown that the government in that particular case had intended to guarantee *continued use* of purchase accounting or amortization of goodwill. The decision turned on an inquiry into the specific facts relevant to the expression of such intent. The court stated:

We conclude that the evidence presented by the parties establishes that the [Bank Board] merely approved Franklin’s use of purchase accounting and amortization of goodwill and did not contractually guarantee Franklin’s continued ability to utilize the purchase method of accounting or to amortize goodwill. In our view, the relevant documents ... demonstrate only [Bank Board] approval of the Franklin–Equitable merger and do not support the existence of an intent to contract on the government’s part. Indeed, all documents relied upon by [the plaintiffs] to demonstrate governmental intent to contract merely acknowledge the government’s approval of purchase accounting or amortization of goodwill; they do not contain any agreement concerning Franklin’s *continued* ability to employ those accounting methods.<sup>170</sup>

The court further noted that certain former government officials made statements during the course of the litigation supporting the claim that the government had in fact intended to contract for the continued use of purchase accounting and amortization of goodwill. The court concluded, however, that the “lack of any statement suggesting an intent to guarantee continued use of purchase accounting and amortization of goodwill *in the documents approving the merger* is more probative of the question of governmental

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<sup>169</sup> See, e.g., *Fifth Third Bank of Western Ohio v. United States*, 52 Fed. Cl. 264, 269 (Ct. Fed. Cl. 2002).

<sup>170</sup> *Suess v. United States*, 535 F.3d 1348, 1362 (Fed. Cir. 2008) (emphasis added).

intent than are statements of government officials made years after the transaction at issue.”<sup>171</sup>

This case illustrates the high burden on plaintiffs to establish the facts demonstrating mutuality of intent in a particular case. The government’s approval of an arrangement deviating from standard accounting rules does not, without more, demonstrate an intent to allow that arrangement to continue indefinitely; and such intent is not to be inferred through silence, or from patterns in similar cases. Instead, proving the existence of an “unmistakable” promise depends on a case-by-case scrutiny of evidence relevant to the parties’ understandings. Moreover, an *absence* of evidence regarding intent at the time of contracting can outweigh an *affirmative showing* of evidence produced during litigation regarding the existence of such intent. As applied, that test raises the bar even higher for establishing the existence of an enforceable “unmistakable” promise.

ii. *Actual authority*

Another ground for precluding the enforceability of an “unmistakable” commitment would be that the promisor did not have the authority to make the relevant promise. Indeed, “[a]n indispensable element of a contract with the Government is the actual authority of the government representative whose conduct is relied upon to bind the Government in contract.”<sup>172</sup> Actual authority must exist both for entering into contract itself and making the specific promises within it.

With respect to the more general requirement of authority to enter into a contract, both the subject matter of the agreement and the manner in which it is entered into are relevant. An agency must have competence or jurisdiction over the issue or subject it purports to govern through a contract.<sup>173</sup> And, when entering into that contract, it must do so in accordance with applicable contracting procedures. Based on a “deep-seated concern over collusion between government agents and contractors” and resulting policy choices regarding how to reflect that concern and prevent such collusion or impropriety, agreements concluded in violation of those procedures have been traditionally declared void *ab initio*, precluding contractors from demanding the government’s performance of the contract or even recovering payment for the value of goods or services provided.<sup>174</sup>

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<sup>171</sup> *Id.* at 1359 (emphasis added).

<sup>172</sup> Fifth Third Bank of Western Ohio v. U.S., 52 Fed. Cl. 637, 640 (2002) (citing Lewis v. United States, 70 F.3d 597, 600 (Fed.Cir.1995); City of El Centro v. United States, 922 F.2d 816, 820 (Fed.Cir.1990)).

<sup>173</sup> See, e.g., Jumah v. United States, 90 Fed. Cl. 603 (Ct. Fed. Cl. 2009), *aff’d* 385 F. App’x 987 (Fed. Cir. 2000).

<sup>174</sup> Alan I. Saltman, *The Government’s Liability for Actions of its Agents that are Not Specifically Authorized: The Continuing Influence of Merrill and Richmond*, 32 PUBLIC CONTRACT L.J. 775, 796 (2003); see also K & R Engineering Co. v. United States, 616 F.2d 469 (Ct. Cl. 1980); United States v. Mississippi Valley Generating Co., 364 U.S. 520 (1961).

No actual collusion or fraud need be shown, and no de minimis exception exists to excuse minor procedural violations.<sup>175</sup>

Turning to the content of the government commitments, the general rule for the enforceability of promises by the U.S. government is that actual authority to make those promises is a prerequisite to their enforcement, but that such authority can be *implied* from the content of laws and regulations.<sup>176</sup> The standard for establishing actual authority, however, appears to be higher for promises that purport to waive sovereign powers than promises in which the commitment at issue is of a purely commercial nature. Post-*Winstar* jurisprudence indicates that to support an enforceable promise for the purposes of satisfying the unmistakability doctrine and waiving sovereign powers, the actual authority required must be explicitly granted through a statute or other positive law, rather than deriving from more general background powers such as the mere authority to contract.<sup>177</sup>

Other Supreme Court precedent further suggests that the relevant authority to contract must include not only the authority to enter into the contract and set terms, but also the authority to contract away sovereign power. That authority, moreover, must have been clearly delegated away to the state contracting entity by the holder of the sovereign power.<sup>178</sup> Thus, if a legislature delegates to a utilities regulator the authority to enter into a contract to govern or fix rates, that delegation does not also automatically authorize the regulator to surrender the power to later revise those rates. “[A]uthority to exercise the governmental power of regulating charges” is not the same as “authority to enter into a contract to abandon the governmental power itself”; and the latter cannot be simply inferred from the former.<sup>179</sup>

Notably, U.S. law also leaves little room for the doctrine of equitable estoppel to be successfully invoked against the government to enforce a promise there was no actual authority to make.<sup>180</sup> The Supreme Court has proclaimed and reaffirmed the rule that if a person takes action in reliance on a government promise or assertion, and the government official or entity did not have actual authority to make that commitment or take that stance, the individual who acted in reliance on that promise or stance will nevertheless not be able to bind the government to the promise or claim damages for the government’s failure to perform it.<sup>181</sup> Although this rule has been criticized as overly harsh, the Court

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<sup>175</sup> *K & R Engineering*, 616 F.2d 469; *United States v. Mississippi Valley Generating Co.*, 364 U.S. 520 (1961).

