

# MODEL BIT: AN IDEAL PROTOTYPE OR A TOOL FOR EFFICIENT BREACH?

JEONGHO NAM\*

## ABSTRACT

*In today's global economy, there are approximately 2,329 Bilateral Investment Treaties in force. The primary purpose of a Bilateral Investment Treaty (BIT) is to provide some level of protection to the investors making a foreign direct investment. BITs namely provide protection against situations where the host state takes discriminatory action against investors, including expropriation of investor property or property rights infringement. Because BITs are primarily "investor-favored," a substantial number of BITs are based on various versions of Model BIT, a pre-drafted contract template that is often formulated by a state with the most investors and capital. While the rationale behind creating a Model BIT is often said to be for the promotion of efficiency and consistency, the actual reason for the signatory states to enter into a BIT based on the Model BIT is the inequality in contractual bargaining power between the investors and host countries who have a need to attract foreign capital. However, a truly effective BIT should be one that is drafted and negotiated on a case-by-case basis, taking into consideration the parties' circumstances, including factors such as politics, economy, culture, and geography. No matter the extent of investment protection a Model BIT may offer, a state, regardless of its wealth or status, has inherent sovereign rights that it can exploit to breach the terms of a BIT. Therefore, a more reasonable approach to promoting foreign direct investment should not be to simply proliferate the number of BITs across the globe, but instead to adopt BITs that are formulated with due diligence and aimed at minimizing the likelihood of breach by the host state.*

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\* Jeongho Nam is an attorney and a recent graduate from Georgetown University Law Center with an LL.M. in International Business and Economics Law. He is serving as a general counsel to an investment firm in South Korea overseeing various international transactions including foreign direct investment and acquisitions of foreign securities. © 2017, Jeongho Nam.

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I. INTRODUCTION

With the continuous expansion of the global economy, the flow of foreign direct investment across continents, or capital mobility, has become a more common occurrence today.<sup>1</sup> A new dimension of international financial mobility, coupled with the initiation of economic policy reforms by many developing countries aimed at attracting foreign investors, has led investors of developed and high-income countries to look beyond their domestic borders for lucrative opportunities.<sup>2</sup> However, the opportunity for profit for investors from developed countries through foreign investment carries its own risks, particularly politically, as the host state may attempt to expropriate the foreign investor's investment assets.<sup>3</sup> Investors from developed nations, while actively seeking an opportunity in developing nations, fear instability and the unpredictability of the political risk; alternatively, many developing nations seek to attract foreign direct investment from developed nations, which can sometimes be their largest single source of external finance.<sup>4</sup> Therefore, since 1950, the bilateral investment treaty (BIT) has gained worldwide popularity.<sup>5</sup> By 2009, more than

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1. See generally UNITED NATIONS, WORLD INVESTMENT REPORT 2013, GLOBAL VALUE CHAINS: INVESTMENT AND TRADE FOR DEVELOPMENT (2013) [hereinafter 2013 Report].

2. RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW I (2008) [hereinafter PRINCIPLES]; RUDOLF DOLZER & MARGARETE STEVENS, BILATERAL INVESTMENT TREATIES xi (1995) [hereinafter BIT].

3. KENNETH J. VANDELDELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION 29 (2010).

4. See PRINCIPLES, *supra* note 2, at 3-7.

5. See Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 652 (1997); see also Genevieve Fox, *A Future for*

2,600 BITs have been concluded, with approximately 179 countries participating in at least one BIT.<sup>6</sup>

As BITs increasingly gained popularity in the international community, the United States, a leading actor in the global economy, began developing a model negotiating text that would serve as a template for future BITs out of concern for the absence of modern investment protection in international law.<sup>7</sup> Since then, the U.S. Model BIT has undergone substantial development; it has been revised and drafted to incorporate extensive input from Congress, corporations, business associations, labor groups, environmental and other non-governmental organizations, and academics.<sup>8</sup>

The primary goal of this Note is to demonstrate that while creating a uniform, or model, BIT is an efficient way of facilitating investment agreements between countries, it may not be the most ideal approach to doing so. A contracting state is more likely to breach a Model BIT than a specifically-tailored BIT that considers the parties' status and circumstances.<sup>9</sup> A pre-drafted Model BIT, while providing a faster way to form an agreement, is less likely to serve as an agreement that is effectively "committable."<sup>10</sup> A typical Model BIT is provided to the parties often fully drafted, similar to the terms and agreement a consumer agrees to when buying a product online, with the critical difference being that a consumer, or host state that is party to a BIT, is more likely to breach the agreement due to its inherent power of sovereignty.<sup>11</sup>

The priority of the parties in forming a BIT should not be to simply commit to an agreement by merely signing a Model BIT that removes

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*International Investment? Modifying BITs to Drive Economic Development*, 46 GEO. J. INT'L L. 229, 229-31 (2014).

6. VANDELDE, *supra* note 3, at 1.

7. BIT, *supra* note 2, at 4; *see also* Kenneth J. Vandeveld, *The Bilateral Investment Treaty Program of the United States*, 21 CORNELL INT'L L. J. 201, 210 (1988).

8. Press Release, Office of the U.S. Trade Representative, U.S. Concludes Review of Model Bilateral Investment Treaty (Apr. 2012).

9. *See* Guzman, *supra* note 5, at 641-42.

10. *See* Fox, *supra* note 5, at 235. The author advocates that a strong investor-state commitment is lacking in BITs and argues that each BIT must be modified based on a proposed tripartite model to serve different levels of developing countries.

11. *See* Guzman, *supra* note 5, at 655-56 ("BITs allow such agreements to be treated like contracts between private parties within a single country . . . any dispute between host and investor-at least any dispute arising out of a negotiated agreement between the two-is matter of international law"); *see also* Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT'L L. J. 67, 76 (2005).

the necessity of engaging in an extensive negotiation process, but instead to formulate an agreement that provides adequate levels of protections and obligations to which the parties can realistically commit. Therefore, a BIT must be drafted in such a way that it carefully approaches the unique differences between the parties involved. Likewise, if a Model BIT is to be drafted to serve its purpose as a “template” or prototype for future BITs, it must be drafted to be open-ended such that it provides ample room for the parties to address and account for their practical differences, such as their differing approaches to politics, the legal system, geography, and economy, in order to foster a successful economic relationship.

Section II, Part A of this Note will examine the key principles of BITs, notably that every BIT should uphold and promote a healthy economic relationship between the state parties. Parts B and C of Section II will examine data indicating whether BITs have been effective in promoting foreign direct investment for developing nations while minimizing international disputes. Part 4 of Section II will examine the U.S. Model BIT prototype as an example, particularly its primary purpose, principal features, and the objectives the U.S. government implemented in drafting the prototype. Section III will examine the factors that demonstrate why the creation of the BIT prototype could actually create consequences inconsistent with the primary purpose of the BIT. Finally, Section IV will focus on how a Model BIT should be revised in order to accommodate the factors laid out in Section III, using the Korea-U.S. Free Trade Agreement (FTA) as an example.

## II. OVERVIEW OF BITS AND THE RISE OF MODEL BITS

### A. *Principles of a BIT*

The primary purpose of a BIT is to create an incentive for new investment, while at the same time establishing rules upon which private foreign investors may rely upon to protect themselves against the host nation’s potentially unjust actions.<sup>12</sup> It is therefore crucial to examine the underlying principles that should be universal to every BIT.

According to Kenneth Vandevolve, the six core principles of every BIT are access, security, nondiscrimination, due process, reasonableness, and transparency.<sup>13</sup> The objective of a BIT should be to encour-

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12. BIT, *supra* note 2, at 12.

13. VANDEVOLVE, *supra* note 3, at 2.

age a host state to allow domestic investment and to facilitate extraterritorial investment,<sup>14</sup> while simultaneously protecting an investor's legitimate expectations based on the promises or assurances provided by the host state.<sup>15</sup> The BIT should impel a host state to refrain from unjustly discriminating against foreign investors, and thus permit the investor to operate freely and with competitive advantages.<sup>16</sup> The BIT should also provide that the state's treatment of foreign investment must be legitimately related to the state's regulatory objective that it be "fair and equitable."<sup>17</sup> To promote a liberal investment environment, the BIT should require a host state to write its local laws transparently for investors so that the parties are familiar with the laws affecting the investments made.<sup>18</sup> Additionally, the BIT should afford foreign investors the right to due process in a third-party international tribunal, primarily because of foreign investors' distrust for local courts.<sup>19</sup> A final principle for a successful BIT is the reflection of realistic differences between the parties.

#### B. Effectiveness of BITs

In light of the growth of foreign investments and the expansion of international activities over the last half-century, a stable legal framework for international investment became necessary, leading to the proliferation of BITs.<sup>20</sup> International scholars have questioned whether BITs have been effective in achieving what they purport to establish, namely, an increase in foreign direct investment and protection of the investors.<sup>21</sup> Rose-Ackerman and Jennifer L. Tobin conducted a study that examined the adequacy of the BIT as a "commitment device," that is, whether BITs have been effective in holding host states to certain standards, and whether a BIT ultimately works as an investment promotion mechanism by causing increases in Foreign Direct Investment (FDI).<sup>22</sup> The study concluded that the BIT itself does not, in fact,

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14. *Id.* at 407.

15. *Id.* at 234.

16. *Id.* at 337.

17. *Id.* at 189-190.

18. *Id.*

19. *Id.* at 427.

20. Salacuse, *supra* note 11, at 68-71.

21. *Id.* at 79, 90.

