

# Terminating to Renegotiate: Bargaining in the Investment Treaty Regime

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February 8, 2019

## **Abstract**

Terminations of bilateral investment treaties constituting part of the backlash against the international investment regime have arguably been a response to investment dispute settlement procedures, and disadvantageous rulings by international courts. But why do most states proceed to renegotiate treaties post-termination? And why do new model investment treaties launched after terminations continue to include dispute settlement clauses? With reference to traditional bargaining theory, I argue that the decisions to terminate old bilateral investment treaties can serve as a bargaining strategy to renegotiate better substantive terms in later negotiations. Some unilateral terminations can be attributed to improved bargaining positions of states previously disadvantaged in treaty negotiations, and the attempts to signal such improvements.

# 1 Introduction

The backlash against the international investment regime has arguably been a response to the investor-state dispute settlement (ISDS) procedures and adverse rulings by arbitration tribunals towards states. In 2017, the lowest number bilateral investment treaties (BITs) were negotiated since 1983, and the number of terminations exceeded the number of new agreements for the first time.<sup>1</sup> Despite the widely spread perception that governance of investments is badly in need of reform, many states continue to support the regime in their international commitments.<sup>2</sup> Many states terminating their BITs have been quick to initiate renegotiations or launch new model BITs, many of which continue to include ISDS provisions and refer them to international arbitration courts such as the International Centre for Settlement of Investment Disputes (ICSID). If states terminate BITs and push back against the regime because of international arbitration, why do they continue to support the regime at the time when its shortcomings are well-acknowledged? After all, ISDS provisions in particular have been accused of unfairly limiting states' regulatory space in the BIT regime, and unnecessarily exposing states to costly lawsuits by foreign companies.

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<sup>1</sup> Ms. Angela Dau-Pretorius, Deputy Director of Ministry of Industrialization, Trade and SME Development in Namibia, address to the UNCTAD High Level IIAs Conference 2018, 24 Oct 2018.

<sup>2</sup> Mexico became the 154<sup>th</sup> member to the regime facilitated by the World Bank when it ratified the ICSID Convention in July 2018 after having stayed outside the regime for several decades. In addition, the Council of the European Union published its mandate to start negotiations for a multilateral, permanent investment court in March 2018. Council of the European Union, "Multilateral Investment Court: Council gives mandate to the Commission to open negotiations," Press release 114/18, (2018), <http://www.consilium.europa.eu/en/press/press-releases/2018/03/20/multilateral-investment-court-council-gives-mandate-to-the-commission-to-open-negotiations/pdf> (September 5, 2018).

Counter to some recent analyses of BIT terminations<sup>3</sup>, I argue that the phenomenon can be largely explained through a rationalist logic. Instead of resulting merely from backlash against ISDS practice within the regime, some terminations of investment treaties such as those by India, Indonesia, and South Africa can serve as a beneficial strategic move to gain higher leverage in later treaty renegotiations over substantive treaty provisions. Terminations are a device for such states to signal their improved bargaining position to treaty partners and to force them back to the negotiating table. States are also motivated to establish greater control to shape the future of the investment regime by designing their own model BITs. “Exit” can therefore amplify “voice” in the international investment regime.<sup>4</sup>

First, I outline the current backlash and efforts to reform the international investment regime and give an example of the evolving bargaining dynamic between two BIT partners, the Netherlands and Indonesia. Second, I illustrate how terminating an investment treaty can serve as a smart strategic move for a state in an attempt to rewrite the terms of cooperation. Such terminations can therefore be described more accurately as a stage in a treaty negotiation process, rather than collapse of cooperation.

## 2 Backlash and Reform

Reform in the international investment regime has been initiated due to the now well-acknowledged need for balanced investment rules. From the very first investment treaty

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<sup>3</sup> Julia Calvert, “Constructing Investor Rights? Why Some States (Fail to) Terminate Bilateral Investment Treaties,” *Review of International Political Economy* 25, no. 1 (January 2, 2018): 75–97, <https://doi.org/10.1080/09692290.2017.1406391>.

<sup>4</sup> Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard University Press, 1970).

between Germany and Pakistan in 1959, the purpose of investment treaties has been to protect foreign investors against unfair treatment and expropriation abroad. For host governments importing capital, BITs have been characterized as providing a commitment mechanism to respect investors' property rights, and against domestic political pressures to regulate, expropriate, or subject foreign multinationals to unfair treatment.<sup>5</sup> Signing up to BITs has also been described as an instance of boundedly rational policy-making, aiming at improvement of diplomatic relations.<sup>6</sup> Since the large number of BITs signed in the 1990s, the importance of maintaining a degree of state regulatory space (SRS) has however been acknowledged<sup>7</sup>: states have increasingly been subject to investor claims when attempting to regulate in the interest of public safety, health, or the environment.<sup>8</sup> The difficulty appears to be striking the balance between efficient investor protections, while preventing “regulatory chill” of host governments. Concerned states and institutions such as the UNCTAD have gone into great lengths to conduct detailed review and initiate reform of investment rules, but these efforts have yet to materialize in a better functioning investment regime.

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<sup>5</sup> Todd Allee and Clint Peinhardt, “Evaluating Three Explanations for the Design of Bilateral Investment Treaties,” *World Politics* 66, no. 1 (January 2014): 47–87, <https://doi.org/10.1017/S0043887113000324>.