<sup>176</sup> Saltman, *supra* note 174, at 783.

<sup>177</sup> *See Fifth Third Bank of W. Ohio v. United States*, 52 Fed. Cl. 829, 834-35 (Fed. Cl. 2002).

<sup>178</sup> *See Home Telephone & Telegraph v. Los Angeles*, 211 U.S. 265 (1908).

<sup>179</sup> *Id.* at 274.

<sup>180</sup> *See, e.g.*, Saltman, *supra* note 174; *see also Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 60 (1984); *Zacharin v. United States*, 213 F.3d 1366, 1371 (Fed. Cir. 2000).

<sup>181</sup> *See, e.g.*, *Office of Personnel Mgmt. v. Richmond*, 496 U.S. 414, 424, (1990); *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 383, (1947). *See also Devon Energy Corp. v. Kempthorne*, 551 F.3d 1030 (D.C. Cir. 2008) (“At the very least, a definitive and binding statement on behalf of the agency must come from a source with the authority to bind the agency. *See Ctr. for Auto Safety v. Nat’l Highway Traffic Safety Admin.*, 371 U.S. App.

has emphasized that if normal rules of agency and estoppel were to apply, the government's treasury would be unreasonably "vulnerable to liability that could not be foreseen, controlled, or prevented by Congress and that such financial exposure does not comport with fundamental notions of sovereignty, nor with constitutional provisions regarding appropriation of such funds."<sup>182</sup>

Some lower courts have made efforts to tailor the rule's application and lessen its impact in particular cases. Decisions have held, for example, that an agency will be bound to commitments made by an official if the relevant limits on that official's authority were those that could not be discovered even after the exercise of reasonable due diligence, such as limits imposed pursuant to internal agency memoranda or guidelines, and not pursuant to publicly available agency regulations or legislation.<sup>183</sup> These departures, however, are narrow, and leave relatively undisturbed the general rule preventing courts from determining that government entities have contracted away their sovereign powers by promising to stabilize the regulatory framework.

## B. Other Legal Challenges

The cases above focused on allegations that government measures of general applicability breached investor-state contracts. The universe of potential causes of action is broader, however, and includes statutory and administrative law claims,<sup>184</sup> as well as constitutional takings and due process challenges. Although reviewing the relevant cases,

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D.C. 422, 452 F.3d 798, 810 (D.C. Cir. 2006) (holding that Associate Administrator for Safety Assurance had no authority to issue guidelines with binding effect on agency); *Ass'n of Am. R.Rs. v. DOT*, 339 U.S. App. D.C. 197, 198 F.3d 944, 948 (D.C. Cir. 1999) (holding a letter and two emails from lower level officials did not amount to an authoritative agency interpretation); *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 326 U.S. App. D.C. 25, 117 F.3d 579, 587 (D.C. Cir. 1997) (stating that a speech of a mid-level official of an agency is not the sort of 'fair and considered judgment' that can be thought of as an authoritative departmental position) (citing *Auer v. Robbins*, 519 U.S. 452, 462 (1997)); [*Amoco Prod. Co. v. Watson*, 410 F.3d 722, 725 (D.C. Cir. 2005), *aff'd sub nom.*, *BP Am. Prod. Co. v. Burton*, 549 U.S. 84 (2006)] (noting 'Dear Operator' letter not binding on agency because not authored by official with authority to announce binding rules)."). *But see* *Broad Avenue Laundry and Tailoring v. United States*, 681 F.2d 746 (1982) (noting government can be estopped even if an undertaking is based on a mistake of law, provided the error is not "palpably illegal"); *Del-Rio Drilling Programs, Inc. v. United States*, 46 Fed. Cl. 683 (Fed. Cl. 2000); (binding the government to action though it was not in strict compliance with procedures).

<sup>182</sup> Saltman, *supra* note 174, at 807.

<sup>183</sup> *Id.* at 802-03.

<sup>184</sup> The federal Administrative Procedure Act authorizes judicial review of agency action, but cautions that such review is narrow. Courts may only set aside agency action on certain specified and narrow grounds, including whether the action was "arbitrary, capricious, an abuse of discretion, or not otherwise not in accordance with law" (5 U.S.C. § 706(2)(A)), "contrary to constitutional right, power, privilege or immunity," (5 U.S.C. § 706(2)(B)), or "without observance of procedure required by law" (5 U.S.C. § 706(2)(D)). 5 U.S.C. § 706(2).



principles, and nuances of each of these types of claims is beyond the scope of this paper, it does paint broad strokes of the takings and due process causes of action, focusing on those normative constitutional law theories as being the most directly analogous to the substantive claims made and issues addressed in the investment treaty disputes reviewed above. The resulting picture illustrates that investors/plaintiffs' chances for successful suits against the government under these theories appear even less likely than recovery under a cause of action for contract breach.

### 1. *Takings Claims*

Cases exist in which plaintiffs have brought takings claims alongside or instead of breach of contract actions, alleging that the governments' actions interfering with their contracts effectively took their property and triggered a duty to pay compensation.<sup>185</sup> The types of claims require different pleading. In particular, a "sovereign act," while a defense in the context of breach of contract claims, is a requirement for liability under the Takings Clause of the Constitution. Due to the different elements of each type of claim, a cause of action that fails on one ground therefore may prevail on the other.<sup>186</sup>

Although there is a high threshold for plaintiffs to prevail on a breach of contract claim seeking relief from a sovereign that interferes with an investor-state contract, successfully mounting a takings challenge to a sovereign act of general applicability is likely even more difficult. One major hurdle to successfully packaging a breach of contract claim as a takings claim relates to the "denominator" issue: taking the extent of interference with property as the numerator in an equation, and the entire "bundle of rights" held as the denominator, the closer the resulting number is to 100%, the more likely a regulatory taking will be found.<sup>187</sup> It thus commonly behooves plaintiffs in