22. *Id.* at 80-81; Susan Rose-Ackerman & Jennifer L. Tobin, *Do BITs Benefit Developing Countries?*, in *THE FUTURE OF INVESTMENT ARBITRATION* 131, 133 (Catherine A. Rogers & Roger P. Alford eds., 2009).

increase FDI.<sup>23</sup> According to the study, the BIT does not determine increased FDI as much as other factors, such as political risk or the developing country's income level, which help determine whether the investors of a wealthy country will invest in the host state.<sup>24</sup> A BIT involving a middle-income country with a relatively stable political regime is likely to attract FDI; a BIT with a low-income, high-political risk country, however, is unlikely to attract FDI,<sup>25</sup> perhaps because of an inherent distrust in the security of the investment. This finding also supports the fact that, among the Organisation for Economic Co-operation and Development (OECD) countries, a BIT has little or no marginal impact and, hence, is not used to attract domestic investment, or sometimes may not be used at all.<sup>26</sup>

C. *Increase in Investor-State Dispute Settlement Proceedings*

A majority of today's BITs attempt to provide investors with a sense of security by including a provision regarding Investor-State Dispute Settlement (ISDS), which allows foreign investors to bring claims against the host state in third-party international tribunals.<sup>27</sup> Although it would be reasonable to expect that the provision of ISDS in many BITs today would deter host states from unjustly expropriating investors' assets,<sup>28</sup> the opposite is also true. From 2000 to 2011, the number of known ISDS cases increased by approximately four times, and in 2012, fifty-eight new known investor-state dispute settlement cases were initiated, marking the highest number of known ISDS claims ever filed in one year.<sup>29</sup> The rapid increase in ISDS cases is attributable to many factors, including increases in FDI flows and national regulatory changes among host nations, which have contributed to the rise in claims of expropriation.<sup>30</sup> For some countries, an increased need for regulation

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23. *Id.* at 132-33

24. *Id.* at 135.

25. *Id.*

26. *Id.*

27. RUDOLF DOZER & MARGARETE STEVENS, *BILATERAL INVESTMENT TREATIES* 129-30 (1995).

28. *See id.* at 130. Innovative feature about ISDS system is that an investor can bring an action against the host state without aid or intervention from his national state.

29. The 2012 Report announced that in 2011, the number of known investor-state based claims was the highest ever, and one year later, the 2013 Report announced that in 2012, the number of known investor-state based claims, again, was the highest ever. *See* UNITED NATIONS, *WORLD INVESTMENT REPORT 2012: TOWARDS A NEW GENERATION OF INVESTMENT POLICIES* 87 (2012) [hereinafter 2012 Report]. *Contra* 2013 Report, *supra* note 1, at 110.

30. 2012 Report, *supra* note 29, at 86.

led to concerns about the ISDS system's potential impact in giving foreign businesses greater legal rights than domestic businesses and constraining governments in their public policy-making abilities.<sup>31</sup>

The first concern when the number of ISDS cases reached a significant amount was the increasing challenges to the competence of the International Centre for Settlement of Investment Disputes (ICSID) in handling disputes, especially concerning the competence of its arbitrators.<sup>32</sup> ICSID rules attempt to eliminate potential prejudice on the part of arbitrators by requiring them to be nationals of countries other than the ones implicated by the parties in dispute.<sup>33</sup> However, this measure has not proven to be foolproof because an arbitrator's qualifications are often challenged based on positions that the arbitrator may have previously taken on certain issues, as evidenced by previous awards or publications.<sup>34</sup>

A second concern regarding the ISDS system is the lack of opportunity to appeal an ICSID judgment. Section 6, Article 53 of the ICSID Convention Rules and Regulations declares that an award shall not be subject to any appeal.<sup>35</sup> While this rule aims to save time and arbitration costs, it nevertheless creates the risk of having to enforce flawed and inconsistent judgments without the possibility of remanding the judgment.<sup>36</sup> Recognizing the possible risk of having to enforce a legal error, a number of modern BITs, including the 2004 Model BIT, have included provisions for an appellate mechanism.<sup>37</sup>

Although the ISDS provision claims to offer security for investors against arbitrary and discriminatory expropriation by the host state, growing concerns and demands for reform of the ISDS system suggest that the system itself might not be the best mechanism for simultaneously protecting investors and the state from unfounded claims. On a

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31. *Id.* at 87 (Australian government issued a trade policy statement announcing that it would stop including ISDS clauses in its future IIAs. Ecuador also initiated State-State proceeding against United States, seeking to overturn a clause in Ecuador-U.S. BIT).

32. *Id.*

33. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention].

34. See 2012 Report, *supra* note 29, at 87.

35. ICSID Convention, *supra* note 33 at art. 53.

36. OECD, INTERNATIONAL INVESTMENT PERSPECTIVES 189 (2006) [hereinafter PERSPECTIVES].

37. *Id.* at 190; U.S. DEP'T OF STATE, TREATY BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF [COUNTRY] CONCERNING THE ENCOURAGEMENT AND RECIPROCAL PROTECTION OF INVESTMENT ANNEX D (2004), <http://www.state.gov/documents/organization/117601.pdf> [hereinafter 2004 Model BIT].

similar note, an increase in ISDS claims will most likely eventually lead to a decrease in FDI because increased ISDS arbitrations send the message that a BIT is not effective in securing the interests of the investors in the host state. This scenario is foreshadowed by the Lone Star scandal that occurred in Korea in 2005.<sup>38</sup> In the Lone Star scandal, a U.S. investor that acquired a distressed Korean bank during Asian financial crisis alleged that its investment was treated discriminatorily by the Korean government, resulting in substantial financial losses.<sup>39</sup> After the scandal, Lone Star filed arbitration against Korea in ICSID in 2012, and FDI in Korea plunged, resulting in job losses for approximately 1.67 million people.<sup>40</sup>

#### D. U.S. Model BIT: The “Prototype”

In response to the expansion of international commerce and in part to protect its investors, the United States first developed a “model” BIT in 1982 to serve as a prototype for the negotiation of future BITs.<sup>41</sup> Since then, a newer edition of the model BIT has been issued by the Office of the United States Trade Representative (USTR), incorporating directives from Congress and standards of protection from existing BITs to “improve investment climates, promote market-based economic reform, and strengthen the rule of law.”<sup>42</sup> Notably, in 2004, the United States released a draft of a new model BIT that proved far more detailed in ensuring the protection of its investors abroad.<sup>43</sup>

Noteworthy features of the 2004 Model BIT include an open-ended definition of “investment” and an added provision concerning the environment that states that the treaty shall never prevent either party from taking appropriate measures for environmental concerns.<sup>44</sup> The 2004 Model BIT also uses Annexes to provide criteria for determining

38. See *infra* Part II C 4 for an in-depth discussion of the Lone Star Scandal.

39. *Id.*

40. Jae-Dong Yu Soo-Jung Shin, *Korea Loses 1.67 Million Jobs Due to Net Direct Investment Outflow*, DONGA ILBO (Oct. 15, 2013), <http://english.donga.com/srv/service.php3?biid=2013101575668>.

41. Sean D. Murphy, *Proposed New U.S. “Model” Bilateral Investment Treaty*, 98 AM. J. INT’L L. 836, 836 (2004).

42. See *id.*; Press Release, U.S. Dep’t of State, United States Concludes Review of Model Bilateral Investment Treaty (Apr. 20, 2012).

43. Laura Henry, *Investment Agreement Claims under the 2004 Model U.S. BIT: A Challenge for State Police Powers?*, 31 U. PA. J. INT’L L. 935, 936 (2010).

44. 2004 Model BIT, *supra* note 37, at art. 12 (“Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”).

indirect and direct expropriation and includes a separate article governing the terms of the Minimum Standard of Treatment, declaring that each party “shall accord to covered investments treatment in accordance with customary international law.”<sup>45</sup> Other notable changes in the 2004 Model BIT include added language protecting the host-state’s authority to take appropriate measures relating to financial services, and modification to the ISDS provision.<sup>46</sup> Included in the ISDS provision was a statute of limitations on claims, as well as the authority granted to state parties to determine issues of treaty interpretation and applications that would be binding in an investor-state tribunal.<sup>47</sup> Perhaps the most notable shift in the 2004 Model BIT is that it has become more state-friendly in its protection of investor interests.<sup>48</sup>

When the Advisory Committee on International Economic Policy (ACIEP) reviewed the 2004 Model BIT, for the launching of the 2012 Model BIT,<sup>49</sup> subcommittee members argued that the Minimum Standard of Treatment was too broad in the 2004 model. They maintained that this provision should be reformed either by codifying BIT-related customary international law or by abandoning reference to customary international law altogether in the BIT.<sup>50</sup> Other arguments by subcommittee members included expanding the definition of “investment” to cover the acquisition of property abroad for investment purposes,<sup>51</sup> creating a Transparency Council that would advise investors on the rules and processes related to business negotiations in the host state,<sup>52</sup> and even recommending the insertion of a provision that requires each state party to allow a person of the other party to participate in the development of a standard procedure affecting investors.<sup>53</sup> Although

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45. PERSPECTIVES, *supra* note 36, at 159, 160, 162; 2004 Model BIT, *supra* note 37, at art. 5.

46. Lise Johnson, *The 2012 US Model BIT and What the Changes (or Lack Thereof) Suggest about Future Investment Treaties*, 8 POL. RISK INS. NEWSL. 2 (2012).

47. *Id.*

48. See *id.* at 1-2 (“Changes that were made in the 2004 version primarily (though not exclusively) included those that were made to be more, rather than less, protective of governments’ regulatory authority and discretion.”).

49. ADVISORY COMM. ON INT’L ECON. POLICY, REPORT OF THE SUBCOMMITTEE ON INVESTMENT OF THE ADVISORY COMMITTEE ON INTERNATIONAL ECONOMIC POLICY REGARDING THE MODEL BILATERAL INVESTMENT TREATY (2009), <https://2009-2017.state.gov/e/eb/rls/othr/2009/131098.htm>.

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.* (“Each Party shall allow persons of the other Party to participate in the development of standards, technical regulations, and conformity assessment procedures that affect investors and to do so on terms no less favorable than those it accords to its own persons. When non-governmental bodies carry out the foregoing activity, each Party shall recommend that such

the 2012 Model BIT does not substantially deviate from the 2004 model,<sup>54</sup> arguments for the reform of the Model BIT suggest that it is, perhaps, difficult to establish an ideal balance between the interests of investors and those of the host state. As a result, the Model BIT will likely remain an institution shifting back and forth between conflicting interests.

