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Dispute by Design? Legalization, Backlash, and the Drafting of Investment Agreements

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The investment treaty regime is currently going through extensive reform. Driven by a raft of investor–state dispute settlement cases, states are asking: How should we draft future investment agreements? This article presents the first empirical analysis of what drives risk in investment agreements. Drawing on states' own reform narratives, and on unique data on the content of over two thousand investment agreements, I analyze how legalization in investment agreements is associated with the risk of attracting investor–state dispute settlement claims. I find that the only legalization dimension that robustly predicts investor–state dispute settlement claims in investment agreements is substantive obligation, and that this risk is not significantly affected by introducing more flexibility or precision. These findings have important implications for states engaged in reform of their international investment policies. Most prominently, they suggest that states should focus more on *what* substantive clauses they include in their investment agreements, rather than on *how* these clauses are written.

Introduction

The investment treaty regime is a unique legal system. Through a network of more than three thousand international investment agreements (IIAs), it creates wide-ranging substantive protections for investors, and a sui generis investor–state dispute settlement (ISDS) system where foreign investors can sue states directly before international arbitration tribunals. This individual right of standing has been frequently used over the last 20 years, so frequently in fact that it has led to talk of a backlash against ISDS (Waibel et al. 2010), and a regime-wide legitimacy crisis (Abebe and Ginsburg 2019). While the risk of ISDS is a deliberate feature of IIAs, the recent wave of ISDS cases has led many states to reconsider their IIA programs. But, does the way IIAs are written really matter? This article is the first to investigate the link between the legal content of IIAs and the risk of attracting ISDS claims.

The importance of legal drafting has been debated ever since legalization of international relations began (Goldstein et al. 2000). Of late, it has resurfaced in the legitimacy debate surrounding the international judiciary in general (Johns 2015), and international investment law in particular (Alschner and Skougarevskiy 2016). While many states were unaware of this when signing their first IIAs (Poulsen 2014), delegating dispute settlement through ISDS was always meant to be risky—it is the stick, while increased inward investment is, at least in theory, the carrot. Legal delegation, however, is not the only risky aspect in IIAs. UNCTAD (2012) highlights that the low levels of clarity in most IIAs make them unpredictable, and by extension more risky.

States are therefore discussing how future IIAs should be written. Despite ongoing reform efforts, the questions about what legal risk IIAs carry and about how innovations in IIA drafting affect that risk remain unanswered. I argue that the risk of investor claims is not only a function of states' inherent propensity to comply with their IIA commitments (Chayes and Chayes 1993), or of exogenous compliance pressure (Downs, Rocke, and Barsoom 1996; Abbott and Snidal 2000). The risk of claims also depends on the obligations to be complied with.

I start my analysis by reviewing states' IIA reform narratives. I find that the drafting issues states grapple with are concentrated around how IIAs legalize the commitments they offer to foreign investors. Drawing on the legalization of world politics literature's conceptual apparatus (Abbott et al. 2000), I formulate five distinct hypotheses of how variations in legalization in IIAs might affect the risk of attracting ISDS claims. To measure legalization in IIAs, I apply unique, novel data on the legal content of a large sample of IIAs. I create five indices measuring different legalization dimensions in the IIAs. I then link the index data with a data set covering all ISDS claims between 1995 and 2017. I find that the only stable driver of ISDS risk in IIAs is the substantive protections investors are afforded and how extensive those protections are. I show that this finding has important implications for how we view risk under IIAs, and how states should approach reform in the future.

The article proceeds as follows: I briefly review the empirical literature and states' IIA reform narratives, then I formulate my hypotheses, present my research design, present my empirical analysis, and discuss the implications of my findings.

IIAs and ISDS

The empirical literature on IIAs and ISDS has focused on why states sign IIAs (Elkins, Guzman, and Simmons 2006; Poulsen 2014) or consent to ISDS elsewhere (St John 2018; Berge and St John 2020), variations in IIA design (Allee and Peinhardt 2010; Alschner and Skougarevskiy

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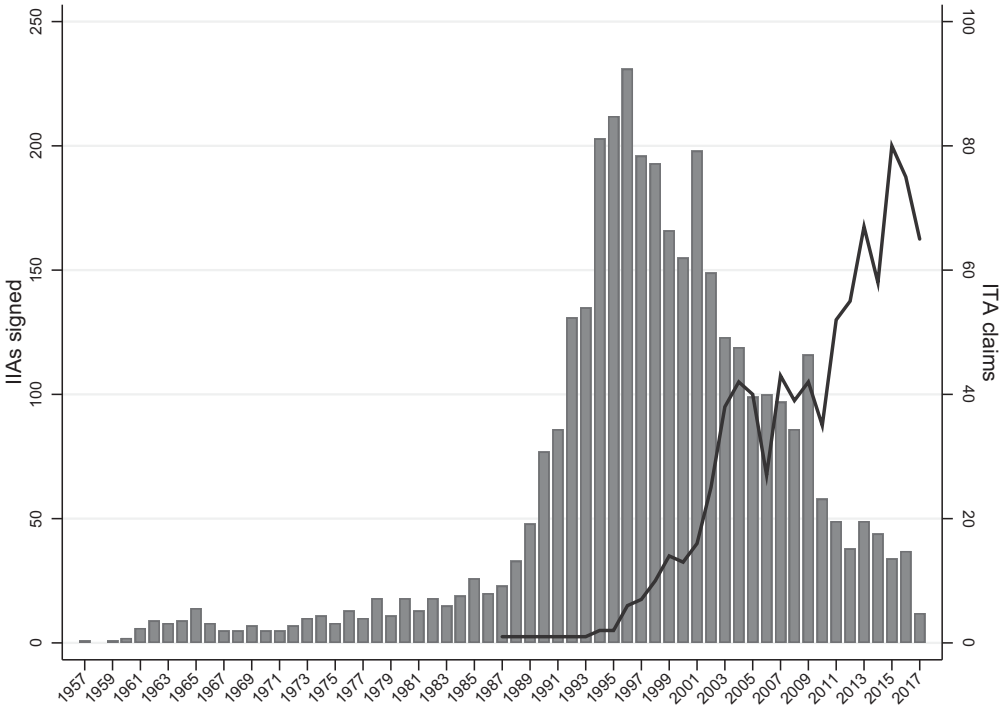

Figure 1. IIAs and investor claims for arbitration over time (UNCTAD).