<sup>6</sup> Lauge N. Skovgaard Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (Cambridge University Press, 2015).

<sup>7</sup> The concept of state regulatory space (SRS) is part of the broader research project to empirically test hypotheses related to substantive features of investment treaties, which is further discussed below. See Alexander Thompson, Tomer Broude, and Yoram Z. Haftel. “Once Bitten, Twice Shy? How Disputes Affect Regulatory Space in Investment Agreements”, PEIO Conference paper (April 2018); and further development of the SRS concept in Tomer Broude, Yoram Z. Haftel, and Alexander Thompson, “The Trans-Pacific Partnership and Regulatory Space: A Comparison of Treaty Texts,” *Journal of International Economic Law* 20, no. 2 (June 1, 2017): 391–417, <https://doi.org/10.1093/jiel/jgx016>.

<sup>8</sup> *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany* (ICSID 2011) and *Philip Morris Asia Limited v The Commonwealth of Australia*, PCA Case No. 2012-12 UNCITRAL (High Court of Australia 2012) have become famous as examples of ISDS used against regulatory efforts of states.

Several states have resulted to terminate some or all of their investment treaties before announcing intentions to renegotiate or launching a new model BIT. Overall, 216 out of some 2300 BITs that have been ratified have gotten terminated (tables 1 and 2).<sup>9</sup>

**Table 1: BITs in force and terminated**

Status of BIT	No. of BITs
In force	2359
Terminated	216
Total	2575

**Table 2: BITs by termination type**

Type of termination	No. of BITs
Expired	3
Replaced by new treaty	104
Terminated by consent	19
Unilaterally denounced	90
Total	216

### **3 Evolution of the Netherlands – Indonesia BIT**

BITs are characterized by a specific bargaining dynamic, which is highly dependent on the changing negotiating powers of the signatory states. The evolution of Netherlands–Indonesia BITs provides an example of a bilateral relationship with changing bargaining positions of the two actors.

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<sup>9</sup> See Appendix A. for a list of terminated BITs.

### 3.1 Initial BIT of 1968

At the point of signing the first treaty in 1968, the Netherlands was one of the most active European states pushing for BITs, especially with developing countries where its companies had investment interests.<sup>10</sup> Indonesia along with many others signed onto the Netherlands' model framework for regulation of investments without much negotiating.<sup>11</sup> Early BITs therefore reflected the distribution of bargaining power between the signatories, where BIT templates were largely provided by a handful of developed western states serving the rights of their investors.

Rational design scholars have argued that specific provisions in international agreements can make them more durable, even when there are large changes in the distribution of bargaining power among the participant states.<sup>12</sup> This is because states can choose to include finite duration and renegotiation clauses into agreements if they anticipate changes in the relative bargaining powers in order to sustain cooperation. However, the 1968 Indonesia-Netherlands BIT included no modalities for amendment or renegotiation, treaty duration of 15 years with automatic and indefinite renewal, and a 15-year sunset clause.<sup>13</sup> At the time, the prospects for bargaining power shocks were not considered likely, or the costs of renegeing on the treaty were considered lower than possible renegotiating costs. Especially

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<sup>10</sup> The first countries to initiate international treaties specifically addressing international investment were major European capital-exportin countries, namely Germany, Switzerland, France, the United Kingdom, the Netherlands and Belgium. Jeswald W. Salacuse and Nicholas P. Sullivan, "Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain," *Harvard International Law Journal* 46 (2005): 67.

<sup>11</sup> For example, as established by an Ecuadorian investment treaties audit commission (CAITISA) during a review of the country's investment treaty program, none of the signed BITs underwent a negotiation process. "Why Did Ecuador Terminate All Its Bilateral Investment Treaties?" Transnational Institute, May 25, 2017, <https://www.tni.org/en/article/why-did-ecuador-terminate-all-its-bilateral-investment-treaties>.

<sup>12</sup> Barbara Koremenos, "Can Cooperation Survive Changes in Bargaining Power? The Case of Coffee," *The Journal of Legal Studies* 31, no. S1 (January 1, 2002): S259–83, <https://doi.org/10.1086/342009>.

<sup>13</sup> Netherlands-Indonesia BIT 1968. Such inflexible features are representative of other early BITs.

developing countries were also conducting boundedly rational policy-making with regards to the early BITs<sup>14</sup>, which may have hindered the bargaining dynamic from resulting in a sustainably flexible treaty.

### 3.2 Renegotiation and the 1996 BIT

By mid-1990s, Indonesia had introduced economic reforms such as de-regulation of the financial sector to improve export competitiveness, and especially the manufacturing sector was attracting foreign investment, generating economic growth and hence improved bargaining power in its bilateral investment relations. The first renegotiation of the Netherlands-Indonesia BIT in 1996, over thirty years later, made changes to the ISDS provisions to include the domestic courts of the host state as a possibility for ISDS, while still preserving the right to arbitration after domestic court proceedings. Treaty duration was reduced to 10 years, and automatic renewal was reduced from indefinite to 10 years. Finally, modalities for amendment and renegotiation became specified in the new BIT.<sup>15</sup> Such changes can be argued to reflect the realization of possible future shocks due to Indonesia's growth, as well as the learning effects resulting from the increasing instance of ISDS cases that were rapidly expanding at the time.<sup>16</sup> The review of the terms of the BIT coincided also with increasing integration of ASEAN cooperation, and generally improved position of Indonesia in the world economy in comparison to its standing in the late 1960s, improving its alternatives to BITs. Furthermore, experience with ISDS had started to highlight the need for more detailed treaty texts.