The USTR heralds the U.S. Model BIT as a “high-standard ‘model’ text that provides investors with improved market access; protection from discriminatory, expropriatory, or otherwise harmful government treatments,” and contends that “[h]igh-standard BITs, such as those based on the U.S. model, improve investment climates, promote market-based economic reform, and strengthen the rule of law.”<sup>55</sup> Not surprisingly, the U.S. Model BIT does seem to embrace all six principles of the BIT discussed in Section II, Part A. First, Article 8 provides freer access to the domestic market of the host state by requiring that neither state party enforce a commitment or requirement on investors, such as a requirement to purchase supplies from the host state in connection with the investment.<sup>56</sup> Second, Article 4 provides for nondiscrimination by declaring that the host state shall treat the investors of the other party no less favorably than it does non-party investors.<sup>57</sup> Article 5 provides security by declaring that covered investments shall be treated according to customary international law, including fair and equitable treatment with full protection and security.<sup>58</sup> Article 11 provides transparency, requiring each state party to publish all regulations and measures to ensure that any changes to the local rules will be made clear to investors.<sup>59</sup> The principle of reasonableness is also found throughout the text. For example, Article 11 provides that investors affected by a government regulation be given reasonable notice and opportunity to comment on the measure.<sup>60</sup> The principle of reasonableness can also be found in Annex B, providing that the scope of investment covers reasonable investment-backed expectations.<sup>61</sup>

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non-governmental bodies in its territory observe this obligation in developing standards and voluntary conformity assessment procedures.”).

54. See Johnson, *supra* note 46, at 2.

55. Press Release, *supra* note 8.

56. 2004 Model BIT, *supra* note 37, at art. 8.

57. *Id.* at art. 4.

58. *Id.* at art. 5.

59. *Id.* at art. 11.

60. *Id.*

61. *Id.* at Annex B.

The U.S. Model BIT has ambiguous characteristics as well. For example, in the 2004 Model BIT, Article 3 requires that states treat investors “no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment . . . or other disposition of investments in its territory.”<sup>62</sup> This article raises additional issues because applicability of this rule requires that there be similar situations, or “like circumstances,” that can create uncertainty when it comes to a unique investment.<sup>63</sup> In addition, the requirement of fair and equitable treatment in Article 5 relies on a “minimum standard,”<sup>64</sup> which, according to F. A. Mann, is a vague concept because the tribunal will ultimately determine whether the conduct was “fair and equitable” considering all the circumstances.<sup>65</sup> Similarly, the requirement of “full protection and security” raises some ambiguity because it is unclear whether the statement refers to full protection and security to an international standard or to the general obligation taken on by the host state.<sup>66</sup> In addition, the U.S. Model BIT does not define “expropriatory measure,” but rather declares it a “case-by-case, fact-based inquiry,” taking into account the economic impact, the extent of government action, and its characteristics.<sup>67</sup> Perhaps the most complex question arising from expropriation is compensation. The 2004 Model BIT declares that compensation be “prompt, adequate, and effective” and that it “be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place.”<sup>68</sup> This standard is extremely ambiguous because numerous methods of valuation may be used to determine the fair market value of a property.<sup>69</sup> Moreover, a dispute over exactly when an expropriation occurred can arise because the Model BIT considers timing to be an important element in calculating compensation amounts, using terms such as “immediately before the expropriation” and “on the date of expropriation.” Because the scope of “expropriation” is broad in reference to discrete government action that constitutes expropriation, the starting point could be difficult to determine.<sup>70</sup> In addition to the above

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62. *Id.* at art. 3

63. BIT, *supra* note 2, at 57.

64. 2004 Model BIT, *supra* note 37, at art. 5.

65. F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52BRIT. Y.B. INT'L L. 242, 244 (1981).

66. BIT, *supra* note 2, at 61.

67. PERSPECTIVES, *supra* note 36, at 162.

68. 2004 Model BIT, *supra* note 37, at art. 6.

69. BIT, *supra* note 2, at 110.

70. 2004 Model BIT, *supra* note 37, at art. 6.

ambiguities, the following factors suggest why the Model itself is insufficient as a template for future BITs, and why the Model should be substantially tailored for every new BIT.

### III. WHY MODEL BITs MAY NOT BE IDEAL

#### A. *Motivation and Asymmetry in Bargaining Power*

The preamble to the 2012 Model BIT reads that one purpose of a BIT is to “promote economic *cooperation*” between the parties.<sup>71</sup> An important question, however, is whether two countries typically sign a BIT with the primary objective of maximizing the economic synergy between both parties. Some argue that the U.S. Model BIT is a one-sided contract drafted in favor of the developed or “wealthy” state, including by being overly protective of its investors.<sup>72</sup> This proposition is supported by the fact that developing countries often actively seek to sign BITs with wealthy countries with the aim of attracting foreign capital to their domestic economies. They are, therefore, likely to accept the terms of the BIT “as is,” or as proposed by the wealthy counterpart’s Model BIT.<sup>73</sup> Furthermore, another reason for their full support is that many developing nations are eager to sign BITs with wealthy nations to attract FDI and, as a result, compete against one another to increase the flow of FDI, bidding away all their benefits.<sup>74</sup> For some developing countries, signing a BIT serves as an indicator that the government regime is engaged in a transformation and willing to cooperate with the international community.<sup>75</sup> Thus, in some aspects, although the treaty contemplates a two-way flow of investments between the state parties, in reality, the flow is usually unidirectional in the context of wealth and status disparities between the two parties.<sup>76</sup> Taking a recent BIT as an example, the U.S.-Rwanda BIT was approved by the U.S. Senate in 2011 with unanimous consent and took effect in

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71. *Id.* at pmbl. (emphasis added) (stating that the parties desire “to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party.”).

72. See Damon Vis-Dunbar, *United States Reviews Its Model Bilateral Investment Treaty*, INV. TREATY NEWS (June 5, 2009), <http://www.iisd.org/itm/2009/06/05/united-states-reviews-its-model-bilateral-investment-treaty/> (expressing concern that the definition of “investment” is overly broad).

73. See Ackerman & Tobin, *supra* note 22, at 131.

74. See SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION 87 (2009).

75. *Id.*

76. M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT: GLOBAL CONSTITUTIONAL AND ADMINISTRATIVE LAW IN THE BIT GENERATION 207 (2d ed. 2004).

January 2012.<sup>77</sup> Although the U.S.-Rwanda BIT was allegedly the product of negotiation and consultation over several years, the text of the BIT does not actually deviate from the text of the 2004 Model BIT.<sup>78</sup> Perhaps one reason is that Rwanda, having just opened its economy and improved its business climate,<sup>79</sup> would have been eager to boost trade and FDI, and the best way to achieve these goals would clearly be to accept the BIT terms of the wealthy state “as is.” However, the government officials of Rwanda should realize that, while signing a BIT according to the terms provided by the United States may appear to trigger an influx of foreign investment, in reality, as illustrated by the abovementioned study, the key elements in increasing FDI are actually government stability and the domestic investment climate.<sup>80</sup> Thus, while it may seem as if a U.S. investor’s willingness to invest in Rwanda is solely attributable to the U.S.-Rwanda BIT, the alternative motive may be the fact that Rwanda itself is undergoing internal political and economic reforms.<sup>81</sup> Assuming the BIT may not be the factor that determines the increase of FDI, the BIT leaves room for dispute between the United States and Rwanda, or any developing country that is a party in other BITs, over unclear terms, such as the scope of “reasonableness” or “expropriation,” as well as a challenge to the state’s sovereignty by allowing investors to bring claims to international tribunals.

In another instance, a unique diplomatic relationship can serve to motivate the undertaking of an unmodified U.S. Model BIT. The South Korea-U.S. FTA, for example, is unique because South Korea is one of the few non-developing countries that have negotiated an FTA with the United States.<sup>82</sup> The South Korean government was heavily criticized by its public for incorporating a 2004 Model BIT into the text of the FTA without performing due diligence and for failing to even

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77. Press Release, Office of the Spokesperson, United States Senate Approves U.S. - Rwanda Bilateral Investment Treaty (Sept. 27, 2011).

78. Compare 2004 Model BIT, *supra* note 37 with Treaty Between the Government of the United States of America and the Government of the Republic of Rwanda Concerning the Encouragement and Reciprocal Protection of Investment, Rwanda-U.S., Feb. 19, 2008, S. TREATY DOC. NO. 110-23 (2008).

79. See John R. Crook, *U.S. Senate Approves Investment Treaty with Rwanda and Mutual Legal Assistance Treaty with Bermuda, Addressing Both Treaties’ Domestic Implementation*, 106 AM. J. INT’L. 141, 141 (2012).

80. See Ackerman & Tobin, *supra* note 22.

81. See Crook, *supra* note 79, at 141.

82. Katherine Wang, *The Korea-U.S. Free Trade Agreement: Motivations For Investor-State Dispute Settlement Provisions*, 18 U.C. DAVIS J. INT’L. L & POL’Y 505, 508 (2012).

negotiate.<sup>83</sup> While the Korean government defended itself by proclaiming that incorporating a Model BIT is a customary practice in an FTA,<sup>84</sup> some scholars have implied that the parties' unique diplomatic relationship—military alliance—served to impel South Korea to accept the incorporation of the 2004 Model BIT, as drafted by the United States, into its FTA.<sup>85</sup> Ever since the Korean War, U.S. troops stationed in Korea have been a crucial component of the security of South Korea amidst the constant threat of nuclear war from North Korea. Many, therefore, speculate that the likely reason for the Korean government's incentive to accept the terms provided by the United States was to maintain a sound diplomatic relationship through the FTA and, at the same time, avoid diplomatic disputes that could have arisen if the Korean government had vigorously negotiated to redraft the BIT to its advantage.<sup>86</sup>

The question of South Korea's motivation is even more strongly supported by the fact that, in BITs between the United States and other countries of comparable global economic power, other countries are less likely than South Korea to accept the U.S. Model BIT as is.<sup>87</sup> In recent years, India has become one of the leading global economic powers, through an agricultural revolution and the growth of the steel and technology industry, making it a growing voice on the international stage. In fact, some media sources have forecasted that India will overtake China as an economic powerhouse by 2030.<sup>88</sup> Perhaps aware of its growing status, India refused to accept an unmodified U.S. Model BIT as is, and proposed against an international dispute settlement clause during the final phase of negotiation.<sup>89</sup> Interestingly, India is already notorious for its fragile investment climate.<sup>90</sup> Therefore, its refusal to accept an international dispute settlement clause can only be explained by India's awareness that it does not necessarily have to allow the United States to gain a higher bargaining position, as it already

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83. See Ki-Jin Kim, *Problems of ISD System*, 21 GYEONGSANG NAT'L U. LEGAL RES. 24, 24 (2013).

