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Incomplete International Investment Law -- Applying the Incomplete Contract Theory

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INCOMPLETE INTERNATIONAL INVESTMENT LAW -APPLYING THE INCOMPLETE CONTRACT THEORY

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I. INTRODUCTION

The Regional Comprehensive Economic Partnership ("RCEP") was signed on November 15, 2020.[1] A perusal of the agreement reveals that its investment chapter appears to have a serious oversight: it is missing investor-state dispute settlement ("ISDS") provisions.[2] The member states agreed on the investment protection clause but failed to agree on ISDS provisions. Instead, they inserted a renegotiation clause to complete these terms after ratifying the treaty. Likewise, the China–Australia Free Trade Agreement ("FTA") lacks several articles addressing investment protection, such as clauses addressing expropriation and the minimum standard of treatment.[3] Although this may impair the ability to attract

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1. Regional Comprehensive Economic Partnership Agreement, Nov. 15, 2020, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/6032/download [hereinafter RCEP.

2. *See id.* at art. 10.18 (discussing renegotiation in the context of investment disputes). Article 10.18: Work Programme

> 1. The Parties shall, without prejudice to their respective positions, enter into discussions on:
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> (a) the settlement of investment disputes between a Party and an investor of another Party; and
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> (b) the application of Article 10.13 (Expropriation) to taxation measures that constitute expropriation,
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> no later than two years after the date of entry into force of this Agreement, the outcomes of which are. subject to agreement by all Parties. The Parties shall conclude the discussions referred to in paragraph 1 within three years from the date of commencement of the discussions.

3. *See, e.g.*, Free Trade Agreement Between the Government of Australia and the Government of the People's Republic of China, Austl.-China, art. 9.9, June 17, 2015, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3454/download.

> 3. Unless the Parties otherwise agree, the Parties shall commence negotiations on a comprehensive Investment Chapter, reflecting outcomes of the review referred to in paragraphs 1 and 2, immediately after such review is completed. The negotiations shall include, but are not limited to, the following:
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> (a) amendments to Articles included in this Chapter;
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> (b) the inclusion of additional Articles in this Chapter, including Articles addressing:

foreign investment, both parties decided not to insert investment protection terms. Instead, they included a renegotiation clause.

The RCEP member states of China and Australia are not the only countries that have failed to complete their international investment agreements ("IIAs"). India and Japan also concluded an incomplete IIA.[4] Further, various Latin American countries[5] and New Zealand similarly concluded incomplete IIAs.[6]

More concerningly, these countries opportunistically postpone renegotiations to complete IIAs. For instance, India and Singapore agreed to renegotiate the reservation list, but the parties are yet to complete their renegotiations despite the fifteen years that have lapsed since the conclusion of the IIA. Likewise, India and Japan agreed to upgrade the terms more than nine years ago, but the parties are yet to fulfill their promises to renegotiate.

This Article employs incomplete contract theory to explain the aforementioned states' behaviors. For instance, the Article examines why countries leave incomplete provisions and postpone renegotiation and how countries discourage other parties' opportunistic postponement.

This study makes two principal contributions to the existing literature. First, it introduces a rather new phenomenon: how states' behaviors are associated with incomplete IIAs. This study develops a typology of incomplete IIAs, explains the reasons for high transaction costs in completing IIAs, and provides a practical remedy to tackle these issues.

Second, the Article addresses how incomplete contract theory could explain the states' behaviors associated with incomplete IIAs. The incomplete IIA issue is a widely known phenomenon among treaty negotiators, but it has garnered little attention in academic literature. Although Alan O. Sykes laid out the foundation of the economic structure

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(i) Minimum Standard of Treatment;
(ii) Expropriation;
(iii) Transfers;
(iv) Performance Requirements;
(v) Senior Management and Board of Directors;
(vi) Investment-specific State to State Dispute Settlement; and
(vii) The application of investment protections and ISDS to services supplied through commercial presence]

4. *See* Comprehensive Economic Partnership Agreement Between Japan and the Republic of India, Japan-India, Feb. 16, 2011 (unpublished), http://www.mofa.go.jp/region/asia-paci/india/epa201102/pdfs/ijcepa_ba_e.pdf.

5. *See, e.g.*, *International Investment Agreements Navigator: Ecuador*, INVESTMENT POLICY HUB (last visited April 20, 2022), https://investmentpolicy.unctad.org/international-investment-agreements/countries/61/ecuador (listing IIAs between Ecuador and other countries).

6. *See, e.g.*, Agreement on the Promotion and Protection of Investments (With Exchange of Notes), China-New Zealand, Nov. 22, 1988, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/764/download.

of IIAs,[7] and Anne van Aaken applied the incomplete contract theory in the field of IIAs, [8] subsequent literature has yet to focus on how incomplete contract theory can shed light on states' behaviors regarding incomplete IIAs.