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<sup>14</sup> Poulsen, *Bounded Rationality and Economic Diplomacy*.

<sup>15</sup> UNCTAD, "International Investment Agreements Navigator" (United Nations Conference of Trade and Development, 2017), <http://investmentpolicyhub.unctad.org/IIA>. The 1996 BIT however included a clause preserving the right to arbitration after domestic court proceedings, hence still placing international arbitration above domestic courts.

<sup>16</sup> For the learning effects resulting from international arbitration in particular, see Yoram Z. Haftel and Alexander Thompson, "When Do States Renegotiate Investment Agreements? The Impact of Arbitration," *The Review of International Organizations* 13, no. 1 (March 1, 2018): 25–48, <https://doi.org/10.1007/s11558-017-9276-1>.

### 3.3 BIT termination in 2014 and the model BIT

The termination decision by Indonesia in March 2014 followed those of South Africa, Ecuador, and Venezuela. Concerns of possibly thousands of “mailbox companies” located in the Netherlands had emerged some years earlier, suggesting that many companies were enjoying the benefits of the investment protections provided by Dutch BITs without actually conducting any of their operations in the country.<sup>17</sup> Shortly after the termination announcement to the Dutch embassy in Jakarta, Vice President Boediono however also declared his intentions to renegotiate all of the country’s BITs to become “adjusted to recent developments”.<sup>18</sup> The termination decision therefore appears to be a carefully considered move towards reform in the country’s investment policy, rather than an attempt to withdraw from the regime completely.<sup>19</sup>

Indonesia’s decision was undeniably motivated by the perceived wave of backlash gaining momentum internationally and following a series of unfavourable rulings from international arbitration. In addition, observers point out that the terminations coincided with a nationalist surge in domestic politics surrounding the parliamentary and presidential elections of 2014.<sup>20</sup> However, Indonesia remains committed to further liberalising trade and protecting investment through the ACIA and the ASEAN Plus Agreements.<sup>21</sup> Furthermore,

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<sup>17</sup> David Price, “Indonesia’s Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?,” *Asian Journal of International Law* 7, no. 1 (January 2017): 124–51, <https://doi.org/10.1017/S2044251315000247>.

<sup>18</sup> “BIT by BIT in Indonesia,” accessed January 21, 2019, <http://www.nortonrosefulbright.com/knowledge/publications/121386/bit-by-bit-in-indonesia>.

<sup>19</sup> This appears to be the strategy of most states terminating BITs. See Clint Peinhardt and Rachel L. Wellhausen, “Withdrawing from Investment Treaties but Protecting Investment,” *Global Policy* 7, no. 4 (2016): 571–76, <https://doi.org/10.1111/1758-5899.12355>.

<sup>20</sup> “BIT by BIT in Indonesia.”

<sup>21</sup> Antony Crockett, “Indonesia’s Bilateral Investment Treaties: Between Generations?,” *ICSID Review - Foreign Investment Law Journal* 30, no. 2 (May 1, 2015): 437–48, <https://doi.org/10.1093/icsidreview/siv003>.



the intention of the Indonesian government was always to return to the negotiation table, with the goal of improving the terms of its investment treaties. The new Indonesian model BIT, intended to be used as a platform for future investment negotiations, includes various different carveouts, safeguards and clarifications: “investments” are defined using the *Salini* test<sup>22</sup>, national treatment is subject to exceptions, and the most favoured nation (MFN) clause contains the exclusion of dispute settlement.<sup>23</sup> The new model BIT represents an attempt to establish clear guidelines how the government can approach renegotiating the terms for future treaties.

The experience of the Netherlands-Indonesia BIT is representative of the evolution of international treaties. After all, most international agreements are renegotiated or replaced rather than not.<sup>24</sup> However, why do some states result to terminating their BITs, some successfully update them through renegotiations, and some continue to rely on old treaties negotiated decades ago? The next section introduces a specific bargaining dynamic, which suggests that even though the ultimate goal of states may be to renegotiate and continue cooperation, it is sometimes beneficial for states to terminate a BIT completely in order to negotiate better terms at a later stage.

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<sup>22</sup> According to the Salini test, an investment is defined according to having four elements: a contribution of money or assets, a certain duration, an element of risk, and a contribution to the economic development of the host state. See Alex Grabowski, “The Definition of Investment under the ICSID Convention: A Defense of Salini,” *Chicago Journal of International Law* 15 (2015 2014): 287.

<sup>23</sup> UNCTAD, “Taking Stock of IIA Reform,” 6, accessed September 2018, [http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d3\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d3_en.pdf).

<sup>24</sup> Haftel and Thompson, “When Do States Renegotiate Investment Agreements?”