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<sup>185</sup> See, e.g., *Century Exploration New Orleans, Inc. v. United States*, 103 Fed. Cl. 70, 77 (Fed. Cl. 2012). In that case, the court allowed the plaintiff to plead both theories. It began its discussion with a review of how the issue had been dealt with in other jurisdictions. See, e.g., *Hughes Commc'ns Galaxy, Inc. v. United States*, 271 F.3d 1060, 1070 (Fed.Cir.2001) (noting that the Takings Clause of the Fifth Amendment "has limited application to the relative rights in property of parties litigant which have been voluntarily created by contract"); *J.J. Henry Co. v. United States*, 411 F.2d 1246, 1249 (Ct.Cl.1969) (stating that when a plaintiff possesses enforceable rights under a contract with the government, "interference with such contractual rights generally gives rise to a breach claim not a taking claim."); *Sun Oil Co. v. United States*, 572 F.2d 786, 818 (Ct.Cl.1978).

<sup>186</sup> See generally *Century Exploration New Orleans, Inc. v. United States*, 103 Fed. Cl. 70, 80 (Fed. Cl. 2012); *System Fuels, Inc. v. United States*, 65 Fed.Cl. 163, 172-73 (2005); *Henry Housing*, 95 Fed.Cl. at 255 (determining that a plaintiff can pursue a takings claim and a breach claim in the alternative until final judgment is rendered on the contract breach claim); *Consol. Edison Co. of N.Y. v. United States*, 67 Fed.Cl. 285, 292 (2005) (noting that both a claim of contract breach and a takings claim can be brought concurrently, and may proceed at "least until the contract claim becomes viable and trumps the takings claim").

<sup>187</sup> See *Tahoe Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302 (2002) (reaffirming the Court's rejection of "conceptual severance"); see also Lise

takings cases to try and divide their bundle of rights into units that will minimize the size of the relevant denominator in order to increase the relative extent of the government's interference with their property.<sup>188</sup>

Yet frustrating that strategy, the infamously complex and convoluted body of U.S. takings law is not warmly receptive to such "conceptual severance" of property rights.<sup>189</sup> Rather, property is to be viewed as a whole, raising the bar for a plaintiff trying to establish that a government measure of general applicability had a severe enough impact on its bundle of contractual rights to support a takings claim.<sup>190</sup>

Another limitation to recovery on a regulatory takings theory is that, even if the degree of interference were significant, governmental measures of general applicability taken for a public purpose are, to a great extent, shielded from expropriation claims.<sup>191</sup> Further, when an interest, right or expectation under a contract is such that it is known to be subject to significant government interference, it is often not considered to be the type of "property" that is protectable under the constitutional prohibition against uncompensated expropriations.<sup>192</sup> Overall, takings claims seeking compensation for a government measure of general applicability that has interfered with an individual or

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Johnson, *After Tahoe Sierra, One Thing Is Clearer: There Is Still A Fundamental Lack of Clarity*, 46 ARIZ. L. REV. 353, 378 (2004) (discussing the impact of that decision). In cases involving a partial interference with the "bundle" of property rights, the *Penn Central* three-factor balancing test applies. *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104 (1978). For regulatory takings cases involving a *total* taking, the *Lucas* per se rule applies. *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1026-27 (1992). When there is a physical taking, a different per se rule applies. *See Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

<sup>188</sup> *Tahoe Sierra*, 535 U.S. 302.

<sup>189</sup> *Tahoe-Sierra*, 535 U.S. at 331; *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 497 (1987). *See also Concrete Pipe & Products of Cal., Inc. v. Construction Laborers Pension Trust for Southern Cal.*, 508 U.S. 602, 644, (1993) ("To the extent that any portion of property is taken, that portion is always taken in its entirety; the relevant question, however, is whether the property taken is all, or only a portion of, the parcel in question").

<sup>190</sup> *Id.*

<sup>191</sup> *See, e.g., Lucas v. S. Carolina Coastal Council*, 505 U.S. 1003, 1072 & n.7 (1992) (stating that takings law looks to the generality of a challenged law in order to determine its permissibility, and elaborating on the rationale for that approach).

<sup>192</sup> *See, e.g., Dames & Moore v. Regan*, 453 U.S. 654, 674 n.6 (1981); *Mike's Contracting, LLC v. United States*, 92 Fed. Cl. 302, 310 (Ct. Fed. Cl. 2010). Under U.S. law, the scope of "property" is not necessarily the same for purposes of assessing protections under and violations of the due process clause, as it is for determining whether compensation is due for a taking. *See Arctic King Fisheries, Inc. v. United States*, 59 Fed. Cl. 360, 372, n.27 (Ct. Fed. Cl. 2004); *Eastern Enterprises v. Apfel*, 524 U.S. 498, 557 (1998) (J. Breyer, dissenting) ("Nor does application of the Due Process Clause automatically trigger the Takings Clause, just because the word 'property' appears in both. That word appears in the midst of different phrases with somewhat different objectives, thereby permitting differences in the way in which the term is interpreted.").

entity's rights or interests under a contract with the government thus appear to stand relatively slight chances of success.

## 2. *Due Process Claims*

Government acts of general applicability that impact the performance or profitability of an investor-state contract may also trigger due process claims. While such claims may be based on alleged procedural due process violations, the type of action relevant to and within the scope of this paper are those alleging breaches of substantive due process. Yet, although such substantive due process arguments might have been well-received during the Supreme Court's rather infamous *Lochner* era, they would likely face an extremely low chance of success under the jurisprudence governing due process protections for economic rights that has reigned from the late 1930s onward.

The *Lochner* era – named so due to a lead case, *Lochner v. New York* – is a time from the late nineteenth century to the early 1930s in which the Supreme Court developed a “constitutional rhetoric glorifying private property and free contract”<sup>193</sup> and accordingly struck down a series of legislative acts purportedly taken in the public interest on the ground that those acts unconstitutionally infringed upon economic and property rights.<sup>194</sup> The Court applied strict scrutiny to government exercises of police powers that interfered with economic liberties, stating that to be upheld against substantive due process challenges, the means put in place by the law must have a “direct relation” to the law's supposed policy goal, and that the goal “itself must be appropriate and legitimate.”<sup>195</sup> Laws that failed to survive the Court's economic due process scrutiny during the *Lochner* era included those regulating gasoline prices<sup>196</sup> and other consumer goods,<sup>197</sup> governing employment agencies,<sup>198</sup> and setting minimum wages<sup>199</sup> and working hours and conditions.<sup>200</sup>

The wide-reaching impact of the Great Depression and the implementation of Franklin Roosevelt's New Deal programs brought the end of the *Lochner* approach.