This Article proceeds as follows: Section II introduces the theoretical background, exploring the literature on applying incomplete contract theory to IIAs and explaining incomplete contract theory. Section III classifies four types of incomplete IIAs, and Section IV applies the incomplete contract theory to the context of incomplete IIAs. Section V concludes.

II. BACKGROUND

A. Literature Review on Applying Incomplete Contract Theory to IIAs

Literature on the economic analysis of IIAs is still in early stages. Previous studies have predominantly focused on the role of IIAs in managing expropriation and regulatory activities.[9] Recently, Sykes laid the foundation of the economic structure of IIAs by arguing that it serves a dual economic function to: (1) discipline the host country policies that impose international externalities on foreign investors and (2) curtail inefficient risks associated with agency costs, risk aversion, asymmetric information, and time-inconsistency issues, which increases the costs of receiving foreign capital to host countries.[10]

Based on these findings by previous studies, van Aaken took the first step in applying incomplete contract theory in the world of IIAs.[11] She argues that a soft term or gap is better than a hard term because hard terms are less open to interpretation and will always be suboptimal after a period of time.[12] Once conditions change, a contract with a hard term will lead

7. Alan O. Sykes, *The Economic Structure of International Investment Agreements with Implications for Treaty Interpretation and Design*, 113 AM. J. INT'L L. 482 (2019).

8. Anne Van Aaken, *International Investment Law Between Commitment and Flexibility: A Contract Theory*, 12 J. INT'L ECON. L. 507 (2009).

9. *See, e.g.*, Henrik Horn & Thomas Tangeräs, *Economics and Politics of International Investment Agreements* (Research Inst. of Indus. Econ.,Working Paper No. 1140, 2017); Emma Aisbett & Jonathan Bonnitcha, *A Pareto-Improving Compensation Rule for Investment Treaties (U. of New S. Wales Law* Research Paper No. 18-80, 2018); Emma Aisbett et al., *Police Powers, Regulatory Takings and the Efficient Compensation of Domestic and Foreign Investors*, 86 *ECON. RECORD* 367 (2010); JONATHAN BONNITCHA ET AL., THE POLITICAL ECONOMY OF THE INVESTMENT TREATY REGIME 127-154 (2017).

10. Sykes, *supra* note 7, at 482.

11. Van Aaken, *supra* note 8, at 507 (arguing that contract theory could be utilized in international investment law in a similar way to how the theory is used in international trade law).

12. *Id.* at 517.

to outcomes that are less desirable than the parties would have agreed upon, had they known of the uncertainties in advance. Thus, van Aaken argues gaps, such as escape or exception clauses, should be inserted to compensate for an unpredictable future.

Wolfgang Alschner observes first-generation investment treaties, usually BITs, are incomplete contracts involving only vague provisions and delegating much of the gap-filling to tribunals, whereas the degree of incompleteness in second-generation IIAs is considerably lower.[13] He argues second-generation investment treaties should assist arbitral gap-filling in first-generation treaties. Likewise, Richard Chen argues that investment tribunals should actively utilize contract theory.[14] For instance, he employs the *least cost avoider approach* to help tribunals fill the gap in the typical IIA to find the contracting states' intent.

In sum, previous studies either explain the economic logic behind states' behavior or provide interpretive tools for tribunals. The literature has not yet described how incomplete contract theory applies to an incomplete IIA. The next Part explains incomplete contract theory in detail.

B. Incomplete Contract Theory

1. Reasons for Incomplete Contracts: High Transaction Costs

Economist R.H. Coase pioneered the transaction costs theory.[15] He argued that any transaction requires different types of costs, such as search or negotiation costs.[16] He further explained that many contracts would not be made if transaction costs were fully and completely considered.[17]

Oliver Williamson subsequently refined the concept of transaction costs,[18] defining it as the costs of negotiating a contract *ex-ante* and monitoring it *ex-post*, as opposed to production costs, which are the costs of enacting the contract.[19] Specifically, *ex-post* costs include the following:

13. Wolfgang Alschner, *Interpreting Investment Treaties as Incomplete Contracts: Lessons from Contract Theory* (July 18, 2013) (unpublished manuscript) (on file at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2241652).

14. Richard C. Chen, *A Contractual Approach to Investor-State Regulatory Disputes*, 40 YALE J. INT'L L. 295, 298 (2015).

15. *See* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

16. R. H. Coase, *The Problem of Social Costs*, 3 J. L. & ECON. 1, 15 (1960).

17. See R. H. Coase, *Notes on the Problems of Social Costs*, *in* THE FIRM, THE MARKET, AND THE LAW 157 (1988).

18. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 15-32 (1985).