84. See *id.*

85. See Wang, *supra* note 82, at 529-33.

86. See *id.* at 529-33.

87. *Id.* at 508-09 (arguing that Australia did not agree with investor state arbitration); see also Ashish Goel, *India U.S. Bilateral Treaty Going Nowhere*, EAST ASIA FORUM (Aug. 31, 2013), <http://www.eastasiaforum.org/2013/08/31/india-us-bilateral-investment-treaty-going-nowhere/>.

88. See *India Overview*, WORLD BANK, <http://www.worldbank.org/en/country/india/overview> (last visited Jan. 11, 2014).

89. Goel, *supra* note 87.

90. *Id.*

enjoys the status of being the world's fourth-largest economy.<sup>91</sup> Similarly, when the United States and Australia implemented an FTA, Australia, like India, removed the clause allowing foreign investors to bring claims directly against the host state, thus limiting the dispute settlement to occur only between the parties.<sup>92</sup> Australia's ability to negotiate with the United States to remove the dispute clause can be attributed to the fact that Australia is the tenth-largest foreign owner of U.S. assets and that the amounts of U.S. investment in Australia are similar.<sup>93</sup> Likewise, in 2014, the European Commission, while negotiating a trade deal with the United States, announced it would seek public consultation on whether to include an investor-state arbitration clause, recognizing that such a provision could have far-reaching consequences.<sup>94</sup> Therefore, comparing U.S. trade agreements with those of nations of comparable economic power poses the question of whether economic cooperation between state parties can, in fact, last when asymmetry in bargaining power is inherent in implementing a BIT. This reflection, in turn, suggests that a U.S. Model BIT may not be an institution established to promote economic cooperation, but is rather solely focused on the interest of its investors.

B. *Differences in States' Ability to Exercise Due Diligence Over a BIT*

Having established the frequent occurrence of unequal bargaining power between parties in a BIT, another difference that contributes to this asymmetry is that some developing countries that are signatories to a BIT often do not have an adequate judicial department that performs due diligence regarding the terms of the treaty. Sometimes, these countries simply lack a legal department sophisticated enough to understand the linguistic variations in certain terms of the treaty.<sup>95</sup> This theory is suggested by the ICSID case in 2003, *SGS v. Pakistan*.<sup>96</sup> In *SGS*, the Swiss Company SGS entered into a Pre-Shipment Inspection

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91. See *India Overview*, *supra* note 88.

92. See generally William S. Dodge, *Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-U.S. Free Trade Agreement*, 39 VAND. J. TRANSNAT'L L. 1 (2006).

93. *Id.* at 23.

94. Oliver Wright, *Sovereignty Fears Lead to EU-US Trade Rethink*, INDEPENDENT, (Jan. 20, 2014), <http://www.independent.co.uk/news/uk/politics/sovereignty-fears-lead-to-euus-trade-rethink-9073111.html>.

95. SORNARAJAH, *supra* note 76, at 207.

96. See *Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction (Aug. 6, 2003), [http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C205/DC622\\_En.pdf](http://icsidfiles.worldbank.org/icsid/ICSIDBLOBS/OnlineAwards/C205/DC622_En.pdf) [hereinafter *SGS v. Pakistan*].

Agreement (PSI Agreement) with the Republic of Pakistan in which SGS agreed to provide inspection services on the goods exported from certain countries to Pakistan.<sup>97</sup> Although the PSI Agreement was mutually performed, the parties disputed each other's performance, eventually resulting in Pakistan terminating the agreement.<sup>98</sup> With regard to the termination, in accordance with the terms of the contract which stated that any disputes not settled amicably must be settled by arbitration in accordance with the Arbitration Act of the Territory presently in place, Pakistan initiated arbitration proceedings in Pakistan.<sup>99</sup> However, at the same time, SGS sought to resolve the dispute by bringing the claim before the ICSID under the BIT between Switzerland and Pakistan. SGS alleged that Pakistan had violated its treaty obligations, specifically by failing to do the following: promote and protect foreign investment, ensure fair and equitable treatment, refrain from taking measure equivalent to expropriation without adequate compensation, and observe its contractual commitment.<sup>100</sup> SGS argued that because the existing BIT sets forth international law obligations of the contracting parties, a violation of the BIT is therefore a breach of international law and a determination based on international law standards is appropriate.<sup>101</sup> In response, the government of Pakistan argued that the ICSID lacks jurisdiction to hear the claim and asked the ICSID to dismiss the claim on the ground that the PSI Agreement had already established a dispute settlement mechanism and arbitration proceeding in accordance with the Arbitration Act of the Territory (of Pakistan) that the parties had freely negotiated.<sup>102</sup> Furthermore, Pakistan argued that because the parties had already agreed to submit disputes elsewhere and, additionally, did not specify whether claims could be filed with ICSID, this, in turn, would actually constitute a breach of the principle of *pacta sunt servanda*.<sup>103</sup> Thus, the central question the ICSID needed to determine was whether it had jurisdiction to determine SGS's claims regarding Pakistan's alleged violations of certain BIT provisions in conjunction with the PSI Agree-

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97. Emmanuel Gaillard, *Investment Treaty Arbitration and Jurisdiction Over Contract Claims the SGS Cases Considered*, in INTERNATIONAL LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 326 (Todd Weiler ed., 2005).

98. *Id.*

99. *Id.* at 311-312.

100. *Id.* at 327.

101. SGS v. Pakistan, *supra* note 96, at ¶ 91.

102. *Id.* at ¶ 47.

103. *Id.* at ¶ 48.

ment. The ICSID held that “where the *fundamental basis* of the claim is a *treaty laying down an independent standard* by which the conduct of the parties is to be judged, *the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state—cannot operate as a bar to the application of the treaty standard,*” implying that the scope of the BIT, in fact, overlaps with the existing contract between the contracting state and the investor, as long as the claim is based on the provisions of the BIT.<sup>104</sup>

While the dispute between SGS and Pakistan may possibly be attributable to the ambiguously-drafted BIT, there also exists another possibility. When the Pakistani government signed the BIT with Switzerland, it was simply unaware of the extent and scope of the BIT’s applicability, which can, in turn, be attributed to the fact that Pakistan may lack a sophisticated legal department to conduct thorough research and analysis to determine the potential consequences of signing a BIT.<sup>105</sup> This theory is supported by the fact that the government of Pakistan received \$100 million of Poverty Reduction Support Credit from the World Bank in 2003 to support Pakistan’s creation of modern governance systems and promote environmental sustainability, land management, legal development and public financial management.<sup>106</sup>

Various statistical data also suggests the proposition that developing countries are likely to become a party in a BIT without fully understanding its terms and scope. One study suggested that the majority of the claims brought to the international tribunal for a violation of a BIT have been against developing countries.<sup>107</sup> The United States has primarily signed BITs with developing countries—eighty percent of U.S. investment treaties are with the developing countries, as classified by the World Bank.<sup>108</sup> As of yet, the United States has never lost a case as a respondent state in a BIT arbitration, and while U.S. investors have not always won their claims against developing nations, one study suggests that we cannot overlook the reality that a developing country

104. *Id.* at ¶ 148.

105. See Gregory Shaffer, *How to Make the WTO Dispute Settlement System Work for Developing Countries: Some Proactive Developing Country Strategies*, in TOWARDS A DEVELOPMENT SUPPORTIVE DISPUTE SETTLEMENT SYSTEM IN WTO (ICTSD Resource Paper N.5) 15, 19, 44 (March 2003), [http://www.ictsd.org/downloads/2008/06/dsu\\_2003.pdf](http://www.ictsd.org/downloads/2008/06/dsu_2003.pdf).

106. COUNCIL ON FOREIGN RELATIONS, BUDGET SUPPORT TO EDUCATION IN PAKISTAN 32 (2012), [http://i.cfr.org/content/thinktank/cue/report\\_dbs\\_in\\_pakistan.pdf](http://i.cfr.org/content/thinktank/cue/report_dbs_in_pakistan.pdf).

107. Kevin P. Gallagher & Elen Shrestha, *Investment Treaty Arbitration and Developing Countries: A Re-Appraisal* 7-8 (Global Dev. & Env’t Inst., Working Paper No. 11-01, 2011), <https://ase.tufts.edu/gdae/Pubs/wp/11-01TreatyArbitrationReappraisal.pdf>.

108. *Id.*

often acquiesces to demands by a foreign investor for fear of a lawsuit which can lead to profound economic risks, as the cost of losing a claim can be more economically significant for a developing nation.<sup>109</sup> While the U.S. Model BIT may have been drafted to serve as a prototype or foundation from which both parties can negotiate and build upon, the more likely reality is that parties from developing nations will accept the unmodified form of the Model BIT, not only to seek FDI, but also because a party may not fully comprehend the meaning of the terms. As demonstrated previously, the economic risk of being the subject of an arbitration can outweigh the benefits of foreign capital. Therefore, one should not overlook the possibility that the United States entering into a BIT with a party from a developing state is akin to an adult entering into a contract with an adolescent.