2016), power in IIA negotiations (Allee and Peinhardt 2014; Simmons 2014), how states' IIA practices change after they experience ISDS claims (Poulsen and Aisbett 2013; Haftel and Thompson 2018), what drives outcomes of ISDS cases (Behn, Berge, and Langford 2018; Donaubauer, Neumayer, and Nunnenkamp 2018), and the issue of arbitrator bias (Langford, Behn, and Lie 2017).

Studies looking at the effects of IIAs have focused on the benefit side of the agreements, that is, their ability to attract investment (Bonnitcha, Poulsen, and Waibel 2017, 155–66) and to depoliticize disputes (Gertz, Jandhyala, and Poulsen 2018). Although enforceability through ISDS is the component of IIAs that make them credible commitments to foreign investors (Elkins, Guzman, and Simmons 2006), the legitimacy debate in the investment treaty regime seems to be driven by the realization that IIAs also carry "low-probability, high-impact risks" (Poulsen 2014, 2). However, research on what drives these risks in IIAs is scant.

The Investment Treaty Regime: A Brief History

The regime that governs the interaction between foreign investors and host states is decentralized. Institutionally, it consists of over three thousand IIAs, the treaties that govern investment arbitration, and the decisions of arbitration tribunals. In this article, I focus on investment agreements. IIAs are state-to-state treaties that define the treatment investors from one state shall be given when investing in the jurisdiction of other treaty parties.

Importantly, most IIAs give investors the ability to bypass national courts in questions of treaty compliance, and to instead use investor–state arbitration. It is the combination of the consent to ISDS and extensive substantive obligations that makes, at least in theory, IIAs enforceable and dependable commitments, and therefore effective tools for states looking to overcome credibility problems vis-á-vis foreign investors.

Although treaty signings peaked in the mid-1990s, case law based on IIAs was long in developing. Only a few ISDS cases were registered before the turn of the century (figure 1). However, a few years after the conclusion of the North American Free Trade Agreement (NAFTA, 1994), North American investors started filing claims under the NAFTA's ISDS clause. Investors around the world soon followed suit. The peak of ISDS claims came in 2015, with eighty claims registered.

Backlash and Reform in the Investment Treaty Regime

In parallel with the broader backlash against the international judiciary (Alter, Gathii, and Helfer 2016; Abebe and Ginsburg 2019; Voeten 2019), the onslaught of ISDS claims has led to a debate around IIAs and ISDS. International organizations have been instrumental in facilitating these discussions, and their core advice is that states need to update old and vaguely worded IIAs (UNCTAD 2012). Many countries have started reforming their IIA policies.

In 2004, the United States and Canada both revised their model IIAs as a response to ISDS claims filed under NAFTA.[1] Key adjustments were to reduce the scope of investments covered in IIAs, and to clarify the meaning of key substantive protection clauses (Gagné and Morin 2006, 368–70). The European Union (EU)[2] has also pushed for language that ensures greater legal certainty in both new[3] and renegotiated IIAs.[4] Due to heavy backlash against the

[1] Model IIAs are public bargaining drafts that states use when they negotiate IIAs.

[2] Since the Lisbon Treaty (2009), member states' IIA policies have been the competence of the EU.

[3] See the extensive use of "for greater certainty" footnotes in the EU–Vietnam free trade agreement: http://ec.europa.eu/trade/policy/in-focus/eu-vietnam-agreement/.

[4] See, for example, the European Commission's proposal to modernize the Energy Charter Treaty: http://trade.ec.europa.eu/doclib/press/index.cfm?id=2017.

ISDS clause in the now shelved Transatlantic Trade and Investment Partnership between the EU and the United States, the EU is also pushing a multilateral investment court system to limit legal delegation in IIAs (Brown 2017).

More extensive policy turns have taken place elsewhere. In 2009, Ecuador and Bolivia denounced the International Centre for the Settlement of Investment Disputes (ICSID), the most frequently used forum for investment arbitration, and in 2012 Venezuela followed suit (Peinhardt and Wellhausen 2016). The denouncements were motivated by sovereignty concerns associated with the delegation of decision-making power under IIAs to the international level. Ecuador has taken exit one step further. After a 2015 audit of Ecuador's IIA program found that most agreements had not been sufficiently negotiated or deliberated, and that they gave too extensive substantive and procedural protections to foreign investors, Ecuador chose to terminate all bilateral IIAs it was party to.

In India, reform has been centered around replacing old IIAs with vague substantive provisions. Indian authorities are concerned that old IIAs unfairly restrict their policy space (Ranjan 2016). In 2015, after an extensive review process, India adopted a new model IIA that reduced substantive obligations, limited the definition of investment, and introduced an exhaustive general exceptions clause. Indonesia has gone through a similar review process, aiming at formulating an updated model IIA to be used in future negotiations. The main worry in Indonesia has been that old IIAs grant too extensive protections and rights for investors, and that they are too broad and vague (Jailani 2016). Both India and Indonesia have let a number of IIAs lapse out of force over the last few years.

Outside-the-box approaches to IIA reform have also been taken. After having problems getting IIAs with ISDS clauses ratified (Campello and Lemos 2015), Brazil decided to focus on investment facilitation rather than on investment protection in their IIAs, limiting delegation to arbitration to state–state disputes (Gabriel 2016).

Other countries have taken soft approaches to reform. Peru has set up domestic institutional structures to manage investment disputes (UNCTAD 2011), while Chile and Mexico have followed the United States and Canada in restricting the scope of investments, and in clarifying substantive provisions in their IIAs (Bonnitcha, Poulsen, and Waibel 2017, 228). Over one hundred fifty states have taken action to reform their IIA programs (UNCTAD 2018).