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<sup>193</sup> Bruce Ackerman, *Carolene Products*, 98 HARV. L. REV. 713, 714 (1985).

<sup>194</sup> See *Lochner v. New York*, 198 U.S. 45 (1905). See also ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 606-07 (2006) (describing a broader definition of economic substantive due process); Matthew S. Bewig, *Lochner v. The Journeymen Bakers of New York: The Journeymen Bakers, Their Hours of Labor, and The Constitution: A Case Study in the Social History of Legal Thought*, 38 AM. J. LEGAL HIST. 413, 422 (1994); Anthony B. Sanders, *The New Judicial Federalism Before Its Time: A Comprehensive Review of Economic Substantive Due Process Under State Constitutional Law Since 1940 and The Reasons for Its Recent Decline*, 55 AM. U. L. REV. 457, 472-74 (2005).

<sup>195</sup> *Lochner*, 198 U.S. at 57-58.

<sup>196</sup> *Williams v. Standard Oil Co.*, 278 U.S. 235 (1929).

<sup>197</sup> *Tyson & Brother v. Banton*, 273 U.S. 418 (1927).

<sup>198</sup> *Ribnik v. McBride*, 277 U.S. 350 (1928).

<sup>199</sup> *Adkins v. Children's Hosp.*, 261 U.S. 525 (1923); see also *Morehead v. Tipaldo*, 298 U.S. 587 (1936), *overruled by Olsen v. Nebraska ex rel W. Reference & Bond Ass'n*, 313 U.S. 236 (1941).

<sup>200</sup> *Lochner*, 198 U.S. 45.

While the Court's decisions striking down social legislation in the name of protecting laissez-faire capitalism had been triggering legislative and public ire since the beginning of that era, invalidation of key parts of the New Deal framework in the 1930s intensified challenges to the Court's authority and legitimacy.<sup>201</sup> Evidence of public opposition to the Court's jurisprudence bubbled up through various Congressional proposals to limit the Court's jurisdiction and power, and culminated in a plan by President Roosevelt to dilute the roles of the Justices by "packing" the Court with new appointees.

Whether in response to those threats to its powers, receptiveness to critiques regarding the legitimacy of having "nine elderly lawyers invalidate the legislative decisions of a majority of [the U.S.'s] elected representatives,"<sup>202</sup> and/or an internal shift in doctrine, in a series of decisions issued between 1934 and 1938, the Court chipped away at the strong protections it had erected around economic rights, and established a doctrinal regime whereby courts would give significant deference to economic legislation and governmental exercises of police powers impacting economic rights and interests.<sup>203</sup> That regime continues to reign today, under which economic legislation<sup>204</sup> is reviewed and frequently sustained under the light scrutiny of the "rational basis" test.<sup>205</sup> Pursuant to that test, economic regulatory legislation is deemed presumptively constitutional, and will be upheld if supported by any rational basis.<sup>206</sup> A plaintiff alleging that a law violates substantive due process "has the burden to negate every conceivable reason which might support the legislative act."<sup>207</sup> Similarly, when looking at executive action, "only the most egregious official conduct" that "shocks the conscience" will constitute the "arbitrariness" necessary to establish a successful substantive due process challenge.<sup>208</sup>

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<sup>201</sup> There is extensive literature on this topic. For a discussion of these issues and useful additional references, *see, e.g.*, JAMES MACGREGOR BURNS, *PACKING THE COURT: THE RISE OF JUDICIAL POWER AND THE COMING CRISIS OF THE SUPREME COURT* ch. 8 (2009).

<sup>202</sup> Ackerman, *supra* note 193, at 715.

<sup>203</sup> *See* *Nebbia v. New York*, 291 U.S. 502 (1934); *West Coast Hotel Company v. Parish*, 300 U.S. 379 (1937); *United States v. Carolene Products*, 304 U.S. 144, n.4 (1938).

<sup>204</sup> Government action interfering with other rights is not necessarily given the same degree of deference. *Cf.* Religious Freedom Restoration Act of 1993, 42 U.S.C. §§ 2000bb to bb-4 (requiring that the federal government "not substantially burden a person's exercise of religion even if the burden results from a rule of general applicability" unless the restriction passes a test of strict scrutiny).

<sup>205</sup> *See, e.g.*, *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998); *United States v. Carlton*, 512 U.S. 26, 33 (1994); *Ferguson v. Skrupa*, 372 U.S. 726 (1963); *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955); *Wickard v. Filburn*, 317 U.S. 111 (1942); *United States v. Darby Lumber Co.*, 312 U.S. 100 (1941); *Olsen v. Nebraska*, 313 U.S. 236 (1941); *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937).

<sup>206</sup> *See Carolene Products*, 304 U.S. at 152.

<sup>207</sup> *B&G Construction Co., Inc. v. Director, Office of Workers' Compensation Program*, 662 F.3d 233, 255 (3d Cir. 2011) (citing *FCC Beach Commc'ns, Inc.* 508 U.S. 307, 315 (1993)) (emphasis in original).

<sup>208</sup> *County of Sacramento v. Lewis*, 523 U.S. 833, 846 (1998).