### C. *Difference in Legal Theories*

#### 1. Conflicting Legal Theories on “Expropriation”

Article 6 of the U.S. Model BIT outlines the host state’s conduct regarding nationalization or expropriation of foreign investment in its territory.<sup>110</sup> Under Article 6, a host state cannot expropriate a covered investment, whether directly or indirectly, unless it is for a public purpose and it is done in a nondiscriminatory manner, with prompt payment of compensation, and in accordance with the law and Article 5, relating to the Minimum Standard of Treatment.<sup>111</sup> At first glance, the text seems to provide sufficient protection for investors. However, considering the complexity of the various legal theories on the definition of “expropriation,” and factoring in diverse national variables, the text of Article 6 may be inadequate.<sup>112</sup> Not surprisingly, most of the disputes arising from BITs involve expropriation of the investment by the host state.<sup>113</sup>

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109. *Id.* at 10.

110. 2004 Model BIT, *supra* note 37 at art. 6.

111. 2004 Model BIT *supra* note 37 at art. 5.

112. See generally OECD, “*Indirect Expropriation*” and the “*Right to Regulate*” in *International Investment Law* (OECD Working Papers on International Investment No. 2004/04, 2004), [https://www.oecd.org/daf/inv/investment-policy/WP-2004\\_4.pdf](https://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf).

113. See MONTT, *supra* note 74 at 231 (“In the case of non-physical and non-direct takings, the disarray begins with issues of nomenclatures. There are several labels competing to describe deprivations that are not easily identifiable: de facto expropriations, creeping expropriations, regulatory takings, indirect expropriations, and situations tantamount to expropriations, just to name a few.”).

The most critical consideration in assessing whether an investor's loss of investment deserves compensation is the balance between individual property rights and the public interest justification for the expropriation, seeing as how the standard of expropriation in a particular state depends on its standard of property rights.<sup>114</sup> Although no state in today's global economy endorses the extreme position of absolute or zero property rights, tension still exists in almost every society between individual property rights and the public interest to varying degrees and with various cultural characteristics.<sup>115</sup> In Germany, Spain, and Chile, for example, property rights consist of two levels: core and periphery rights.<sup>116</sup> With this duality in individual property rights, strong protection is provided for core rights and weak protection for periphery rights.<sup>117</sup> Similarly, in France, property rights are characterized as "the artichoke right," meaning that one's property rights remain the same even if many attributes are removed, so long as the core remains untouched.<sup>118</sup> This dual classification of property rights suggests that some states' judicial systems show higher degrees of deference to government actions affecting the property rights' periphery. In contrast, an individual's core property right is not recognized in some states, notably China and Canada.<sup>119</sup> Property rights in China have been recognized as collective or public rights, especially concerning land ownership, and the idea of individual "core" property rights has not been recognized at all.<sup>120</sup> In the face of a growing shift toward democratic governance and an increase in foreign investment, China amended its constitution in 2004 to recognize individual property rights by adding the following clause: "legally obtained private property of the citizens shall not be violated."<sup>121</sup> However, many believe this reform is still premature and requires further development within China's legal system for it to actually be effective.<sup>122</sup>

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114. *See id.* at ch. 4.

115. *Id.*

116. *See id.* at 175-76.

117. *Id.* at 175.

118. *Id.* at 176.

119. *See* Guoqiang Tian, *Property Rights and the Nature of Chinese Collective Enterprises*, 28 J. COMP. ECON. 247, 251 (2002); *see also* Bryan P. Schwartz & Melanie R. Bueckert, *Regulatory Takings in Canada*, 5 WASH. U. GLOB. STUD. L. REV. 477, 477 (2006).

120. *See* Tian, *supra* note 119 at 251.

121. LINDA YUEH, *ENTERPRISING CHINA: BUSINESS, ECONOMIC, AND LEGAL DEVELOPMENTS SINCE 1979*, 190 (2011).

122. *See* Chris Buckley, *China Approves Amendments on Property and Human Rights*, N.Y. TIMES, Mar. 15, 2004, <http://www.nytimes.com/2004/03/15/world/china-approves-amendments-on->

Differences in the legal theories of “property” are also reflected by the collective data. According to the 2013 *International Property Rights Index*, which rates security levels of property rights in a particular state, the United States obtained an overall score of 7.6, and scored a 7.2 on the Legal and Political Environment scale measuring the state’s stability in its rule of law and independent judiciary system for enforcing individual property rights.<sup>123</sup> In contrast, Rwanda obtained a score of 6.2 and 5.7, respectively; an even more striking difference was found for India, a state with which the United States is negotiating trade agreements, which scored a 5.5 and 4.4, respectively.<sup>124</sup> Apparent differences in the party states’ domestic systems with respect to property rights suggest that perhaps a BIT should do more than direct parties to compensate investors for expropriation—aiming rather to become more sophisticated in addressing differences of a political or judicial nature that would potentially affect the investors’ rights in a host state.

In light of the existence of different theories of “property,” how does the Model BIT define “expropriation”? In a Model BIT, the definition of “expropriation” is to be interpreted in accordance with Annexes A and B, which declare that Article 6 regarding expropriation intends to reflect customary international law.<sup>125</sup> Traditionally, in customary international law, the concept of expropriation has been reserved for cases dealing with full or substantial deprivations of property rights, meaning the state’s action can be labeled as expropriation only when it interferes with an individual’s core right to the property.<sup>126</sup> However, while a Model BIT directs expropriation to be interpreted in accordance with customary international law, it simultaneously allows loss in “reasonable investment-backed expectation” to be eligible for compensation from expropriation in Annex B.<sup>127</sup> The problem here is that the concept of an investor’s “reasonable investment-backed expectation” is

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property-and-human-rights.html (concerning that the amendment may nonetheless be futile due to its vagueness).

123. 2013 *International Property Rights Index: United States*, PROP. RIGHTS ALL., <https://www.internationalpropertyrightsindex.org/country/united-states-usa> (last visited Sept. 15, 2017).

124. 2013 *International Property Rights Index: Rwanda*, PROP. RIGHTS ALL., <https://www.internationalpropertyrightsindex.org/country/rwanda> (last visited Sept. 15, 2017); 2013 *International Property Rights Index: India*, PROP. RIGHTS ALL., <https://www.internationalpropertyrightsindex.org/country/india> (last visited Sept. 15, 2017).

125. 2004 Model BIT, *supra* note 37, at Annex A, B.

126. MONTT, *supra* note 74, at 233-34.

127. 2004 Model BIT, *supra* note 37 at Annex B.

not a core property right, but more likely a periphery right.<sup>128</sup> Therefore, in a situation in which an investor brings a claim against a host state for its regulatory measures that adversely affect the investor's reasonable expectations, customary international law may not be an appropriate standard in providing a solution, and frequently, it will be inevitable to resort to the ICSID for relief. However, some scholars have argued that it is too dangerous to allow an international tribunal to determine whether a state's regulatory measure is for a public purpose because regulatory measures are a policy decision and not a judicial question.<sup>129</sup>

## 2. Differences in Legal Institutions

Even if both parties were to share similar legal theories on the standard of expropriation and the scope of property rights, the inherent difference in legal institutions may pose another obstacle in reaching a balance between state sovereignty and a foreign investor's property rights. The two main legal institutions in the world today are civil law and common law, and the difference in characteristics between the two legal systems can, in fact, result in a clash between the state's judiciary and the foreign investor within the framework of the Model BIT.<sup>130</sup>

In a common law system, judges rely on precedent and inductive reasoning based on precedent ultimately creates the law.<sup>131</sup> Because legal precedents guide the development of a comprehensive system of law, jurists and legal scholars do not play a significant role in creating the system.<sup>132</sup> Therefore, a common law system embodies the principle of open-endedness, such that the outcome of the case law will be the best predictor of the development of law. However, countries based on civil law have comprehensive codes that cover an abundance of legal

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128. MONTT, *supra* note 74, at 175, 181, 198-99. Core property right is a fundamental property right that can be compensated with relative ease. Reasonable investment-backed expectation is a right that is property right that derives out of the investor's core property rights in his investments.

129. *Id.* at 184.

130. See THE ROBBINS COLLECTION, BERKELEY SCHOOL OF LAW UNIVERSITY OF CALIFORNIA, THE COMMON LAW AND CIVIL LAW TRADITIONS (2010), <https://www.law.berkeley.edu/library/robbins/pdf/CommonLawCivilLawTraditions.pdf>; see generally KOJO YELPAALA, DRAFTING AND ENFORCING CONTRACTS IN CIVIL AND COMMON LAW JURISDICTIONS (1986) (demonstrating differences in two regimes' treatment of contract law).

131. JAMES G. APPLE & ROBERT P. DEYLING, A PRIMER ON THE CIVIL-LAW SYSTEM, FED. JUDICIAL CTR., 34 (1995), <https://www.fjc.gov/sites/default/files/2012/CivilLaw.pdf>.

132. *Id.*

topics, including private law, criminal law, and commercial law.<sup>133</sup> In a civil law country, unlike a common law country, legal scholars and jurists play a crucial role in developing the system of law.<sup>134</sup> The legislature in the civil law tradition supplements and updates the codes in those areas in which the legal scholars have suggested that codes are defective or incomplete.<sup>135</sup> Therefore, legislatures in civil law traditions strive to provide predictability and clarity of legal orders by attempting to achieve comprehensive and complete codes of law.<sup>136</sup>

The common law system's "open-endedness" is ultimately built on involvement and decisions made by people, seeing as one of the main elements in the common law system is the jury trial; the civil law system, however, relies on a judge to establish the facts of a case.<sup>137</sup> South Korea's legal system, for example, is founded upon civil law, based mostly on codes and statutes.<sup>138</sup> Consequently, its legal system has less open-endedness than does the U.S. legal system. To illustrate, the Fifth Amendments of the U.S. Constitution prohibits the government from taking "without just compensation."<sup>139</sup> In contrast, Article 23 of the Korean Constitution, while guaranteeing the property rights of all citizens, declares that expropriation or restriction of the use of private property and compensation "shall be governed by the Act,"<sup>140</sup> meaning that if the Act does not provide compensation for the government's expropriation or taking, the owner of the property is left without remedy. A notable example is the Greenbelt policy in South Korea, established by the "Town Planning Act" of 1971 to develop an environmental protection area.<sup>141</sup> The Act severely restricted landowners on certain tracts from initiating development, substantially depriving them of their property rights.<sup>142</sup> The landowners demanded compensation for their involuntary loss,<sup>143</sup> arguing that a lack of a compensation

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133. *Id.* at 36.