From a bird's-eye view, certain commonalities in states' reform narratives emerge. States are worried about the levels and rigidity of investor protection under IIAs, the scope of investors covered by IIAs, the ambiguity of treaty texts, and the functioning of investor–state arbitration. These elements are all subcomponents of what has been called *legalization* of international relations (Abbott et al. 2000). In the next section, I formulate five hypotheses about how the degree of legalization in IIAs might influence the risk of attracting ISDS claims.

Legalization and the Risk of ISDS Claims

The relations between states can be legalized along three dimensions: obligation, precision, and delegation. Highly legalized institutions are those where "rules are *obligatory* on parties [...] in which rules are *precise* [...] and in which authority to interpret and apply the rules has been *delegated* to third parties acting under the constraint of rules" (Abbott et al. 2000, 418, emphasis added). The legalization literature assumes that states, facing uncertainty around the motives and actions of others, use variations of obligation, precision, and delegation to design effective international institutions. But what are the consequences of legalization?

Obligation

Obligation concerns the degree to which states are bound by international agreements (Abbott et al. 2000, 408). IIAs are often referred to as commitment devices that help states attract foreign investment in the face of poor domestic property rights institutions (Elkins, Guzman, and Simmons 2006). It is instructive to divide the notion of obligation in IIAs into three subcomponents: substantive obligation, flexibility mechanisms, and scope of investment coverage. More substantive protections and greater scope increase the obligation of an agreement, while greater flexibility waters down obligation. Overall, states' reform narratives seem to imply that more obligation in IIAs carries a higher risk of attracting ISDS claims.

Substantive obligation concerns how many and how extensive the standards of treatment in an agreement are. The most common substantive provisions in IIAs are national treatment, most-favored nation treatment, compensation for expropriation, and fair and equitable treatment (Bonnitcha, Poulsen, and Waibel 2017, 93–125).[5]

For capital-importing states, extensive substantive obligations in IIAs might be perceived as risky, because they increase the protection levels they have to extend to foreign investors. In their 2015 model IIA, India therefore elected to drop substantive protections such as most-favored nation treatment[6] and the umbrella clause.[7] Capital-exporting states such as the United States, on the other hand, favor high levels of substantive obligation. Indeed, the United States has introduced an array of new substantive obligations, such as prohibitions on performance requirements,[8] in their IIA practice. This leads to the following testable hypothesis:

Hypothesis 1: *IIAs with extensive substantive obligations should attract more ISDS claims than IIAs with less extensive substantive obligations do.*

One way to ease the amplitude of substantive obligations in IIAs is to use *flexibility* mechanisms (Abbott et al. 2000, 409). Many of the menu options in the United Nations Conference on Trade and Development's (UNCTAD) reform scheme are meant to accommodate flexibility in IIAs (2015, 133–4). The most widely used flexibility mechanisms in IIAs are escape clauses and policy carve-outs,[9] and using such mechanisms in IIAs is seen as one avenue for states to secure more domestic policy space. The increased focus on flexibility in IIAs has manifested itself in more extensive annexes and schedules in recently finalized IIAs.[10] The testable hypothesis reads as follows.

[5]For more examples, see Online Appendix A.

[6]See Online Appendix A.6.

[7]Umbrella clauses require treaty parties to comply with obligations outside the IIA, most notably commitments under investor–state contracts (Bonnitcha, Poulsen, and Waibel 2017, 113–5).

[8]Performance requirements are restrictions on the use of inputs and outputs by foreign investors in their operations, for example, local hiring requirements or import restrictions (Vandevelde 2010, 419).

[9]Escape clauses exempt specific policy measures from the agreement under certain conditions, for example, high-security risk situations (Vandevelde 2010, 178–9). Carve-outs exclude certain economic sectors from the scope of the treaty (Bonnitcha, Poulsen, and Waibel 2017, 117).

[10]See, for example, recent IIAs completed by the EU (e.g., EU–Singapore Investment Protection Agreement, 2018), Canada (e.g., Canada–Moldova BIT, 2018), and Indonesia (e.g., Australia–Indonesia Comprehensive Economic Partnership Agreement, ch. 14, 2018).

Hypothesis 2: *IIAs with high levels of flexibility should attract fewer ISDS claims than IIAs with low levels of flexibility do.*

The breadth of a treaty's *scope* also influences the overall obligation it carries.[11] Even though investment agreements were initially meant to protect only direct investors, the definition of investment under IIAs has historically been very broad (Bonnitcha, Poulsen, and Waibel 2017, 50). For example, under the United States' 1994 model bilateral investment treaty (BIT), investment is defined as "every kind of investment owned or controlled directly or indirectly", followed by a nonexhaustive list of assets that fall within this definition.[12] After NAFTA however, the United States made it a priority to limit the definition of investment in IIAs. In their 2004 model BIT, they therefore included explanatory notes to narrow down the definition of investment, and to include characteristics such as "the commitment of capital, the expectation of gain or profit, or the assumption of risk".[13] Mexico and Chile have also narrowed down the definition of investment in their IIAs to avoid giving protection to portfolio investors. The testable hypothesis reads as follows.

Hypothesis 3: *IIAs with broad scope clauses should attract more ISDS claims than IIAs with more narrow scope clauses do.*

Regardless of design, there will always be uncertainty about how an international legal regime will be interpreted (Johns 2015). Uncertainty can stem from the precision of the legal rules of the regime, or from the degree to which interpretation of rules is delegated to third parties. I discuss each aspect in turn.

Precision

Precision concerns the clarity of a legal regime's rules for appropriate behavior (Abbott et al. 2000, 412). States can increase the precision of IIAs by using explanatory or interpretative language in substantive and procedural provisions, for example, by defining standards that guide how obligations shall be interpreted. In their recent treaty practice, the United States has, for example, changed the specification of national treatment from being applicable when "like situations" exist to being applicable in "like circumstances", to ensure that comparisons are made with respect to investors or investments on the basis of relevant characteristics (Dolzer and Schreuer 2012, 198).[14] Explicitly clarifying the intended interpretation of substantive provisions is also one of the recommendations in UNCTAD's reform package (2015, 136–8).