## 4 Improved Bargaining Power from Termination

The reasons behind the termination of existing BITs can be explained with reference to traditional bargaining theory. While withdrawal from unbeneficial treaties seems intuitive, with relation to investment treaties such a move can be risky: host states have to be cautious with the kind of signal they wish to send to international investors, as termination of investment treaties may be interpreted as a sign of anti-foreign investor attitudes, and a protectionist or nationalist direction in the state's economic policy. The inclusion of sunset clauses in most BITs also makes sure that the terms of the treaty remain in force often decades after termination, and hence termination does not result in any immediate relief from problematic treaty commitments. In addition, as in most international cooperation, a state must consider whether the collapse of cooperation is a better alternative than a somewhat unsatisfactory status quo arrangement. Cooperation especially in international investment occurs "in the shadow of the future", and treaty termination can be interpreted by others as defection, potentially resulting in negative consequences in the future. Given the potentially costly consequences of treaty termination, the increasing occurrence of withdrawal from BITs demands an explanation.

Each of the two states who are members to a BIT have preferences over which terms should be included into the treaty. Impressive efforts have been made to map their contents, some including hundreds of different treaty-features, either manually coding or using automated text-as-data techniques to collect expansive datasets.<sup>25</sup> For the purposes of illustrating the underlying bargaining dynamic, I however assume a one-dimensional bargaining space over

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<sup>25</sup> Wolfgang Alschner and Dmitriy Skougarevskiy, "Convergence and Divergence in the Investment Treaty Universe - Scoping the Potential for Multilateral Consolidation," *Trade, Law and Development* 8 (2016): 189; Haftel and Thompson, "When Do States Renegotiate Investment Agreements?" See also Barbara Koremenos, *The Continent of International Law: Explaining Agreement Design* (Cambridge University Press, 2016). for a dataset on multi-issue agreements and treaties with associated cooperation problems.

an example treaty feature, state regulatory space (SRS), concept developed by Broude, Haftel and Thompson. SRS encompasses those treaty provisions that can contribute to a larger policy-autonomy of host states with regards to various public policy domains, such as inclusion of an ISDS clause or presence of most favored nation (MFN) clause.<sup>26</sup>

The example of SRS is chosen as previous research has found that leaders of capital importing countries have in the past tended to oppose terms indicating low SRS, such as features that delegate dispute settlement to the ICSID in the fear of sovereignty costs.<sup>27</sup> On the contrary, the capital exporting country in the dyad can be expected to prefer stricter protections for their investors in the partner country, hence preferring treaties with smaller SRS.<sup>28</sup> The described bargaining dynamic is however applicable with regards to any other treaty feature over which the negotiating states have opposite preferences. The dynamic therefore is a zero-sum game between the two negotiating states – when one gets terms closer to its ideal point, the other moves further away from theirs. If the two states however manage to strike an acceptable deal over the treaty, a negotiated BIT results in positive-sum benefits for both: foreign investors' risks are decreased by the guarantees of for example fair and equitable treatment, which in turn encourages investments into countries which otherwise may struggle to attract foreign investment.

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<sup>26</sup> Thompson et. al. "Once Bitten, Twice Shy?". See also further development of the SRS concept in Broude, Haftel, and Thompson, "The Trans-Pacific Partnership and Regulatory Space."

<sup>27</sup> Todd Allee and Clint Peinhardt, "Delegating Differences: Bilateral Investment Treaties and Bargaining Over Dispute Resolution Provisions," *International Studies Quarterly* 54, no. 1 (March 1, 2010): 1–26, <https://doi.org/10.1111/j.1468-2478.2009.00575>.

<sup>28</sup> Capital exporting countries usually have strong domestic interest groups, such as a large presence of multinational companies lobbying for stronger overseas investment protections, and hence the state has "political incentives to act in accordance with the wishes of these interests". Allee and Peinhardt., "Delegating Differences", 9.

Arguably it would be in neither states' interests to negotiate a BIT which would not strike an efficient balance between SRS and foreign investor protection, i.e. one that would provide either too little or too much regulatory freedom to states. Indeed, the treaty preferences within the dyads is no longer as clear as for much of the 20<sup>th</sup> century: most states both import and export significant levels of capital; South-South investment has increased rapidly over the past decades; and European states that in the past have been considered as champions of investor rights overseas have now started to defend their regulatory rights after themselves having become targets of legal action. States overall recognize the need for balanced rules for investment. However, due to the fragmented nature of rule-making in the investment regime, and the lack of centralized authority in determining what the optimal extent of SRS – or any other BIT feature – is, investment rules continue to be a bargaining game between two states, with their own preferences and model treaties.<sup>29</sup>

Adopting these assumptions over the preferences of the two example states, an illustration of a one-dimensional bargaining space between them in BIT-negotiations is presented in figure 1.

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<sup>29</sup> Others have argued that fragmented governance regimes benefit powerful states, who have the resources to navigate complex regulatory environments and bargaining power to negotiate large volumes of bilateral treaties, instead of multilateral ones. See for example Eyal Benvenisti and George W. Downs, “The Empire’s New Clothes: Political Economy and the Fragmentation of International Law,” *Stanford Law Review* 60, no. 2 (2007): 595–631.