134. *Id.* at 29.

135. *Id.*

136. *Id.*

137. *Id.* at 27.

138. See generally Hamyoung Jeong, *The Role of Administrative Law in Economic Development and Democracy in Korea*, in INTRODUCTION TO KOREAN LAW 85 (Korea Legis. Res. Inst. ed., 2013).

139. U.S. CONST. amend. V, §6.

140. DAEHANMINGUK HUNBEOB [HUNBEOB] [CONSTITUTION] Oct. 29, 1987 art. 23 (S. Kor.).

141. Chang-Hee Christine Bae, *Korea's Greenbelts: Impacts and Options for Change*, 7 PAC. RIM L. & POL'Y J. 479, 480 (1998).

142. *Id.* at 487.

143. *Id.* at 495.

provision in the Act was unconstitutional.<sup>144</sup> The Korean Supreme Court responded, however, that “[i]n line with [the public interest to prevent uncontrolled growth of urban areas and to preserve the national environment as a healthy living environment], it is acceptable that the landowner suffer personal losses, and therefore the Act, which precludes compensation, is not unconstitutional.”<sup>145</sup>

Continuing with the South Korea-U.S. example under the Model BIT, if an U.S. investment was expropriated by the Korean government as a result of a regulatory measure such as the “Town Planning Act,” and the investor was left uncompensated for the aforementioned reason, the government would have the obligation to compensate for the loss, assuming that the measure was nondiscriminatory and for a public purpose.<sup>146</sup> However, because of the character of the civil law system, the government would have no obligation to compensate for the loss of domestic investors, who are equally affected by the government’s regulatory measure. If the government were to only compensate foreign investors, an unintended “reverse” discrimination would occur, possibly followed by internal conflicts, such as protests and domestic investors’ resentment toward their government and foreign investors. If the host state’s government refused to compensate, treating foreign investors the same as domestic investors, then foreign investors would nonetheless have claims to bring against the host state. To avoid such a dilemma, it would be advantageous for the host state to avoid implementing regulations that would affect foreign investors, even if the regulations might be necessary for maintaining public interests. In addition, foreign investors generally favor a predictable and consistent legal system in which everyone competes on even footing, rather than a system in which certain parties receive favorable treatment by the host state. The U.S. Model BIT’s failure to consider the differences in legal theories and institutions of party states can thus have unintended consequences, detrimental to the internal stability of the host state and to the economic cooperation of both parties.

### 3. Differences in Territoriality

Differences in each country’s policies toward its own physical attributes, such as its natural resources, territoriality, and environment, are additional factors that complicate the success of a Model BIT. In the

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144. *Id.* at 498.

145. *Id.*

146. See 2004 Model BIT, *supra* note 37, at art. 6.

United States, the exploitation of natural resources for economic purposes is deeply rooted in history. U.S. environmental policy includes a system of governance that is constitutionally limited and divided, imposing major restrictions on the government's power to restrict environmental exploitation by a private party.<sup>147</sup> Thus, U.S. corporations and businesses frequently resist their government's environmental policies, in contrast to the corporatist cooperative culture of South Korea.<sup>148</sup> In addition, in the United States, the enactment of environmental regulatory measures requires government agencies to explicitly justify their regulation proposals publicly and in courts with substantial evidence.<sup>149</sup> By contrast, the Korean model of environmental policy is characterized by a strong central government acting vigorously to resolve environmental problems by continuing to implement environmental policies at a progressive rate.<sup>150</sup> To illustrate, from 1997 to date, eighteen new environmental acts were legislated in Korea, with more bills pending in the National Assembly.<sup>151</sup> Nonetheless, according to the OECD, Korea must implement additional environmental policies to counter ever-persisting environmental problems.<sup>152</sup>

Such a difference in environmental approaches is an inevitable variable that will likely ultimately lead to conflicts between the host state and investors. While the United States is one of the largest countries in the world, with a territory of 3.8 million square miles and a population of approximately 316 million, South Korea is a country with a territory of 38,345 square miles—one-sixth the size of Texas—and a population of 48.6 million.<sup>153</sup> This means that while approximately 83 people live within one square mile in the United States, approximately 1,267 people live per square mile in South Korea. Taking into account the fact that seventy percent of Korean territory is covered by mountains, South Korea is one of the most densely populated countries in

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147. Richard N. L. Andrews, *United States*, in NATIONAL ENVIRONMENTAL POLICIES, A COMPARATIVE STUDY OF CAPACITY-BUILDING 25, 25 (Martin Jānicke & Helmut Weidner eds., 1997)

148. See generally Dennis L. McNamara, *Comparative Corporatism*, in CORPORATISM AND KOREAN CAPITALISM (Dennis McNamara ed., 1999).

149. See Andrews, *supra* note 147, at 35.

150. *OECD Environmental Performance Review of Korea*, OECD, <http://www.oecd.org/env/country-reviews/37436565.pdf> (last visited Jan. 11, 2014).

151. *Id.* at 1.

152. *Id.* at 2.

153. *Compare Korea Profile*, BBC NEWS ASIA PACIFIC, <http://www.bbc.co.uk/news/world-asia-pacific-15291408> (last visited Jan. 11, 2014) with *United States Profile*, BBC NEWS US & CANADA, <http://www.bbc.co.uk/news/world-us-canada-16761057> (last visited Jan. 11, 2014).

the world.<sup>154</sup> The need for government intervention and constant legislation for new policies to preserve and monitor the environment is unavoidable in South Korea and in other countries with similar geographic characteristics.<sup>155</sup> Considering that most BITs occur between wealthy and developing countries, a likely prospective is that wealthy foreign investors will bring claims against their developing counterpart as state legislators develop new policies and regulations consonant with the state's economic development. The likely consequence of the BIT's inattention to geographical differences would be frequent claims against the host state by foreign investors for losses incurred as a result of the host state's regulatory measures to protect its environment. Not only might some foreign investors not understand the need for such regulations, but they could also wrongly perceive the frequent legislating of policies and regulatory measures as discriminatory.

#### 4. Differences in Economic Capacity

Like the differences in territoriality, the striking differences in capital power cannot be overlooked and are not an easy obstacle to overcome for the Model BIT. Undoubtedly, the United States is one of the strongest capital powers in the world today, with \$41,538.1 GDP per capita, while Korea's GDP per capita was \$24,358.80 in 2012.<sup>156</sup> The difference is even more striking in the U.S. FTAs with developing countries such as Colombia, which had a GDP per capita of \$7,752 in 2012, or Rwanda, which had a GDP per capita of \$620 in the same year.<sup>157</sup> Potential conflict resulting from these economic disparities is illustrated by the case study involving the Lone Star scandal in South Korea. During the 2003 Asian financial crisis, Lone Star Funds, a Dallas-based equity firm, acquired 70.9% of Korea Exchange Bank

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154. Sara Kirchheimer, *Landforms of Southern Korea*, USA TODAY (Nov. 4, 2015) <http://traveltips.usatoday.com/landforms-southern-korea-40441.html>.

155. Jong-Il You, *Chapter Nine: The Korean Model of Development and Its Environmental Implications*, UNITED NATIONS UNIV. (1995), <http://archive.unu.edu/unupress/unupbooks/80901e/80901E0k.htm>.

156. *GDP Per Capita*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.PCA> P.CD (last visited Jan. 11, 2014).

157. *Id.*; See also Kevin J. Fandl, *Bilateral Agreements and Fair Trade Practices: A Policy Analysis of the Colombia-U.S. Free Trade Agreement*, 10 YALE HUM. RTS. & DEV. L. J. 64, 84-85 (2007) (suggesting that in FTA, economic benefit is often greater for the developed state, because it can export more goods with easier entry, and the effect of FTA may not be significant for developing country if it does not have strong export practice).

shares for \$1.2 billion dollars.<sup>158</sup> After Korea's economic recovery, however, Lone Star tried to sell its shares and exit the Korean market with \$7 billion dollars of profit. Lone Star suddenly garnered an influx of attention and criticism from Korean citizens, as evidenced by the demonstration organized by the Korea Exchange Bank union protesting Lone Star's so-called "eat-and-flee" strategy of pocketing large profits.<sup>159</sup> Pressure from the public and from politicians led to the Korean government's intervention in Lone Star's attempt to exit, bringing allegations against Lone Star of stock manipulation.<sup>160</sup> Wrangling with the courts, regulators, and lawmakers, combined with the public backlash over profits from the investment, all derailed Lone Star's attempt to sell the shares. Ultimately, Lone sold its stake to another Korean bank at a far lower price than anticipated.<sup>161</sup> At the close of 2012, Lone Star announced it would begin arbitration with South Korea in ICSID.<sup>162</sup>

The Lone Star scandal illustrates the conflict that can arise in an investor-state relationship and is attributable to the disparity in the two countries' capital capacities. Here, Lone Star made a legitimate investment; it took a risk, purchased shares of stock at a low price, and attempted to sell the shares when their prices increased. However, the Korean public viewed Lone Star's actions not as an investment, but rather as a private foreign firm's use of its capital power to engulf one of the largest banks in Korea and eventually take hold of a large portion of Korean capital by disposing of its shares.<sup>163</sup> Such a perspective reflects a pervasive hostility toward foreign capital,<sup>164</sup> rooted in Korean taxpayers' experience of repayment of debt incurred from the International Monetary Fund (IMF) crisis, and a persistent concern regarding the outflow of national wealth.<sup>165</sup> Considering the size of the Korean

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158. Shu-Ching Jean Chen, *Lone Star Stands Up to South Korea*, FORBES (Feb. 7, 2006), [http://www.forbes.com/2006/12/07/lone-star-korea-markets-equity-cx\\_jc\\_1207markets04.html](http://www.forbes.com/2006/12/07/lone-star-korea-markets-equity-cx_jc_1207markets04.html).