The precision of an IIA can affect the risk of ISDS in two ways. First, with low levels of precision, investors' expected utility (the chance of winning something) should increase because more uncertainty should increase the chances that respondent states, insecure over whether they will lose, settle claims before legal proceedings begin. When ISDS cases are settled, investors almost always get some sort of compensation.

Second, because it is more difficult to predict the outcomes of claims based on vague treaty clauses than of claims based on well-specified clauses, and because there are no time limits on the different stages of ISDS proceedings, investors with secondary objectives, such as hindering the passage of a law or scaring a country away from passing certain legislation (what has been labeled "regulatory chill"), might find it more attractive to use vague IIAs than well-specified IIAs as vehicles for claims. With higher uncertainty around what is lawful under an IIA, the longer ISDS proceedings should take. Long proceedings, in turn, have the potential for stymieing regulation or legislation longer, because states often await rulings on measures challenged under ISDS before they enact them. Recent evidence suggests that ISDS claims are increasingly being filed for secondary objectives (Pelc 2017). The testable hypothesis reads as follows.

Hypothesis 4: *IIAs with high levels of precision should attract fewer ISDS claims than IIAs with low levels of precision do.*

Delegation

Delegation, or judicialization, in international relations concerns the degree to which international "courts gain authority to define what the law means" (Alter 2014, 64). Dispute settlement is most highly legalized when the parties to the underlying agreement agree to binding third-party decisions based on clearly applicable rules (Abbott et al. 2000, 415). The standard ISDS mechanism in IIAs represents a relatively high level of legal delegation.

With low delegation, courts or tribunals are unlikely to issue substantive rulings.[15] When delegation increases, adjudicatory bodies become more likely to rule substantively on issues within their jurisdiction (Johns 2015, 5–6). A higher likelihood of a substantive ruling, in turn, might change the utility of the claimant-investor seeking redress for a (perceived) violation of rights under an IIA, and thereby might increase the chances that an ISDS claim will be filed. To be sure, with higher delegation, the chances that the investor "gets" something by filing a claim should increase, regardless of whether that something is monetary compensation or a secondary objective.

A related argument can be made by way of transaction cost logics. One way states can reduce the legal delegation in IIAs is to demand that investors pass certain hurdles before they can file ISDS claims, such as demanding exhaustion of domestic legal remedies before giving access to arbitration (UNCTAD 2015, 147). With more hurdles (and less delegation), claimant-investors' (transaction) costs to filing ISDS claims increase, which, in turn, changes their overall utility. Overall, the testable hypothesis reads as follows.

Hypothesis 5: *IIAs with high levels of delegation should attract more ISDS claims than IIAs with low levels of delegation do.*

Research Design

Dependent Variable: ISDS Claims

I use two dependent variables, both recording ISDS claims counts.[16] The first variable observes the count of ISDS claims per treaty. The second variable observes each treaty once per signatory, for each year the treaty has been in force. Thus, it records claims at the treaty–country–year level.[17]

[11] Scope in IIAs is defined *materially*, through definitions of investments and investors under the agreement—and it is defined *temporally*, through, for example, defining whether substantive protection for investors is given both pre- and post-establishment, or only post-establishment.

[12] United States' model BIT (1994), Art. 1.

[13] United States' model BIT (2004), Art. 1.

[14] Compare Art. 3 in the United States' 2004 model BIT with Art. 3 in its 2012 model BIT.

[15] ISDS tribunals rule on different stages of the proceedings. They first decide if they have jurisdiction to hear a case ("jurisdictional rulings"), before they issue substantive rulings on the merits of claims, including (a) whether the investor has the right of compensation, and (b) the size of compensation.

[16] Data on ISDS claims were taken from UNCTAD: https://investmentpolicy.unctad.org/investment-dispute-settlement.

[17] For example, the bilateral IIA between Argentina and the United States yields twenty-six observations for each country, from 1991 until 2016.

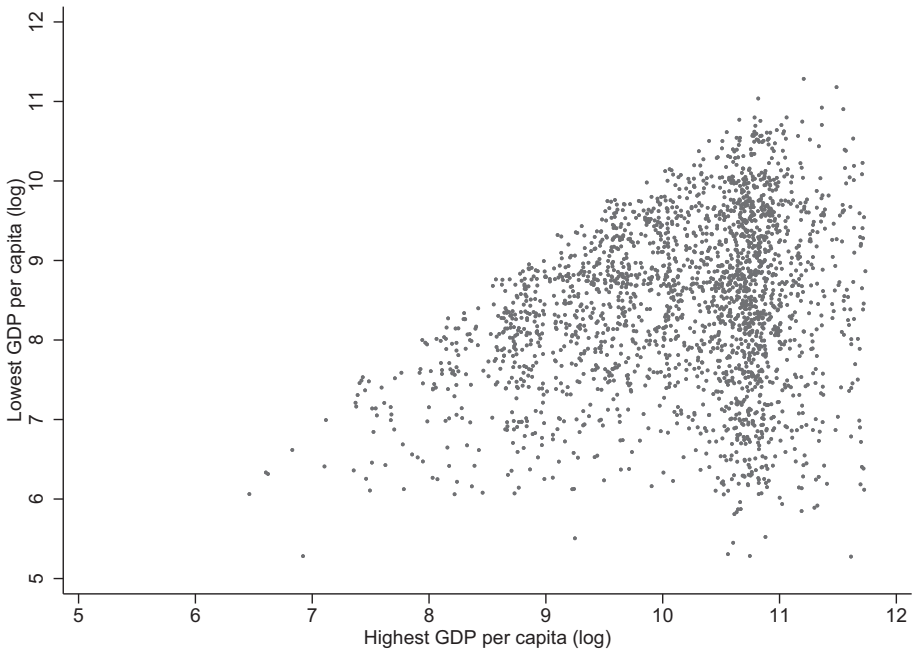

Figure 2. Gross domestic product per capita (log) ratios in country dyads covered by IIAs.