#### IV. INVESTOR-STATE TRIBUNALS, U.S. LAW, AND IMPLICATIONS FOR INTERNATIONAL LAW

Comparing international investment tribunals' and U.S. courts' respective assessments of the scope of enforceable "commitments" and government liability for interference with those undertakings reveals a notable divergence. Both arbitral tribunals and U.S. courts declare deference to sovereign acts of general applicability; both also recognize that governments do not have unbounded authority to exercise their sovereign power to the detriment of investor-state contracts. Nevertheless, the two "systems" differ in terms of the respective tests they apply to determine whether the government has ceded its ability to take action interfering with previously made commitments. More specifically, the requirement of unmistakability under U.S. law is significantly relaxed in if not entirely absent from tribunals' decisions, which take a much more lenient view of the requirements necessary to establish and enforce a government promise *not* to exercise sovereign authority in the future.<sup>209</sup>

One key point of distinction between the two systems is tribunals' decisions finding enforceable and non-revocable "commitments" in legislative or regulatory frameworks. Decisions such as *EDFI v. Argentina*, *Enron v. Argentina*, *LG&E v. Argentina* and *Occidental v. Ecuador (2004)*, which identify non-retractable undertakings in general domestic laws and regulations, contrast starkly with the approaches taken by U.S. courts to deny the existence of "unmistakable" promises to waive sovereign authority when those promises are general and not clearly made to a specific individual or entity.

A second related and also significant area of divergence is tribunals' apparent willingness to bind governments to "undertakings" that, under domestic law, may not be legally binding on either the government or the investor. Whereas statements by government officials<sup>210</sup> and representatives of state-owned enterprises,<sup>211</sup> positions taken by agencies,<sup>212</sup> and illegal contracts or deals involving procedural or other irregularities<sup>213</sup>

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<sup>209</sup> Cf. *Glamis Gold Ltd. v. United States*, NAFTA/UNCITRAL Ad hoc, Award, ¶¶ 800-02 (June 8, 2009) (finding no "specific inducements" the repudiation of which could potentially give rise to a breach of NAFTA Article 1105); ¶ 22 & n.24 (noting that although it viewed a repudiation of specific assurance as potentially giving rise to liability under the NAFTA, it would take no position on the "type or nature of repudiation measures that would be necessary to violate international obligations").

<sup>210</sup> See, e.g., *Técnicas Medioambientales Tecmed v. Mexico*, ICSID Case No. ARB (AF)/00/2, Award, (Grigera Naon, Fernandez Rozas, Bernal Vereza), May 29, 2003, ¶¶ 158-174.

<sup>211</sup> *Occidental Petroleum Corp. v. Ecuador*, ICSID Case No. ARB/06/11, Award, Oct. 5, 2012, ¶¶ 517-526.

<sup>212</sup> See, e.g., *Occidental v. Ecuador (2004)*, *supra* note 35, ¶ 184.

<sup>213</sup> See, e.g., *BCB Holdings Ltd v. Attorney General of Belize*, CCJ Appeal No. CV 7 of 2012, BZ Civil Appeal No. 4 of 2011, Judgment, July 26, 2013 (addressing enforceability of illegal promise regarding taxation); *RDC v. Guatemala*, ICSID Case No. ARB/07/23, June, 29, 2012, ¶¶ 212-236 (considering impact of allegations of illegality on treaty claim); *Phillips Petroleum Co. Venezuela Ltd. v. Petroleos de Venezuela*, ICC International Court of Arbitration, Case No. 16848/JRF/CA, Sept. 17, 2012, ¶¶ 180-204

have been deemed to give rise to enforceable undertakings by tribunals, U.S. courts adopt a narrower approach to the types of actions that can constitute binding promises regarding future exercise of sovereign power. Commitments must be made by an individual or entity with actual authority to make the commitment,<sup>214</sup> and must be legally binding;<sup>215</sup> the doctrine of estoppel, moreover, is largely unavailable to protect investors in cases of mistaken reliance.<sup>216</sup>

While imposing a greater share of the risk on investors, these requirements serve a number of policy purposes. By, for instance, requiring actual authority for any “unmistakable” promise, U.S. doctrine serves at least four key functions. First, it promotes government accountability. Express statutory delegation of authority to contract is an act observable to and reviewable by the public. To the extent the delegated authority leads to liability, constituents are able to assess the relative fault of the body that granted or received and exercised the delegated powers.<sup>217</sup> Second, it enables governments to control and account for commitments that can give rise to future liabilities, and to better evaluate the costs and benefits of a given transaction. Third, it limits government liability for the actions of its agents taken outside the bounds of their authority, and imposes upon those who contract with the government the “risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority.”<sup>218</sup> This in turn encourages investors to do due diligence into the relevant legal framework in order to identify whether authority for a commitment in fact exists. Through incentivizing such ex ante investigation and due diligence, the requirement for actual authority can work as a prophylactic tool for avoiding subsequent disputes as to the existence of that power and, more generally, to promote greater understanding of the host state’s legal and regulatory machinery. And fourth, the requirement of actual authority helps preserve separation of powers that could be upset if a court were to enforce an action taken by the executive branch that exceeded the scope of authority that had been delegated to it by the legislative branch.

By incorporating strict requirements for enforceability of government contracts, including actual authority, compliance with appropriate form and procedures, and mutuality of intent – the unmistakability doctrine narrows the circumstances in which a government can (intentionally or inadvertently) impact the rights of those not given a

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(addressing issues of illegality in contract claim); *Wena Hotels Ltd. v. Egypt*, ICSID Case No. ARB/98/4, Dec. 8, 2000, ¶¶ 111-117 (considering illegality in treaty claim).

<sup>214</sup> *See supra* Part III.A.4.

<sup>215</sup> *See id.*

<sup>216</sup> *See id.*

<sup>217</sup> *See, e.g.,* Burch, *supra* note 92, at 334. Burch identifies these benefits in connection with discussing the express delegation doctrine. He notes that under the express delegation doctrine, “[f]or a city to bind a state, not only must the legislature assume some responsibility for authorizing the city to do so, but the city itself would be on more explicit notice that its contracting decisions had better pan out in the long-run because they will share in the blame if they do not. In the absence of the express delegation doctrine,” it is difficult to “locat[e] accountability for bad bargains.”

<sup>218</sup> *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 383 (1947); *see also* *California Sand & Gravel, Inc. v. United States*, 22 Cl. Ct. 19, 26 (1990) *aff’d*, 937 F.2d 624 (Fed. Cir. 1991) (same).

voice in the contracting decision. Courts consequently have at their disposal several rules directing them to take a narrow and skeptical view of allegedly clear and binding promise made behind closed doors without the knowledge or input of other impacted government branches or authorities, or affected constituents.<sup>219</sup> The doctrine thus protects the ability of future governments to take measures in the public interest, and the rights of constituents and stakeholders to have a government that regulates on their behalf.