159. Seojin Cha & Jun Yang, *Lone Star Faces Fight to Keep Investment Gains on Korea Exchange Bank Sale*, BLOOMBERG NEWS (Nov. 18, 2011), <http://www.bloomberg.com/news/2011-11-18/lone-star-cleared-to-sell-korea-exchange-bank-to-hana-after-one-year-delay.html>.

160. *Id.*

161. *Id.*

162. Isabella Steger, *Lone Star Begins Arbitration with South Korea*, WALL ST. J. (Nov. 22, 2012), <http://online.wsj.com/news/articles/SB10001424127887324352004578134653915418628>.

163. James C. Schopf, *The Lone Star Scandal: Was It Corruption?*, in KOREA YEARBOOK, 2007: POLITICS, ECONOMY AND SOCIETY 83, 106 (Rüdiger Frank eds., 2008).

164. *Id.* at 105.

165. *Id.*

economy, an outflow of \$7 billion dollars would, no doubt, have been alarming.

The Lone Star scandal highlights another potential issue, in that a substantial difference in capital power between the parties can lead to a private investor from the wealthy party taking control of a significant portion—or even engulf—an entire industry in a developing country by using capital power alone, thus leading to monopolization.

Furthermore, if that industry is the primary source of the host state's wealth, or one upon which the people of the state primarily depend, a foreign investor's stakes could be at risk because the host state would be pressured to intervene against the investor's share of the industry.<sup>166</sup> For example, the corn industry is a major sector of Mexico's economy, not only because corn is a mainstay of the Mexican diet, but also because Mexico is one of the largest corn producers in the world.<sup>167</sup> In 1994, NAFTA was implemented, and U.S. corn producers freely entered the Mexican corn industry.<sup>168</sup> The expectation was that the price of corn would equalize in the United States and Mexico, but in reality, Mexico's corn industry was no match for the U.S. corn industry, which represented fifteen percent of global corn production.<sup>169</sup> With the onset of an influx of a corn supply from the United States to Mexico, corn prices in Mexico dropped drastically by approximately twenty-five percent within just four years and threatened the livelihoods of local producers.<sup>170</sup> While U.S. producers could afford to sell corn at a lower price to gain a competitive advantage, Mexican local producers could not.<sup>171</sup> This capital power, which demotivated the local producers to compete against U.S. producers, gradually caused the local Mexican corn market to die out and pushed many local producers to move to another industry, eventually allowing U.S. corn producers to take

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166. See generally *id.*

167. See Alejandro Nadal, *Corn and NAFTA: An Unhappy Alliance*, GRAIN (Jun. 20, 2000), <http://www.grain.org/article/entries/214-corn-and-nafta-an-unhappy-alliance>; See also, James C. McKinley Jr., *Cost of Corn Soars, Forcing Mexico to Set Price Limits*, N.Y. TIMES (Jan. 19, 2007), [http://www.nytimes.com/2007/01/19/world/americas/19tortillas.html?\\_r=0](http://www.nytimes.com/2007/01/19/world/americas/19tortillas.html?_r=0).

168. North American Free Trade Agreement, *drafted* Aug. 12, 1992, *revised* Sept. 6, 1992, Can. Mex.-U.S., 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA].

169. See *Trade*, U.S. DEP'T. OF AGRIC. ECON. RES. SERV., [http://www.ers.usda.gov/topics/crops/corn/trade.aspx#UwomF\\_ldUoM](http://www.ers.usda.gov/topics/crops/corn/trade.aspx#UwomF_ldUoM) (last visited Jan. 11, 2013).

170. Rick Relinger, *NAFTA and U.S. Corn Subsidies: Explaining the Displacement of Mexico's Corn Farmers*, PROSPECT: J. OF INT'L AFF. AT UCSD (Apr. 19, 2010), <http://prospectjournal.org/2010/04/19/nafta-and-u-s-corn-subsidies-explaining-the-displacement-of-mexicos-corn-farmers-2/>.

171. *Id.*

control of the market.<sup>172</sup>

The story does not end here, however. Several years later, corn prices skyrocketed worldwide.<sup>173</sup> Now dependent on an imported corn supply, this price increase riled the Mexican public to the extent that it threatened Felipe Calderón's presidency in 2007.<sup>174</sup> Mexican lawmakers called on Calderón to impose price controls, and he later announced that he had reached an agreement with major corn distributors to stabilize the price.<sup>175</sup> The reason behind the skyrocketing price is unclear, but many experts speculate that the monopolist corn industry manipulated the price.<sup>176</sup> Regardless of whether the price of corn was purposefully manipulated, under a Model BIT, a host state's intervention to set a price limit could serve as a cause of action against the state in an ICSID arbitration because it would arguably constitute indirect expropriation given the losses incurred from regulation. The state might succeed in arguing that regulation is necessary for public purposes, and thus its action does not constitute expropriation. According to the Model BIT, though, even if the host state's regulation serves a public purpose, it must be nondiscriminatory.<sup>177</sup>

When a foreign investor acquires a significant portion of the industry or, in an extreme case in which a foreign investor takes over the industry itself, how can the state show that industry regulation is nondiscriminatory? What may seem like an extreme scenario is actually illustrated in *Bechtel v. Bolivia*.<sup>178</sup> In *Bechtel*, an U.S. corporation won a bid to control the water supply of the Bolivian city of Cochabamba after the Bolivian government decided to privatize the city's water supply.<sup>179</sup> Once Bechtel had obtained control over the water supply of Cochabamba, Bechtel allegedly raised the price of water by average of thirty five percent, sparking a citywide rebellion that demanded Bechtel's exit.<sup>180</sup> Eventually, public protest forced the government to rescind the

172. *Id.*

173. McKinley, *supra* note 167.

174. *Id.*

175. *Id.*

176. *Id.*

177. 2004 Model BIT, *supra* note 37, at art. 5 §.4 (“[E]ach Party shall accord to investors of the other Party, and to covered investments, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments . . .”).

178. Amanda L. Norris & Katina E. Metzidakis, *Public Protests, Private Contracts: Confidentiality in ICSID Arbitration and the Cochabamba Water War*, 15 HARV. NEGOT. L. REV. 31 (2010).

179. *Id.* at 34-36

180. ANDREAS KULICK, *GLOBAL PUBLIC INTEREST IN INTERNATIONAL INVESTMENT LAW* 295 (James Crawford & John S. Bell eds., 2012).

contract with Bechtel, and Bechtel filed a claim with ICSID, seeking damages of more than \$25 million.<sup>181</sup>

What both *Bechtel* and the Mexican corn crisis illustrate are the consequences of overlooking the momentous asymmetry in capital power between the state parties, with the assumption of comparative economic advantage. Particularly problematic in these cases, is that the Model BIT provides protection for investors without providing any protection against possible exploitation of a host state by a foreign investor.

#### IV. CAN MODEL BITS WORK?

##### A. *Designing the BIT Prototype*

In Section II of this Note, the goal and principles of the BIT were discussed. The goal of the BIT is to promote economic cooperation while providing protection for investors from unjust expropriation by the host state. For the BIT to be successful, it should embrace the six principles of access, nondiscrimination, due process, security, reasonableness, and transparency.<sup>182</sup> But a successful BIT should also embrace the unique differences between the state parties, which the current Model BIT seems to overlook. Section III laid out the factors attributing to these differences. Therefore, how should the Model BIT be restructured to become a universal template that can accommodate the factors described in Section II? The goal of Section IV is to recommend revision of the current Model BIT, with the hope that it can someday serve as a prototype not only for BITs involving the United States, but also between other countries too.

A successful prototype should have a balance of both open-endedness and narrowness. It should be open-ended to provide space for the state parties to negotiate and recognize their differences, which can affect their investors. At the same time, it should be narrow on certain provisions to minimize the risk of a dispute. In addition, the United States and other developed nations, as global economic leaders, should take some responsibility to avoid asymmetrical or one-sided treaties with developing countries. While greater bargaining power may benefit the wealthy state party in the short term, it is important to note that developing a state-signed BIT that heavily favors one counterpart may suggest that the state lacks a governmental branch to carefully

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181. Norris & Metzidakis, *supra* note 178, at 42.

182. VANDEVELDE, *supra* note 3, at 2.

review the terms of the treaty.<sup>183</sup> In turn, the state may continue to struggle with political and judicial instability, which could have a detrimental effect on foreign investors.

With respect to achieving open-endedness in the prototype, the U.S. Model BIT should reserve an article to address differences in legal theories and potential regulatory measures resulting from the unique territorial characteristics of a state party. Perhaps after Articles 3, 4, and 5, which lay out the conduct of the host state, an additional article could be added that declares, for example, that each party shall recognize certain particularized territorial and environmental characteristics of the other state, and shall recognize that frequent regulations may be necessary in light of these characteristics. Furthermore, to address the differences in the parties' economic capacity and geography, an annex or separate article could be reserved in which the parties negotiate on how to limit or allow access to certain industries. As the Mexican corn crisis demonstrated, if the treaty had limited foreign investors' ability to enter the Mexican corn industry, Mexico would not have become dependent on corn imports, and the crisis could have been avoided. Likewise, almost every state has an industry upon which it primarily depends, and even with a BIT, the state should be able to exercise its sovereignty in protecting that industry.