Using both of these dependent variables makes it possible to say something about how legalization affects ISDS risk when just using explanatory variables at the treaty and treaty pair levels, and how that risk is affected by controlling time-specific and confounding factors at the respondent-state level.

The second dependent variable differs in conceptualization from previous empirical studies, using dyad-year units of analysis. In these studies, home and host states under IIAs are defined ex ante, and only host states are assumed to stand at risk of facing ISDS claims (e.g., Allee and Peinhardt 2010). The least developed parties to IIAs are assumed to be host states.

Assume that only the least developed party to an IIA risks facing ISDS claims is problematic for two reasons. First, in the last decade, we have witnessed the proliferation of South–South IIAs (Poulsen 2010). Figure 2 also depicts substantial variation in the (a)symmetry of bilateral economic relations covered by IIAs in my sample. Second, ISDS risk under IIAs is de facto bidirectional. There are nine bilateral IIAs where both treaty signatories have faced ISDS claims, and prominent ISDS cases illustrate that investors can shop into favorable IIA protection from other countries than their state of residence.[18]

With that said, IIAs are inherently dyadic, and it is important to account for information about the bilateral relationship in analyses of these agreements. I therefore control for the economic asymmetry between treaty parties and how long each IIA has been in force, in both the treaty and treaty–country–year-level models.[19]

Where terminated IIAs have survival clauses (Dolzer and Schreuer 2012, 166–77), I stretch the agreement's duration to account for the expanded time of protection. I use the year of notice of arbitration to define when claims occur. Where a claim is brought under multiple IIAs, I register separate claims for each IIA. Because ISDS was put into widespread use only in the mid-1990s, I limit my period of observation to 1995–2017.

Independent Variables: Legalization in IIAs

Unlike the research agenda on trade agreements (Dür, Baccini, and Elsig 2014; Baccini, Dür, and Elsig 2015), research on investment agreements has lacked the necessary data on the contents of IIAs to study the causes and consequences of treaty design. To measure legalization in IIAs, I present the first application of data from UNCTAD's IIA mapping project.[20] The project has mapped over hundred legal content variables in 2537 IIAs. The coding project is a collaboration between UNCTAD and almost fifty universities worldwide. Under the supervision and coordination by UNCTAD, each agreement is coded by two or more law students, who then consolidate their results. Using coders with a wide array of native languages has allowed UNCTAD to code IIAs that are available in marginal as well as mainstream languages. As such, UNCTAD's approach gives it an edge in coverage as compared to automated content coding, which is more constrained by treaty language (Alschner and Skougarevskiy 2016).

After removing IIAs without ISDS clauses and IIAs that never entered into force, my effective sample is 2078 agreements.[21] To measure legalization in these agreements, I start by evaluating to what extent each of the elements UNCTAD has mapped contributes to a higher or lower value on any one of the five legalization dimensions, as they were defined and discussed in the "Legalization and the Risk of ISDS Claims" section.

[18] Compare, for example, *Philip Morris v. Uruguay* (2010) and *Philip Morris v. Australia* (2011). Philip Morris is headquartered in the United States, but they sought protection under the Switzerland–Uruguay BIT (1988) in the former case, and the Australia–Hong Kong BIT (1993) in the latter.

[19] See more on the estimation method in the "Results" section 4 and control variables in Online Appendix B.

[20] Data and methodology are found at: https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping.

[21] See Online Appendix D for a discussion of selection effects.

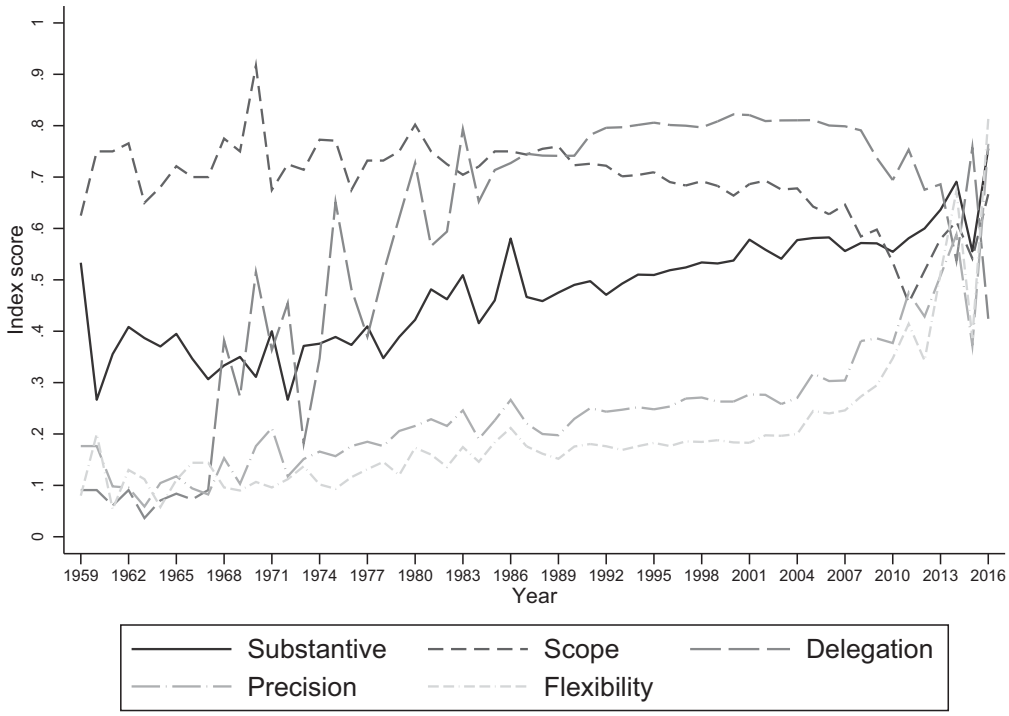

Figure 3. Average annual score on each legalization index in IIAs signed between 1959 and 2016.