A third area of divergence relates to tribunals' practices of interpreting ambiguity in the contract in favor of affirming, rather than rejecting, the existence of a commitment to waive future use of sovereign power. The *Enron* tribunal, for instance, stated that if the legal framework existing at the time "was intended to be transitory[,] it should have also been clearly advised to prospective investors."<sup>220</sup> Likewise, the *EDFI* tribunal asserted that if Argentina had not intended to bear the risk of loss for future regulatory changes, it "could have said so" in its contract.<sup>221</sup> Both cases required the respondent states to clearly reserve future exercises of sovereign power, and thus stand in stark opposition to the U.S. unmistakability cases, which will only enforce promises to refrain from (or compensate for) future exercises of sovereign power if there is mutuality of intent behind the promises and the commitments themselves are clearly expressed.

A fourth area of divergence relates to how a finding of unmistakability or a specific commitment can be impacted by the purpose or type of regulatory action which it purports to freeze. With respect to the purpose of the regulatory action, the early U.S. cases indicate that courts applied a relatively strict "unmistakability" test when enforcing the alleged promises threatened to hinder development of the new nation and its efforts to construct and operate crucial infrastructure. In contrast, *Winstar*, decided nearly two centuries later, suggests a less sympathetic view of government needs to modify the legal framework. Nevertheless, as revealed by *Yankee Atomic* and *Century Exploration*, courts even in the post-*Winstar* era are still reluctant to find "unmistakable" promises of legal stability, particularly where the existence and enforcement of such promises would hinder the government's ability to respond to crises, react to matters of public interest, and address harms caused or negative externalities imposed by private actors once the problems are discovered.

Further, U.S. courts appear to shape the strictness with which they apply the "unmistakability" test based on the type of action at issue. Courts have apparently been particularly reluctant to find "unmistakable" commitments not to modify fiscal regimes. In upholding the tax measure challenged in *Providence Bank*, for instance, the U.S. Supreme Court reasoned:

That the taxing power is of vital importance; that it is essential to the existence of government; are truths which it cannot be necessary to reaffirm. They are acknowledged and asserted by all. It would seem that the relinquishment of such a power is never to be assumed. We will not say that a state may not relinquish it;

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<sup>219</sup> Cf. *BCB Holdings Ltd v. Attorney General of Belize*, CCJ Appeal No. CV 7 of 2012, BZ Civil Appeal No. 4 of 2011, Judgment, July 26, 2013 (discussing *BCB Holdings Ltd. v. Attorney General of Belize*, LCIA Arb. No. 81169, Aug. 18, 2009); *Phillips Petroleum Co. Venezuela Ltd. v. Petroleos de Venezuela*, ICC International Court of Arbitration, Case No. 16848/JRF/CA, Sept. 17, 2012, ¶¶ 180-204.

<sup>220</sup> *Enron Corp. v. Argentina*, *supra* note 63, ¶ 137.

<sup>221</sup> See *EDFI v. Argentina*, *supra* note 42, ¶ 960.

that a consideration sufficiently valuable to induce a partial release of it may not exist: but as the whole community is interested in retaining it undiminished. That community has a right to insist that its abandonment ought not to be presumed, in a case in which the deliberate purpose of the state to abandon it does not appear.<sup>222</sup>

The importance of the taxation power, plus the broader “community” interest in retaining that power, thus counseled for a hard look at the unmistakable nature of promises that would purport to cede it. More recent cases such as *Merrion v. Jicarilla Apache Tribe* echo those considerations and concerns.

The taxation power was also given special protection by the plurality in *Winstar*. It noted that the unmistakability doctrine could apply even in “risk shifting” agreements if the risk allegedly being assumed by the government was the risk of loss caused by additional tax assessments because the remedy (i.e., a rebate of the taxes assessed) would effectively make the “risk shifting” agreement a promise to waive the sovereign power to tax.

In investor-state arbitrations, neither the purpose nor type of the regulatory action at issue has seemed to impact the level of scrutiny tribunals have applied to determine whether the government had in fact guaranteed to waive its powers. Tribunals have correspondingly found implied promises of stability that barred government action taken in response to financial crises,<sup>223</sup> and through exercise of fiscal policy.<sup>224</sup>

A fifth area of divergence is in the relevance U.S. courts and investment tribunals respectively assign to the temporal scope of the alleged commitment. As the court in *Rogers Park* noted, a commitment for a specific form of treatment is not necessarily a commitment for that treatment over the life of the contract and irrespective of changed circumstances. Given the *degree* of the waiver that a long-term promise to restrain from taking sovereign action would imply, courts seem to apply a heightened degree of scrutiny to the “unmistakable” nature of government guarantees that purport to bind them for an extended period of time and restrict the authority of future administrations irrespective of changing constituents, policies, and circumstances. Indeed, a number of cases finding that the requisite unmistakability was absent involved alleged promises that purported to last for decades, if not indefinitely.<sup>225</sup> U.S. courts’ reluctance to find such

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<sup>222</sup> *Providence Bank v. Billings*, 29 U.S. 514, 561 (1830).

<sup>223</sup> *See, e.g.*, cases involving claims against Argentina discussed *supra*, Part II.B.1. and II.B.2. As those cases illustrate, although the public purpose of a measure may not bar a finding of breach, it may be relevant to determine whether an exception to liability under the treaty will apply.

<sup>224</sup> *See, e.g.*, cases involving claims against Ecuador discussed *supra*, Part II.B.1 and II.B.2. In some cases, treaties expressly restrict liability for or tribunals’ review of taxation measures. The scope and effect of such carve-outs was also addressed in *Occidental v. Ecuador (2004)* and *Occidental v. Ecuador (2012)*.