With respect to the narrowness, the Model BIT should draw a clear line regarding the definition of expropriation and investment. As already discussed, the term expropriation in Article 6 of the Model BIT is extremely broad. Not only does it use general language, such as "adequate and effective compensation," it also does not define the scope of the "public purpose" or "expropriation."<sup>184</sup> The Model BIT's broad definition of investment must be narrowly tailored as well. In Article 1, the definition section of the document, investment is defined as "every asset that an investor owns or controls, directly or indirectly."<sup>185</sup> Further, Annex B notes that, when determining whether expropriation has occurred, the government's interference with "reasonable investment-backed expectation" shall be considered, meaning that the investor's failure to gain an expected return may constitute an expropriation of the investment.<sup>186</sup> Such a broad definition of investment is dangerous because it could potentially bring additional claims against the host state by foreign investors. Perhaps the ideal tactic

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183. See SORNARAJAH, *supra* note 76, at 207.

184. See 2004 Model BIT, *supra* note 37, at art. 6.

185. *Id.* at art. 1.

186. See *id.* at Annex B.

would be for the parties to negotiate exactly what constitutes an investment, and to limit the scope of the investment to avoid disputes. Meanwhile, the prototype could narrow the scope of the investment by limiting “every asset” to “tangible” or “physical” assets for now, thus eliminating the potential claim for loss of “reasonable investment-backed expectation” or other future-oriented intangible assets.<sup>187</sup>

Finally, with one objective of the U.S. Model BIT being to promote economic cooperation, good governance, rule of law, and transparency around the world, the United States, as a global economy leader, should take some responsibility for looking out for the interests of the counter state party, especially those of developing countries, rather than focusing solely on protecting its investors. It is evident from the Model BIT that it is drafted primarily to protect U.S. investors and their assets abroad. As examined previously, the Model BIT’s strong favor toward U.S. investors is evident in the insistence by developed nations on changing it, while developing nations tend to accept the Model BIT as is. Asymmetrical bargaining power of the treaty will inevitably leave one party with substantially more profit than the other party, and not only will it cause internal conflicts within the developing state, it can also backfire on the foreign investors.<sup>188</sup> Therefore, while guaranteeing that its investors are treated with the standard of “Fair and Equitable Treatment in accordance to customary international law,” as laid out in Article 5,<sup>189</sup> the Model BIT could also be a prototype of a higher quality if it were to consider creating an environment of fair and equitable competition for domestic and foreign investors. Of course, doing so would be a daunting task for the parties to renegotiate how to structure the standard of limiting and allowing access to foreign investors in a particular industry. However, if achieved, it would likely facilitate economic prosperity and foster the continuance of a stable diplomatic relationship.

Even if the Model BIT is to be both open-ended and narrow to better serve its purpose, as demonstrated above, it may still fall short if the developing-state party lacks resource to adequately assess the potential consequences of a BIT and negotiate the meaning and scope of the provisions.<sup>190</sup> Uncertainty surrounding BIT standards can have espe-

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187. *See id.*

188. *See* KULICK, *supra* note 180 (describing Bolivian public protest to expel Bechtel from Bolivia, which led to military suppression in which a teenager was killed and more than a hundred people were wounded).

189. 2004 Model BIT, *supra* note 37, at art. 5.

190. *See* discussion, *supra* Part II B.

cially devastating economic effects for the developing nations that are less well-equipped to mitigate the risks of litigation, perhaps due to a lack of legal authority or counsel that would be able to provide valuable guidance on how a treaty provision has been applied in a similar factual setting.<sup>191</sup> Therefore, as one author has noted, one solution would be for the international community to establish an international legal assistance center to ensure that developing nations not only have affordable access to the legal authority and expertise necessary to prevent potential investor claims,<sup>192</sup> but also to review the draft of a BIT and conduct due diligence, taking into account the various factors that may have been overlooked by the parties. Thus, by creating a legal assistance center, not only will the developing nations be fully informed about the investment treaty, but fairness will also be promoted and lead to a more efficient and effective arbitration process, thereby diminishing the number of claims.<sup>193</sup>

#### B. *Application to Korea-U.S. FTA*

The U.S.-South Korea Free Trade Agreement (KORUS FTA), the second largest U.S. FTA, went into effect on March 15, 2012.<sup>194</sup> While the KORUS FTA has given rise to high expectations of increased economic activity, not surprisingly, the ISDS provision in Chapter 11 of the KORUS FTA has been under consistent scrutiny and debate in Korea, labeled as the “poisonous clause” by the Korean public.<sup>195</sup> The ISDS provision, which has been incorporated into the KORUS FTA along with rest of the 2004 Model BIT, allows a foreign investor to seek redress for damages from alleged breaches by the host government in the ICSID.<sup>196</sup>

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191. Eric Gottwald, *Leveling the Playing Field: Is it Time for a Legal Assistance Center for Developing Nations in Investment Treaty Arbitration?*, 22 AM. U. INT’L. REV. 237, 260 (2007).

192. *Id.* at 265.

193. *Id.*

194. *New Opportunities for U.S. Exporters Under the U.S.-Korea Trade Agreement*, OFF. OF THE U.S. TRADE REP., <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta> (last visited Jan. 11, 2013).

195. See William H. Cooper, CONG. RES. SERV., THE U.S. SOUTH KOREA FREE TRADE AGREEMENT (KORUS FTA): PROVISIONS AND IMPLICATIONS 1 (Mar. 7, 2013), <http://www.fas.org/sgp/crs/row/RL34330.pdf>; See also Hyun-jung Bae, [DUP] ‘The Poisonous Clause Must be Revised’, KOREA HERALD (Nov. 22, 2012), <http://www.koreaherald.com/view.php?ud=20121122000693>.

196. Free Trade Agreement between the Republic of Korea and the United States of America, U.S.-S. Kor., June 30, 2007, *modified*, Dec. 5, 2010, <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> [hereinafter KORUS FTA].

According to some Korean legal scholars, the ISDS provision in the KORUS FTA is a threat that will eventually jeopardize Korea's sovereignty and judicial system.<sup>197</sup> Among many criticisms, a predominant one is that the ISDS provision allows investors to bring claims for the damages they incurred even indirectly, and thus will deter the Korean government from legislating new public policy.<sup>198</sup> Another argument against ISDS is that the Korean Constitution does not require just compensation for governmental expropriation in certain situations, but if foreign investors can nonetheless claim compensation for the Korean government's action, there will be inequality among domestic and foreign investors.<sup>199</sup>

Currently, there is great demand in Korea to renegotiate the terms of the BIT, especially regarding the ISDS provision.<sup>200</sup> As demonstrated by the active protests against the KORUS FTA, leaving the FTA intact with the 2004 Model BIT will only fuel the prevalent hostile sentiment toward foreign capital.<sup>201</sup> Renegotiation, if it occurs, should substantially alter the terms of the Model BIT to serve the needs of both countries. Therefore, the BIT between these two countries should specifically address differences in legal theories, and articulate with clarity what constitutes expropriation in South Korea and in the United States. Thus, for example, because legal theories on the core/periphery rights pertaining to the property can be different, the BIT could instead set the percentage of loss incurred in the investment to provide a substantial deprivation claim. Furthermore, considering the parties' differing legal institutions, a BIT should impel foreign investors to first exhaust local remedies and allow U.S. investors to bring a claim against the Korean government when the investor has been discriminated against. To avoid such discrimination, it is essential to avoid monopolization of certain sectors of the Korean economy, in contrast to Mexico's failure to do so and as foreshadowed by the Lone Star scandal.<sup>202</sup> For the Korean government, it would be difficult to avoid accusations of discrimination if the foreign investor were the only

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197. See Kim, *supra* note 83, at 24.

198. *Id.* at 40.

199. *Id.*

200. Eun-joo Jung, *Supreme Court Recommends Renegotiation of ISD Clause*, HANKYOREH (Apr. 26, 2012), [http://english.hani.co.kr/arti/english\\_edition/e\\_international/530076.html](http://english.hani.co.kr/arti/english_edition/e_international/530076.html) (“[Korean Supreme Court] submitted opinion to the government in 2006 stating that the investor-state dispute system (ISD) in the [KORUS FTA] ‘could give rise to extreme legal chaos.’”).

201. *South Koreans Protest a Free Trade Agreement with US*, PRESS TV (Mar. 15, 2012), <http://www.presstv.com/detail/231785.html>.

202. See discussion *supra* Part II E.

party affected by the regulation. Therefore, considering the respective differences in the size of market and capital, the parties could reach an agreement in setting investment limits to prevent monopolization.

## V. CONCLUSION

The global market is largely perceived today as a single, oversized marketplace subject to an increase in the volume of BITs and a corresponding increase in capital mobility. Robert Ingersoll once said, “commerce is a great civilizer.”<sup>203</sup> With the expansion of the global market, FDI, when it enters the domestic markets of developing nations, can certainly contribute to their development. However, prospective state parties must not forget how the diversity of states and the existence of unique variables can have a significant impact on trade. The U.S. Model BIT is an extremely powerful tool because not only are there many less developed nations looking to sign an investment treaty with the United States, but it is also expected to grow into a more important set of documents that will contribute to the development of international investment law. Therefore, the U.S. Model BIT should not only be a remedial institution for its investors, but it should also be an institution that promotes and strengthens the global investment landscape. The factors described in Section II are only difficult to notice when the primary purpose of the prototype is to protect national interest. The United States is undoubtedly the leading state in the global economy.<sup>204</sup> Thus, it should bear some responsibility in looking after the other countries in the international community rather than solely focusing on protecting the interest of its own investors. Alternatively, developing nations looking to sign a BIT with the United States, or even other wealthy, developed nations, should remember what Thomas Jefferson once said: “The selfish spirit of commerce knows no country, and feels no passion or principle but that of gain.”<sup>205</sup>

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203. *Thoughts on the Business of Life*, FORBES, <http://thoughts.forbes.com/thoughts/business-robert-g-ingersoll-commerce-is-the> (last visited Feb. 4, 2014).

204. *World's Top 100 Economies*, WORLD BANK, (2010), <http://siteresources.worldbank.org/INTUWM/Resources/WorldsTop100Economies.pdf>.

205. *Thoughts on the Business of Life*, FORBES, <http://thoughts.forbes.com/thoughts/selfishness-thomas-jefferson-the-selfish-spirit> (last visited Feb. 4, 2014).