I then create five additive indices based on the sets of binary items. Because each index is made up of different numbers of items, they are normalized to vary between 0 and 1 to make the comparison of effects easier.[22] It should be noted that the fact that each item is given equal weight does *not* mean that each item is assumed to carry the same risk. Most lawyers would agree that fair and equitable treatment, a much-debated IIA provision that has been invoked in 41 percent of all ISDS cases, carries more legal risk than the entry and sojourn of personnel provisions. I use additive aggregation because I lack precise, exogenous theoretical reasons for evaluating the relative value of the items,[23] and because there is minimal substitutability between them (Goertz 2006, 129–55). With that said, the following results are robust to using indices aggregated with latent trait analysis (a type of factor analysis for binary data), and when giving the most frequently invoked IIA provisions double weight in the indexation.[24]

Figure 3 maps the average levels of legalization in IIAs over time,[25] as measured by the five indices. First, there has been a steady upward trend in the substantive obligations in IIAs. Second, while early IIAs accommodated relatively low levels of flexibility, there has been a significant increase in the use of these mechanisms over time. Third, while investment and investor definitions in IIAs historically have been broad, states have limited access to protection under IIAs over time. Fourth, precision in IIAs has historically been very low, but there has been a marked up-tick in the use of explanatory language in IIAs from 2007 and onward. Fifth, legal delegation in IIAs has increased over time, but has dropped a bit of late. In the context of the legitimacy debate in the investment treaty regime, the trend lines indicate that states' reform actions so far have been centered on increasing precision and flexibility, while reducing the scope of coverage and legal delegation.

Because both ISDS claims (Freeman 2013) and states' capacity to influence the contents of IIAs when negotiating with other states (Alschner and Skougarevskiy 2016) have been found to depend on domestic institutional and economic factors, I use various structural control variables in the models that follow. See Online Appendix B for a discussion of these variables, and Online Appendix C for descriptive statistics.

Results

Figures 4 and 5 plot the coefficients from two sets of regressions: one observing ISDS claims at the treaty level and the other observing ISDS claims at the treaty–country–year level.[26] As the dependent variables used in both sets of analyses record *numbers* of ISDS claims, I use count estimation. Because of overdispersion in both variables, I use negative binomial regression instead of Poisson estimation.[27] Moreover, I use zero-inflated negative binomial regression in the treaty–country–year models, because of the extreme number of zero-claim observations.[28]

The first set of models (figure 4) are estimated using robust standard errors. Model 1 is a baseline model, including only the legalization indices. Model 2 controls for intra-IIA asymmetry in economic development. Model 3 adds a control for how many years every IIA has been in force.

The second set of models (figure 5) are estimated using robust standard errors clustered on IIAs, and year fixed

[22]The legalization dimensions are remarkably uncorrelated. See Online Appendix C.

[23]See Online Appendix A.6 for a discussion of most-favored nation clauses and substantive obligations in IIAs.

[24]See Online Appendix E.

[25]To illustrate the broader IIA developments, figure 3 also includes IIAs *without* ISDS clauses.

[26]See Online Appendix E for full regression models.

[27]See Online Appendix B for more on estimation methodology.

[28]See Online Appendix C, table C1.

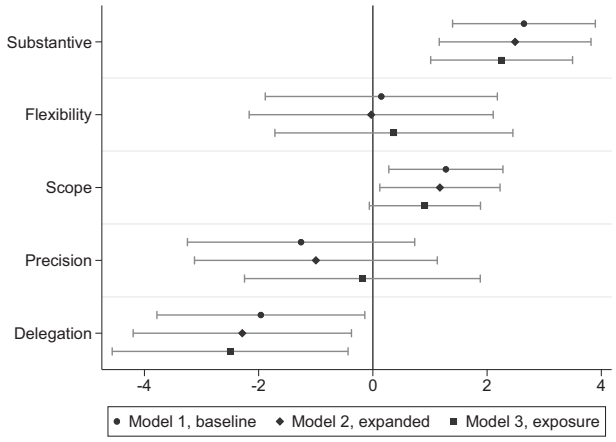

Figure 4. Coefficient plot, treaty-level analyses. Negative binomial regression models. Whiskers represent 95 percent confidence intervals. Control variables omitted.

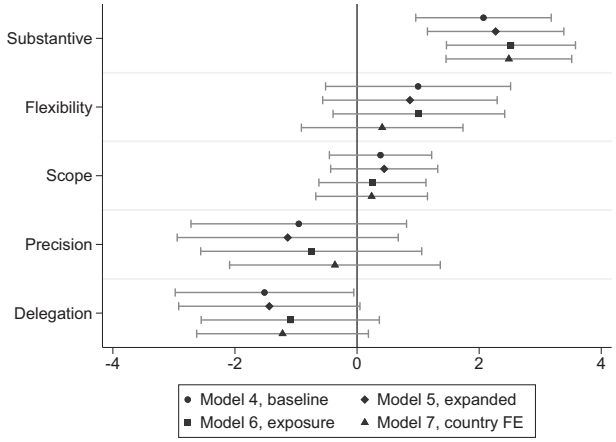

Figure 5. Coefficient plot, treaty–country–year-level analyses. Zero-inflated negative binomial regression models. Whiskers represent 95 percent confidence intervals. Control variables omitted.

effects. Model 4 is a baseline model including only the legalization indices and a control for respondents' previous exposure to ISDS claims. Model 5 expands by using the full set of control variables described in Online Appendix B. Model 6 further controls for time exposure of IIAs, while Model 7 adds country fixed effects.

The first thing to note is that of the five IIA legalization dimensions, the only robust predictor of ISDS claims is substantive obligation. Increasing the levels of substantive protections under an IIA is associated with a substantially increased risk of attracting ISDS claims, supporting *Hypothesis 1*. The relationship between substantive obligation and ISDS risk is significant at the 1 percent level across all models.

Second, the treaty-level models presented in figure 4 indicate a more moderate support for *Hypothesis 3*. Increasing the scope of investments and investors covered under IIAs is associated with a slight increase in the risk of attracting ISDS claims. Third, there is also some evidence that the level of legal delegation under IIAs is associated with an increased risk of ISDS claims, but the direction of this relationship runs counter to *Hypothesis 5*. Decreasing levels of delegation in IIAs is associated with a higher risk of ISDS claims. However, neither of these two relationships is robust to controlling for time- and country-specific factors. Flexibility and precision levels in IIAs are not associated with the risk of ISDS.