<sup>225</sup> *See, e.g.*, *Bridge Proprietors v. Hoboken Co.*, 68 U.S. (1 Wall.) 116 (1883); *Rogers Park Water v. Fergus*, 180 U.S. 624 (1901); *Century Exploration New Orleans, LLC v. United States*, 110 Fed. Cl. 148, 172 (Fed. Cl. 2013) (“[N]othing in plaintiffs’ lease can be read to provide static treatment for their activities in perpetuity.”).



promises appears to evidence their discomfort with requiring strict adherence to these long-term governmental commitments.<sup>226</sup>

In contrast, decisions decided by investment tribunals to date reflect less reluctance to strictly enforce long-term promises. In a number of cases, a framework established in law has interpreted to be a framework that persists over time. Tribunals have also further elevated the importance of stability and of maintaining promises in accordance with their original terms by awarding lost profits over the originally foreseen life of intended deals and in accordance with the legal regimes applying to those arrangements at the time of their conclusion.<sup>227</sup>

Fundamentally, the different approaches in the international and domestic law realms raise the question of whether (a) the gaps indicate that domestic law practices are falling below and should be ratcheted up to international law standards; (b) international tribunals have developed a rule that goes beyond what international law requires (or permits); or (c) the two standards – domestic and international – are different because they can and should be.

With respect to that first possibility, it is a firm principle that compliance with the domestic law of the host state is not a complete defense to a violation of international law. Thus, to the extent that the approach being taken by international investment tribunals represents international law, a U.S. court's refusal to order compensation for a sovereign act of general applicability that interferes with an investor's expectations based on government "commitments," could arguably give rise to a breach of international law notwithstanding the legitimacy of the court's decision under domestic law.

The question that must be asked in this context is whether the tribunals' approach does in fact constitute international law binding on domestic systems. As noted above, tracing the development of this rule as a norm of international law and gauging its legitimacy is outside the scope of this paper. But two initial observations can be made: First, the fact that consistency with domestic law is not a defense to breach of international law does not mean that domestic law is irrelevant to international law. Rather, the former is a gauge and a factor that can determine the content of the latter.<sup>228</sup> Given that state practice is an element of customary international law, and that assessing the existence of a rule of customary international law is an inductive exercise requiring a survey of states' approaches, both the apparent absence of such a survey in arbitration cases, and the notably divergent principles in U.S. law, hurt the argument that tribunals' pronouncements taking relatively wide views of enforceable commitments and consequent sovereign liability reflect customary international law.<sup>229</sup>

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<sup>226</sup> See cases cited *supra* note 225; see also *supra* note 131.

<sup>227</sup> See, e.g., *Occidental Petroleum Corp. v. Ecuador*, ICSID Case No. ARB/06/11, Award, Oct. 5, 2012, pp. 185-221, 308.

<sup>228</sup> See *supra* Part I. See also ILA, FINAL REPORT OF THE COMMITTEE ON THE FORMATION OF CUSTOMARY (GENERAL) INTERNATIONAL LAW: STATEMENT OF PRINCIPLES APPLICABLE TO THE FORMATION OF GENERAL CUSTOMARY INTERNATIONAL LAW, 729 (2000) (hereinafter ILA Report).

<sup>229</sup> In a pleading before an investor-state tribunal, the U.S. elaborated upon its view of the current requirements under customary international law regarding treatment of aliens:

Sufficiently broad State practice and *opinio juris* thus far have coincided to establish minimum standards of State conduct in only a few areas, such as the

Second, these heightened protections of stability may be argued to reflect an autonomous treaty standard that demands more than is required by the minimum standard of treatment. Still, it is questionable whether, in light of the significant practical implications of the tribunals' approaches for the scope of government liability, states would have agreed to assume such potentially large additional exposure through rather vague commitments to stability and predictability in treaty preambles and articles on "fair and equitable" treatment. Indeed, states have argued expressly that they did not possess such intent.<sup>230</sup> And such proclamations are relevant when interpreting the treaty to which the relevant states are bound.<sup>231</sup>

A second possible response to the gap between domestic and international decisions is that tribunals have developed a rule that is so unhinged from state practice and intent that it goes beyond what international investment law requires (or permits).<sup>232</sup> Again, while assessing the soundness of that proposition is outside the scope of this paper, it is worth raising the necessary follow-up question of whether, in fact international decisions have gone too far, remedies or avenues exist to ratchet their rule back down. Limited avenues for judicial review largely insulate individual awards from

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requirements to provide compensation for expropriation; to provide full protection and security (or a minimum level of internal security and law); and to refrain from denials of justice. In the absence of an international law rule governing State conduct in a particular area, a State is free to conduct its affairs as it deems appropriate. (internal footnotes omitted).

Apotex Holdings, Inc. v. United States, Counter-Memorial on Merits and Objections to Jurisdiction of United States of America, ICSID Case No. ARB(AF)12/1, Dec. 14, 2012, ¶ 353.

<sup>230</sup> See, e.g., *Enron v. Argentina*, Decision on the Application for Annulment of the Argentina, ¶ 296.

<sup>231</sup> See VCLT, Art. 31(3)(b) (stating that treaty interpretations shall take into account "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation"). See also "Under Article 31(3)(b), tribunals look for a 'concordant, common and consistent' sequence of acts or pronouncements about a treaty that 'is sufficient to establish a discernible pattern implying the agreement of the parties regarding its interpretation.' Subsequent practice may include executive, legislative, and judicial acts. It can be between the parties or internal within one party, provided that it is known by the other parties. Not every treaty party has to have engaged in a common practice, so long as all assent or acquiesce to it." Anthea Roberts, *Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States*, 104 AM. J. INT'L L. 179, 200 (2010) (internal citations omitted). Yet despite the requirement to consider subsequent state practice in treaty interpretation, tribunals to date have given relatively little weight to it in decisions. See Roberts, *supra* note 231, at 215 (stating tribunals have "tended to overlook or undervalue state practice in interpretation").

<sup>232</sup> Concerns regarding the legitimacy, desirability and appropriateness of tribunals' creation and extension of an international "common law of investment" through their decisions in investment arbitration cases have been expressed by other commentators. See, e.g., Jason W. Yackee, *Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality*, 32 FORDHAM INT'L L.J. 1550, 1611 (2008) (internal citations omitted).

challenges; yet the lack of a formal system of precedent leaves room for tribunals in future cases to reexamine and redirect their trajectories, perhaps taking into account some of the approaches domestic courts have developed to allow for claims against governments and protect the contracting parties' expectations, yet still reflect the unique needs and interests of states to retain and exercise sovereign authority without facing potentially crippling liability.