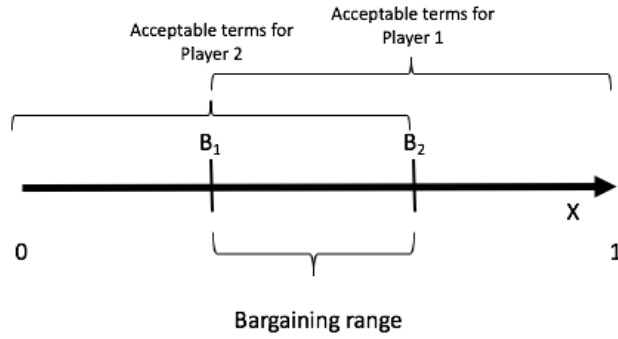


Figure 1. One-dimensional bargaining space between two players with opposing preferences and a common bargaining range<sup>30</sup>

$B_1$  and  $B_2$  stand for the “bottom lines” for Player 1 and Player 2 respectively, representing the smallest and largest amount of SRS they are willing to accept. A treaty with  $x < B_1$  would encompass a treaty so limiting to its SRS that Player 1 would rather not have a BIT at all than sign such unfavorable terms, possibly exposing the government to excessive arbitration. The opposite is true for Player 2, from whom  $x > B_2$  would not protect its investors effectively, and a no-deal becomes the more favorable option, as it does not involve the costs associated with negotiations.<sup>31</sup> While the two states have opposite preferences over the extent of SRS provided by a BIT, joint gains exist for successfully negotiated BIT if a bargaining range exists: the states both stand to benefit from cooperating, i.e. negotiating a treaty the terms of which fall somewhere between  $B_1$  and  $B_2$ .<sup>32</sup>

<sup>30</sup>  $X$  stands for SRS in a BIT, and it lies within the space  $X = [0,1]$ , e.g. runs from 0 for “no SRS” to 1 for “maximum SRS”. Here it is assumed that 1 “maximum SRS” is the highest flexibility for a state’s regulatory freedoms as possible given that they still prefer to have a BIT, e.g. a treaty with plenty of exceptions clauses and features allowing state regulation. In practice, states preferring “as large SRS as possible” at all costs would not choose to sign a BIT at all. See Haftel and Thompson, “When Do States Renegotiate Investment Agreements?” Utilities for Player 1 and Player 2 are defined as  $u_1(x)=1-x$  and  $u_2(x)=x$  respectively, where  $x \in X$ . Therefore,  $u_1(x)$  decreases in  $x$ , and  $u_2(x)$  increases in  $x$ .

<sup>31</sup> Even if a treaty is signed by the leading negotiators at the international level, in most countries international legislation has to be ratified at the national level. Bottom lines can therefore be also defined based on the minimum terms required for the ratification of the treaty to be politically feasible domestically: a large number of countries have signed BITs without ever ratifying them domestically.

<sup>32</sup> Cooperation enabled by common interests, and mutual gains from reaching a compromise are the key building blocks of the neoliberal institutionalist IR scholarship. See for example Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton University Press, 1984), <http://www.jstor.org/stable/j.ctt7sq9s>; Robert Owen Keohane and Joseph S. Nye, *Power and Interdependence* (Longman, 2011); Robert O. Keohane and Lisa

The terms found acceptable for a treaty by states are however not stable. Two types of changes can cause a change in states' preferences, which may drastically alter the bottom lines of the parties: 1.) changes in the regulatory issues of international investment, and 2.) changes in the relative bargaining power of states, which I will briefly consider below. As a result, this may cause the status quo BIT no longer to be satisfactory for one or both parties.

#### 4.1 Changes in regulatory issues

Recent developments in the investment regime have caused changes in what is considered as acceptable for BIT commitments. States have become aware of the adverse consequences of their treaty commitments after they experience international arbitration and change their preferences over treaty terms after having been subject to ISDS proceedings.<sup>33</sup> Interpretation of treaty texts by ad hoc tribunals has been considered problematic, and many states have expressed their desire to limit the interpretation powers of third-party arbitrators.<sup>34</sup> Shifts in the perceived practice of international tribunals are also possible, for example in the form of concerns over arbitrator bias.<sup>35</sup> Domestic political opinion and developments are also a major cause of change for international agreements, as for example pressures to regulate with regards to public health, environment, and finance have increased within some states, causing pressure on governments to negotiate larger SRS.

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L. Martin, "The Promise of Institutional Theory," *International Security* 20, no. 1 (1995): 39–51, <https://doi.org/10.2307/2539214>.

<sup>33</sup> Lauge N. Skovgaard Poulsen and Emma Aisbett, "When the Claim Hits: Bilateral Investment Treaties and Bounded Rational Learning," *World Politics* 65, no. 2 (April 2013): 273–313, <https://doi.org/10.1017/S0043887113000063>; Haftel and Thompson, "When Do States Renegotiate Investment Agreements?"

<sup>34</sup> This is manifested by inclusion of clauses limiting interpretation powers of the treaty by third parties in some new BITs.

<sup>35</sup> Julian Donaubauer, Eric Neumayer, and Peter Nunnenkamp, "Winning or Losing in Investor-to-State Dispute Resolution: The Role of Arbitrator Bias and Experience," *Review of International Economics* 26, no. 4 (2018): 892–916, <https://doi.org/10.1111/roie.12347>.

Such changes result in the old status quo BIT being outdated for the purposes of one or both states. Figure 2 illustrates a situation where due to the change in regulatory issues the BIT is no longer within the bargaining range: due to the changes discussed, the bottom line of Player 1 has shifted towards higher SRS ( $x \rightarrow 1$ ), making the BIT unable to meet the new criterion for a mutually beneficial treaty. The BIT however satisfies the conditions for an acceptable treaty for Player 2, who in this scenario would prefer as little SRS as possible.