To illustrate further, figure 6 presents predicted ISDS claims counts for different values of substantive obligation, holding other variables at their means. Going from the lowest level of substantive obligation to the highest level of substantive obligation increases the expected count of ISDS claims by a factor of almost nine. While the predicted effect size is quite small for one IIA—going from minimum to maximum on substantive obligation is associated with one extra ISDS claim every 63 years[29]—there are a few things to keep in mind. Countries are usually signatories to many IIAs, and most IIAs remain in force for many decades. The compound ISDS risk for most states is therefore much higher. For example, if Germany, the country with the most IIAs in force (127), but whose agreements have relatively low substantive obligation (0.581 on average),[30] increased the average level of substantive obligation across its IIAs to the level of substantive obligation in American IIAs (0.919 on average), that would be associated with one extra ISDS claim for Germany every year.[31]

Moreover, even one single ISDS case may have serious consequences for states. Governments spend on average US$5 million on legal defence per ISDS case, which is five times higher the average costs in disputes under the World Trade Organization (Pelc 2017, 566), the mean compensation awarded to successful claimants is US$508 million (Wellhausen 2016, 17), and ISDS cases are associated with reduced inflows of investment for respondent states (Allee and Peinhardt 2011). With that said, the most risky move states can make is to sign IIAs in the first place. That is why, I argue, it is a move they should contemplate properly, and on a case-by-case basis. My main findings are robust to a broad range of robustness and sensitivity checks.[32]

Conclusion and Discussion

This article represents the first analysis of the link between the content of IIAs and the risk of attracting ISDS claims. Using unique data on the legal content of over two thousand IIAs, I find that the degree of substantive obligations is the only legalization dimension in IIAs that is robustly associated with an increased risk of attracting ISDS claims. Moreover, the association between substantive obligations and ISDS is not mitigated by increasing flexibility or precision in IIAs. This is a very important insight, seeing as how flexibility and precision are frequently touted as fruitful treaty-making tools for softening the impact of substantive obligations in IIAs.

More generally, there are a few ways to understand my findings. First, they might reflect that investors increasingly have relied on old IIAs when filing ISDS claims. Figure 7 plots the average age of IIAs used for ISDS claims over time. Whilst the average IIA used in 1995 was signed 5 years prior, the average IIA used in 2015 was 20 years old. Only six ISDS claims in my sample were based on IIAs signed in 2010 or later. The policy implication here is that states need to continue updating their old IIAs, but how?

[29] The increase is 0.0158. 1/0.0158 = 63.291.

[30] Germany's IIAs are largely based on an old treaty template prepared by the Organization for Economic Co-operation and Development (OECD) in the late 1960s (Berge and Hveem 2018).

[31] 0.0581 in substantive obligation is associated with 0.006 ISDS claims per year. 0.006 × 127 = 0.762 predicted ISDS claims per year. 0.919 in substantive obligation is associated with 0.014 ISDS claims per year. 0.014 × 127 = 1.778 predicted ISDS claims per year.

[32] See Online Appendix E.

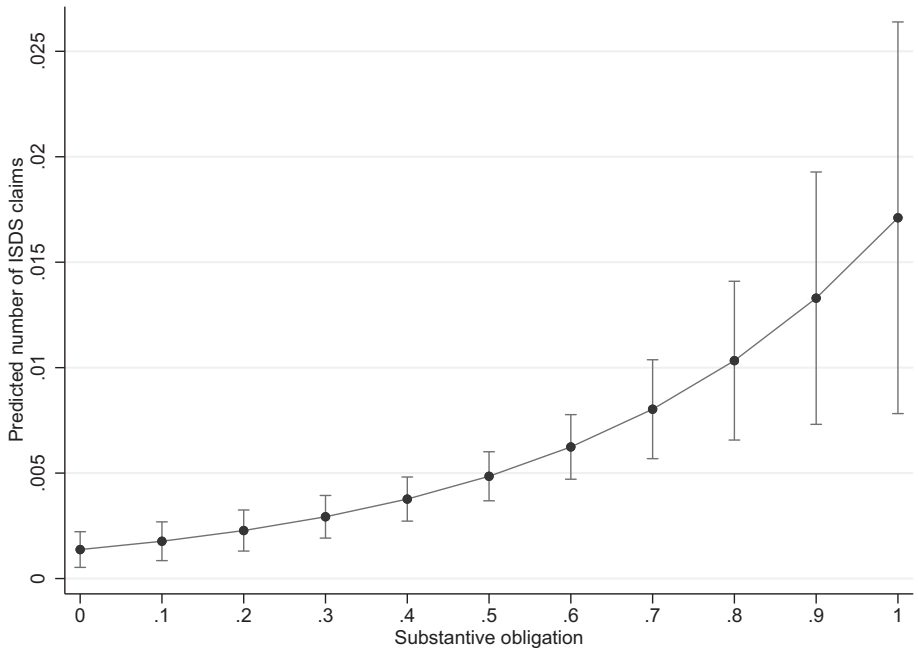

Figure 6. Predicted annual count of ISDS claims for different levels of substantive obligation in one IIA. Whiskers represent 95 percent confidence intervals. Other variables held at their mean. Based on Model 6, figure 5.