Finally, as suggested by the third possibility, it may be plausible that the international law standard does require more than domestic law, but does so uniquely for foreign investors, and that therefore two parallel standards of investor protection and state liability can and should legitimately exist. Or, to state it differently, one response to the contention that international law standards should not have jumped beyond domestic law requirements is that such a gap is warranted in accordance with political process theory. That theory emphasizes the role of participation in the political process and contends that court action should generally defer to legislative judgments as those judgments reflect the majority stance on public policy issues, but that courts must also provide special protection to minority or powerless groups that are unable to have any meaningful input in that political process. Some have argued that foreign investors' inability to vote in elections puts them at a disadvantage which much be compensated for through stronger protections granted through investment treaties.

But weighing against that contention, particularly in cases involving an investor-state contract, there are a number of factors that seem to increase the foreign investor's leverage to more than compensate for the lack of an official vote. This includes the ability to have direct access to government officials in the pre-contract phase and through the life of the deal; the resources of multinational enterprises that can and are reported to be increasingly dedicated to various forms of government lobbying;<sup>233</sup> the resources of multinational enterprises that can be put to advertising and other public relations activities; the growth in treaty provisions requiring or encouraging states to give foreign investors the right to comment on proposed regulations and provide input in standard setting;<sup>234</sup> and the fact that, through the foreign investors' presence in the host country,

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<sup>233</sup> As noted in note 20, *supra*, efforts to influence government actors may also happen through other, illicit, means, such as through bribery.

<sup>234</sup> See, e.g., 2012 U.S. Model BIT, Art. 11. Among other things, that article states:  
Each Party shall allow persons of the other Party to participate in the development of standards and technical regulations by its central government bodies. Each Party shall allow persons of the other Party to participate in the development of these measures, and the development of conformity assessment procedures by its central government bodies, on terms no less favorable than those it accords to its own persons.

*Id.*, Art. 11(8)(a). Article 11 also contains other clauses regarding foreign investors' abilities to make comments on proposed new regulations and host governments' responsibilities to respond to those comments. See also, e.g., Australia-Malaysia Free Trade Agreement, art. 17.3(3), May 22, 2012 (requiring states "to the extent possible" to publish proposed measures and give foreign investors the opportunity to comment); Dominican Republic – Central America – United States Free Trade Agreement, art. 18.2(2)(b), May 28, 2004 (same); Canada-China Foreign Investment Protection

various stakeholders impacted by and tied to that foreign investor (e.g., employees and customers of the investor or investment, and individuals who supply the investor or investment goods and services) can serve as a proxy for the foreign firm's interests in an election when that firm has developed and maintained positive relationships with those stakeholders.

Moreover, a number of states have confirmed that they do not view investment treaties as granting foreign investors *substantive* rights that go beyond those enjoyed by domestic individuals or entities.<sup>235</sup> Thus, even if the political process theory were to justify the existence of two different standards as a policy matter, there remains the question of whether, as a matter of law and based on state-party intent, the treaties do create the disparate degrees of protections and, if so, what the treaty standard actually requires.<sup>236</sup>

## V. CONCLUSION

A review of the investment tribunals' decisions and approaches taken by U.S. domestic courts illustrates the chasm between the two in terms of their views of the scope of enforceable government "commitments" and consequent state liability for interference with those undertakings. Stability – given overriding primacy in investment law cases – assumes a more subordinate position in U.S. doctrine.

In contrast to practice under U.S. law, international tribunals' approaches in treaty-based investor-state arbitrations largely shift the risk of regulatory change from investors to states (and taxpayers), putting greater pressure on governments to refrain from taking action to refine and upgrade their laws and regulations. By placing a greater share of the risk of regulatory modification on states, the tribunals' approaches also may reduce investors' incentives to otherwise mitigate those risks and costs associated with potential future regulation or penalties by staying ahead of the curve in terms of

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Agreement, art. 17(3), Sept. 9, 2012 ("encourag[ing]" states to provide advance notice and opportunity to comment).

<sup>235</sup> The United States, for example, explained its view of the relationship between domestic and foreign law in its counter-memorial in *Glamis Gold*:

[T]he Trade Promotion Act of 2000, which explicitly recognized that "United States law on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law," ... direct[s] the United States to negotiate agreements that:

[do] not accord[] greater substantive rights [to foreign investors] with respect to investment protections than United States investors in the United States [are accorded under U.S. law], and to secure for investors important rights comparable to those that would be available under United States legal principles and practices...

.... It is inconceivable that the *minimum standard of treatment* required by international law would proscribe action commonly undertaken by States pursuant to national law.

*Glamis Gold v. United States*, Counter-Memorial of the Respondent United States of America, Sept. 19, 2006, pp. 233-34.

<sup>236</sup> See VCLT, Art. 31(1).

performance on environmental, good governance, and social issues. A consequence of this risk shifting thus may be less effort by investors to proactively minimize the “off-the-books” contingent environmental or other liabilities they hold that “can be a substantial source of risk for industries, especially when regulation [or enforcement] is suddenly strengthened.”<sup>237</sup>

Given the weighty policy implications of decisions regarding whether and when to hold states liable for measures of general applicability that impact investor-state contracts, it is an area in which tribunals should enter with awareness and caution, and in which they can and should draw on approaches taken by domestic legal systems, including that of the U.S., both to assess what the state of international law is and to gain a fuller picture of the mechanisms those systems have used to grapple with the similar issues and tensions between private rights and sovereign powers that are raised when investors and states contract. Otherwise, their development and enforcement of rules that appear to far overreach what domestic legal systems allow threatens to further raise questions about the legitimacy of arbitral decisions, and the appropriateness of having important questions of public policy and domestic legal ordering decided in fora with limited ties or accountability to affected constituents.

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<sup>237</sup> PAVAN SUKHDEV, CORPORATION 2010: TRANSFORMING BUSINESS FOR TOMORROW’S WORLD 76 (2012).