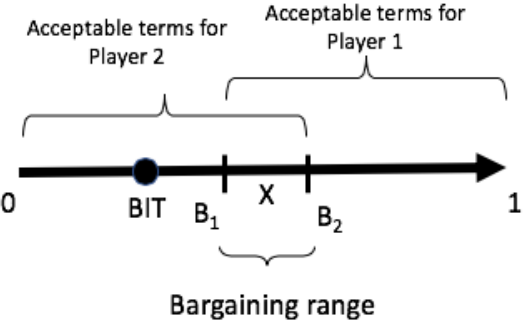


Figure 2. Bargaining space when the bottom line of Player 1 ( $b_1$ ) has changed such that the status quo BIT is no longer within the bargaining range. However, the BIT is within the range of acceptable treaty terms for Player 2.

It is also possible that both states have significantly updated their preferences. In a more realistic scenario, both signatory states agree that higher SRS has to be incorporated into the old BIT, for example by recognizing states' right to regulate when financial stability is at stake. Figure 3 illustrates a dynamic where there is an overlap in the acceptable terms for both states, but the status quo BIT no longer satisfies these requirements.

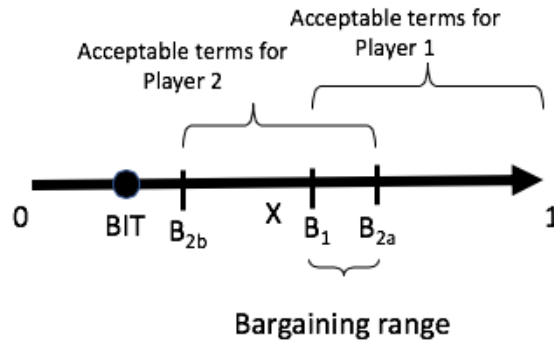


Figure 3. Bargaining space when the bottom lines of both players have changed such that the status quo BIT no longer is within the range of acceptable terms for either.

The destiny of the old BIT in both scenarios of Figure 2 and 3 will be renegotiation, as the BITs no longer result in positive sum gains for both states. While Player 2 in Figure 2 may be satisfied with the status quo BIT as it falls within the range of its acceptable terms, without accommodating Player 1’s updated preferences the treaty will be unilaterally terminated by Player 1, as it is better off without the treaty than keeping it. Cooperative gains however still exist, and hence renegotiation is possible.

## 4.2 Changes in relative bargaining power

Even if there are no radical changes in the regulatory issues at stake, the relative bargaining power of signatory states during the lifetime of a treaty can alter the acceptability of the status quo agreement. Changes in the bargaining power of the states who account for the largest number of BIT terminations are noticeable: Indonesia for example has improved its position since the establishment of the ASEAN Economic Community in 2015, which offers economic cooperation opportunities in the form of a large market in the world of some US\$2.6 trillion and 622 million people, hence improving its options for sources of investment



and economic cooperation.<sup>36</sup> Growing economic power, increased foreign direct investment flows, stronger domestic property rights, or membership to alternative bilateral or multilateral arrangements with investment provisions are all factors which can significantly improve its alternatives to the status quo BIT.<sup>37</sup> The payoff of the no-treaty outcome has therefore improved, reflecting a changed bottom line and stronger negotiating position: if before a state had to compromise to accommodate the negotiating party's wishes, it may now wish to dictate more strictly the terms under which it is willing to cooperate.<sup>38</sup>

Figure 4 illustrates a situation where Player 1 has improved its bargaining position, which is reflected in a bottom line closer to  $x=1$ . In contrast to situation in Figure 2 however, although Player 1's bargaining position has improved, the BIT still lies within the bargaining range.

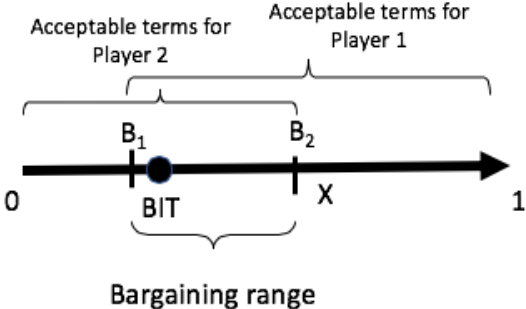


Figure 4. Bargaining space when the bottom line of Player 1 ( $b_1$ ) has changed, however the status quo BIT is still within the bargaining range.

<sup>36</sup> ASEAN (2018) "ASEAN Economic Community" <http://asean.org/asean-economic-community/> (September 2018)  
<sup>37</sup> See Roger Fisher and William Ury, *Getting to Yes: Negotiating an Agreement without Giving In* (Random House, 1981). who outline the theory of Best Alternative to Negotiated Treaty as a conceptualization of bargaining power, which is dependent on an actors' outside options in any negotiation.  
<sup>38</sup> States who have terminated most BITs to date are countries that have mainly imported capital in the past. It has primarily been the emerging economies who have experienced rapid growth and become increasingly embedded to the world economy that can be argued to have improved their bargaining leverage through improved outside options, and who therefore are attempting to shape global economic governance more reflective of their preferences. Capital importing countries may now prefer larger regulatory space than is provided by the old BITs, which it negotiated in a weaker bargaining position.