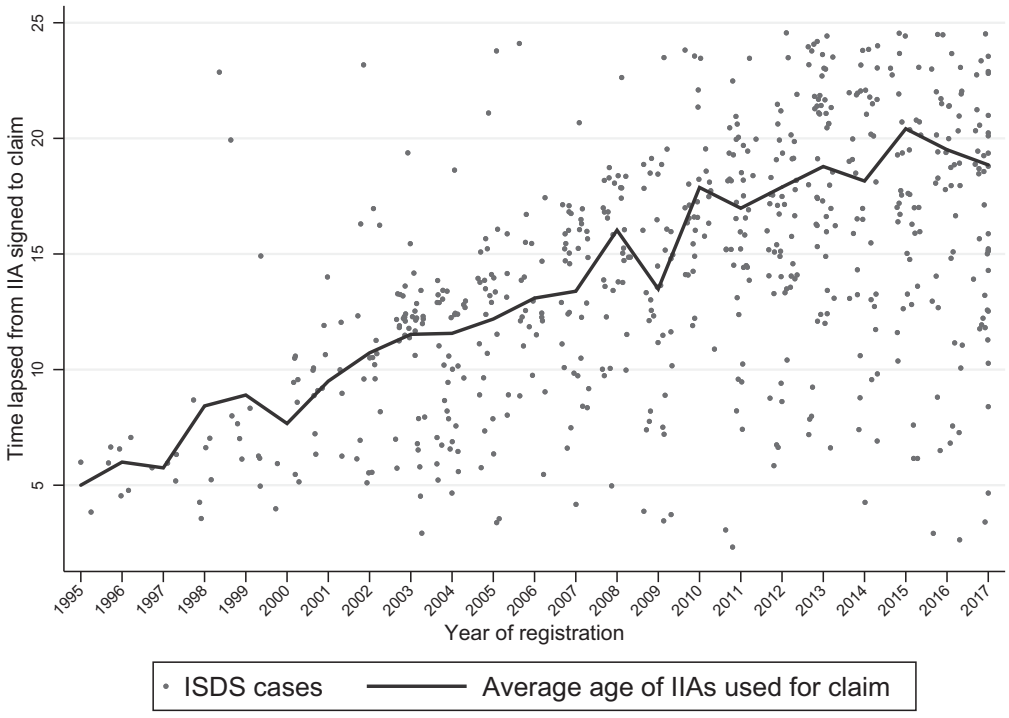

Figure 7. Mean age of IIAs used as the legal basis for investor claims, per year.

Second, and to that end, my findings imply that states engaged in IIA reform should focus more on *what* protections they give under IIAs, rather than on *how* protections are written. The trends in IIA making depicted in figure 3 illustrate that while states have made extensive changes in terms of how precise and flexible their IIAs are of late, the core substantive protection clauses have remained largely the same. It is not a given however, that the risk of attracting ISDS claims is reduced by introducing clearer and more detailed treaty language or by including more policy flexibility. Said a well-known practitioner-cum-academic:

> The driving factors behind most [ISDS] claims have little to do with how the relevant treaties are structured or drafted. [...] With a standard like fair and equitable treatment, even when its content is specified like in the Comprehensive Economic Trade Agreement [between the EU and Canada], there is

still plenty of room for interpretive flexibility and discretion.[33]

An example of a country that has actually chosen to remove substantive clauses from their treaty practice is India, who dropped several substantive obligations in their 2015 model IIA. However, innovating in a norm-heavy system is tough. The Indian model's stark departure from mainstream IIAs has made it a difficult starting point in negotiations.[34] The United States, who are currently in the process of negotiating an IIA with India, have expressed concerns over India's departure "from the high standards" in previous IIAs.[35] The United States experienced this same resistance to innovation themselves, when they in the early 1980s arrived as latecomers on the IIA stage with a new IIA model (Vandevelde 1988, 212).

The important thing is that every state chose the model that is right for them. For conflict-ridden countries, that might mean committing to strong substantive obligations in areas such as protection from strife. For countries in economic transition, building in flexibility mechanisms might be important given insecurity over where their economies will be in 10 years. For some countries, it might even be pertinent to ask, like Brazil has done, whether they need ISDS in their IIAs—or whether they need IIAs at all. While the results presented in this article suggest that changes in substantive obligations in IIAs are associated with changes in the risk of ISDS, the most risk-driving thing states can do is to sign IIAs with ISDS in the first place.

Third, my findings might also reflect how IIAs are interpreted by arbitrators. Recent empirical research finds that arbitrators have been insufficiently cognizant of variations in IIA design when applying precedent (Alschner and Hui 2019). By reading new agreements in light of case law based on old IIAs, arbitrators might end up rolling back IIA innovations. One way to reign in this type of arbitrator discretion is by using joint interpretative statements in IIAs (Johnson and Razbaeva 2014), but more research is needed into whether *unlike* IIAs are interpreted *alike*. Moreover, it is important that states, in their role as respondents, ensure that arbitrators actively engage with novel provisions and novel treaty language in ISDS proceedings. IIA reform does not end with a renegotiated IIA; it is a process that continues into the litigation of the agreement.

In the contexts of the broader backlash against the international judiciary and of emerging research on the dejudicialization of international relations (Abebe and Ginsburg 2019), an important insight from this article is also that the legitimacy crisis in the investment treaty regime is partially driven by the depth of legalization. As was cautioned against in the early 2000s (Goldstein and Martin 2000), too much legalization can create backlash against international cooperation. In this context, it is interesting to note that while it is legal delegation through ISDS that has driven the backlash in the investment treaty regime, what drives the risk of ISDS claims in IIAs is substantive obligations. As such, actors worried about the cost side of IIAs should keep an eye on the substantive provisions in IIAs, not just on their ISDS clauses.

To that end, the legalization indices developed in this article can be useful going forward. For legal practitioners, having aggregate estimates of obligation, precision, and delegation in a large sample of IIAs might be useful when benchmarking and comparing different agreements. For scholars interested in diffusion and high-level rule development, the data set presented in this article might be useful when tracking how countries' treaty programs have developed over time, and how different states have approached reform. The legalization data can also be used to further the research agenda on the link between IIAs and investment. Does treaty drafting matter for countries' abilities to attract foreign investment?

A few other avenues for research follow from this article. First, more in-depth research into the risk individual substantive provisions carry in IIAs would be useful for policy-makers. Second, there is room for further work on disentangling the risk that individual provisions in IIAs carry, and to analyze most favored nation clauses' effect on overall risk within countries' IIA networks. Third, extending the current analysis to the decision stage would also be interesting—does IIA drafting matter for outcomes in ISDS? Lastly, future research should look into the circumstances under which certain design features are likely to result in ISDS claims.

Supplementary Information

Supplementary information is available at the *International Studies Quarterly* data archive.

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