The difficulty of successful renegotiation in a situation illustrated by Figure 4 lies in the lack of incentives of the other party to accommodate new demands of their treaty partner. This becomes evident when contrasting scenarios where the status quo BIT is either outside or within the bargaining range, represented by Figures 5 and 6 respectively. The payoffs of keeping the status quo BIT for both players are noted by  $(s, 1-s)$ .

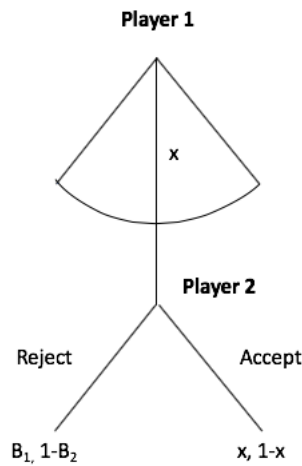


Figure 5. Old BIT outside bargaining range

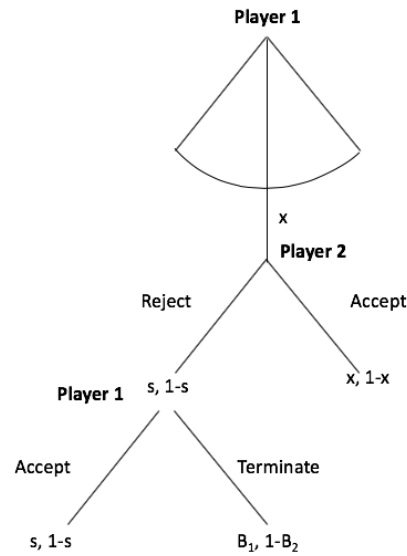


Figure 6. Old BIT within bargaining range

In the bargaining games of Figures 5 and 6, player 1 initiates BIT renegotiations due to its changed bargaining position. In the renegotiation of figure 2, if Player 1 offers terms slightly better than the bottom line of Player 2, i.e.  $x=B_2-\epsilon$ , Player 2 will be better off accepting the new terms than letting cooperation collapse, and BIT can be successfully renegotiated. In a situation illustrated by figure 3, however, renegotiation will become difficult. The terms of a BIT will not be renegotiated when  $s>B_1$ , e.g. when the payoffs for Player 1 are higher from keeping the existing treaty than terminating it. This is because to improve its payoffs, Player 1 would have to offer new terms such that  $x>s$ , which would result in worse payoffs for Player 2 than is provided by the status quo BIT. Player 2 can confidently reject the

renegotiation attempt, knowing that Player 1 is better off sticking with the status quo BIT than terminating it.

The stylized game theory illustration is limited to maximum of two-move protocol: the player who gets to make the first move, and the player who makes the final offer to “take it or leave it” usually determines the outcome of negotiations where cooperative gains exist.<sup>39</sup> This is important for the real-world dynamics of BIT terminations and renegotiations, as no real limitations are in place as to how many “moves” are allowed. Especially an authoritarian regime with no serious domestic political pressures may be able to “lose” the game over a specific BIT, with the hopes of renegotiating at a later stage. Such a strategy is the only one that can improve the terms of the BIT for Player 1 if its bargaining strength has not improved ( $s > B_1$ ), or if it is struggling to convince the treaty partner of such improvement. Whether termination option is preferable to Player 1 will depend on the costs of renegotiation and whether they outweigh the benefits of the possible new treaty.<sup>40</sup>

Changing the status quo BIT towards a more favorable one can therefore be near-impossible for the capital exporting country when the status quo BIT continues to be present, even if its bargaining position has improved. The extent of uncertainty about each other’s bottom lines, and the often-significant costs associated with renegotiation attempts make BIT

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<sup>39</sup> Contrasting the Nash bargaining solution and the Rubenstein bargaining model illustrate the difference bargaining protocols make to the outcome of negotiations. John F. Nash, “The Bargaining Problem,” *Econometrica* 18, no. 2 (1950): 155–62, <https://doi.org/10.2307/1907266>; John Nash, “Two-Person Cooperative Games,” *Econometrica* 21, no. 1 (1953): 128–40, <https://doi.org/10.2307/1906951>; Ariel Rubinstein, “Perfect Equilibrium in a Bargaining Model,” *Econometrica* 50, no. 1 (1982): 97–109, <https://doi.org/10.2307/1912531>.

<sup>40</sup> If renegotiation is costly because of time and effort that must go into the process, Player 1 might be better off keeping the status quo than attempt to terminate and then renegotiate. The impact of costly negotiation is discussed in the literature with regards to the renegotiation-proofness principle (see for example Joel Watson and Jim Brennan, “The Renegotiation-Proofness Principle and Costly Renegotiation,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, May 1, 2002), <https://papers.ssrn.com/abstract=318726>).

termination a likely.<sup>41</sup> From the perspective of states wishing to reform their international investment commitments, first terminating the old BITs provides a strong negotiating tactic.<sup>42</sup> Advantages of restarting negotiations from a clean slate are strong, as they force former treaty partners back to the negotiating table, assuming cooperation is still profitable for both. Some states who have terminated their BITs have also decided to formulate their intentions and goals into a new model BIT to guide new negotiations, which admittedly provides clarity over the often highly complex and legalistic language of investment treaties.<sup>43</sup>

## 5 Conclusions

BITs can be terminated by states who wish to improve the terms of their treaty commitments, without the actual intention of withdrawing from the investment regime completely. BITs have mainly been terminated by states whose bargaining power has improved, in which case termination can function as a valuable strategic tool to gain leverage in later renegotiations. While experience with ISDS, as well as other changes in the investment regime itself may have acted as an important learning device and catalyst for termination decisions, states have however not uniformly resulted to terminations, nor attempted to do away with related clauses. Reform efforts focus more on the substantive aspects of BITs.

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<sup>41</sup> In bargaining, actors often have great incentives to deceive the other party about their true bargaining position, as it can prove an efficient negotiation tactic.

<sup>42</sup> Renegotiations with an existing status quo are tricky to win for the player initiating the talks, see Andrew H. Kydd, *International Relations Theory* (Cambridge University Press, 2015).

<sup>43</sup> Tarald Laudal Berge and Øyvind Stiansen, “Negotiating BITs with Models. The Power of Expertise,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, October 12, 2016), <https://papers.ssrn.com/abstract=2851454>.

The need for reform in the international investment regime, as well as states' strategies to pursue such reform are of key interest for both researchers and policy makers of international political economy. Decisions to terminate, renegotiate, or launch new model BITs especially by emerging economies are reflective of more complex, strategic dynamics, where new actors may have a larger role to play than in the past. Overall, the recent developments in the investment treaty regime are reflective of changes in other global governance regimes: while individual actors make strategic decisions, and rationally design institutions to serve their purposes, the shape of a governance regime as a whole does not follow a design master plan. The international investment regime is highly fragmented and complex, with no centralized authority or hierarchy due to the web of overlapping bilateral and multilateral treaties. Whether centralization efforts in global governance regimes could help to overcome the sometimes-counterproductive bargaining dynamics, the study of international legal regimes can largely benefit from analysis reaching beyond the analysis of final treaty texts. Further investigation of actors' strategic decisions, and what their motivations behind pushing for certain treaty clauses are can be highly informative of the developments of global governance regimes.

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## Appendix A. Unilaterally terminated BITs by state

State	No. terminated BITs	Terminated BITs (year signed/year terminated)	Model BIT since termination
Bolivia	11	Spain (2001/2012); USA (1998/2012); Austria (1997/2013); Ecuador (1995/2018); Denmark (1995/2014); Argentina (1994/2014); Netherlands (1992/2009); Sweden (1990/2013); BLEU (1990/2014); France (1989/2013); Germany (1987/2013)	Bolivia Model BIT, drafting
Ecuador	23	Guatemala (2002/2008); Sweden (2001/2018); Finland (2001/2010); Honduras (2000/2008); Nicaragua (2000/2008); Peru (1999/2017); Dominican Republic (1998/2008); Cuba (1997/2008); Canada (1996/2018); Romania (1996/2008); Germany (1996/2018); <i>Bolivia (1995/2018)</i> ; France (1994/2018); El Salvador (1994/2008); United Kingdom (1994/2018); China (1994/2018); Argentina (1994/2018); Paraguay (1994/2008); <i>Venezuela (1993/2018)</i> ; Chile (1993/2018); USA (1993/2018)	OPEC Fund Model Agreement, 2001
India	23	Trinidad and Tobago (2007/2017); China (2006/2017); Slovakia (2006/2017); Bahrain (2004/2017); Hungary (2003/2017); Belarus (2002/2017); Croatia (2001/2017); Austria (1999/2017); Argentina (1999/2013); Australia (1999/2017); <i>Indonesia (1999/2016)</i> ; Turkey (1998/2017); Spain (1997/2016); Egypt (1997/2016); Switzerland (1997/2017); Oman (1997/2017); Netherlands (1995/2016); Denmark (1995/2017); Malaysia (2017); Germany (1995/2017); Russian Federation (1994/2015); Czech Republic (1996/2017); Italy (1995/2017)	India Model BIT, 2015
Indonesia	21	Singapore (2005/2016); Bulgaria (2003/2015); Germany (2003/2017); Cambodia (1999/2016); <i>India (1999/2016)</i> ; Romania (1997/2016); Turkey (1997/2016); Pakistan (1996/2016); Spain (1995/2016); China (1994/2011); Lao (1994/2015); Slovakia (1994/2015); Netherlands (1994/2015); Malaysia (1994/2015); Egypt (1994/2014); Hungary (1992/2016); Norway (1991/2004); Viet Nam (1991/2016); Switzerland (1974/2016); France (1973/2015); Italy (1991/2015)	Indonesia Model BIT, drafting
South Africa	10	Spain (1998/2013); BLEU (1998/2013); Argentina (1998/2017); Austria (1996/2014); Denmark (1996/2014); France (1995/2014); Germany (1995/2014); Switzerland (1995/2014); Netherlands (1995/2014); United Kingdom (1994/2014)	SADC Model BIT, 2012
Venezuela	2	<i>Ecuador (1993/2018)</i> ; Netherlands (1991/2008)	None

Table includes unilaterally terminated BITs as reported in the UNCTAD Investment Treaty Database in January 2019. BITs in italics included twice under terminations of both parties.