19. *Id.* at 21

> (1) the maladaption costs incurred when transactions drift out of alignment . . . (2) the haggling costs incurred if bilateral efforts are made to correct *ex post* misalignments, (3) the setup and running costs associated with the governance structures (often not the courts) to which disputes are referred, and (4) the bonding costs of effecting secure commitments.[20]

Many economists accept this view. Therefore, the concept of transaction costs covers (1) search, (2) bargaining, and (3) enforcement costs.[21] Search costs refer to the costs of finding goods and services, or negotiating partners in the market. A buyer cannot obtain one's preferred goods unless the buyer expends a certain amount of cost to enter the market, search for these goods and services, and find a negotiating partner who sells these goods and services. In addition, bargaining costs refers to the cost of hiring attorneys to negotiate complete agreements with negotiating partners, such as the cost of hiring attorneys to negotiate and draft agreements. Finally, enforcement costs are the costs of ensuring that other negotiating partners comply with the terms of the agreed contracts. Typically, enforcement costs are low when violations of the agreement are easy to observe and punishment is cheap to administer.

Consider the world of zero transaction costs, where both contracting parties enjoy perfect information of the world. In this situation, we can expect a perfect and complete contract in which every contingency is anticipated, and the risks are efficiently assigned because all information is communicated between the parties. Each resource is allocated to the party that values it the most, and each risk is allocated to the party that bears the risk at the lowest cost. The resulting contract will allocate risks and obligations perfectly and efficiently in every state, and the resulting zero bargaining costs make it easier for both contracting parties to agree on terms.

Unfortunately, perfect and complete contracts do not exist because the transaction costs are never zero, and it is impossible for parties to foresee every possible contingency.[22] Contracts also always require the search costs of finding negotiating partners and the bargaining costs to complete the agreements. In reality, a contract is always incomplete because the parties fail to include all the relevant variables.[23]

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20. *Id*.

21. Carl J. Dahlman, *The Problem of Externality*, 22 J. L. & ECON. 141, 148 (1979) (suggesting that transaction costs include: (1) search and information costs; (2) bargaining and decisions costs; and (3) policing and enforcement costs. Dahlman points out that what these three elements have in common is that they all represent resource loss due to lack of information).

22. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 225 (5th ed. 2008).

23. ROBERT E. SCOTT & PAUL B. STEPHAN, THE LIMITS OF LEVIATHAN: CONTRACT THEORY AND THE ENFORCEMENT OF INTERNATIONAL LAW 76 (2006). For incomplete contract theory in legal studies, *see* Richard Craswell, *The "Incomplete Contracts" Literature and Efficient Precautions,* 56 CASE W. RES. L. REV. 151 (2005); See also, Robert E. Scott & George G. Triantis, *Incomplete Contracts and the*

In short, the presence of incompleteness is not necessarily indicative of failure, inefficiency, or error. Rather, leaving gaps (i.e., leaving aspects undecided) and renegotiating later is rational if today's transaction costs are high or tomorrow's are expected to be low.

2. Problems of Incomplete Contracts: Opportunism

Scholars have approached opportunism in different ways. Judge Richard Posner and Professor Victor P. Goldberg regarded opportunism as taking advantage of another party's vulnerability.[24] Williamson defined opportunism as "self-interest-seeking with guile."[25] Professors Goetz, Scott, and Muris linked opportunism as an attempt to redistribute an already allocated contractual pie.[26] For instance, Muris believed that opportunism occurs "when a performing party behaves contrary to the other party's understanding of their contract, but not necessarily contrary to the agreement's explicit terms, leading to a transfer of wealth from the other party to the performer."[27]

Incomplete contracts suffer from opportunism because of their incompleteness and gaps. Gaps encourage contracting parties to engage in opportunistic behavior.[28] In other words, "when a party that has the flexibility to adjust its performance in the future as conditions change, it will always choose the best alternative option for itself, even though the option may not be the best for both negotiating parties."[29]

The following are relevant examples describing opportunistic behavior. Parties use force majeure clauses to protect themselves from natural disasters. But due to high transaction costs, parties may insert vague and incomplete provisions in the force majeure clause without specifically defining the term *natural disaster*. With this gap, either party could later justify its noncompliance by a natural disaster. Warranty provisions are another opportunistic practice. For instance, suppose a seller and buyer agree on a warranty provision that states the seller will use his best effort to fix a specific machine. Both parties may want to leave a gap in the warranty provision because predicting

Theory of Contract Design, 56 CASE W. RES. L. REV. 187, 193 (2005).

24. READINGS IN THE ECONOMICS OF CONTRACT LAW 17 (Victor P. Goldberg ed., 4th ed. 1989).; RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 89 (4th ed. 1992).

25. WILLIAMSON, *supra* note 18, at 47.

26. Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1139 (1981); Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521 (1981).

27. Muris, *supra* note 26, at 521.

28. William J. Aceves, *The Economic Analysis of International Law: Transaction Cost Economics and the Concept of State Practice*, 17 U. PA. J. INT'L ECON. L. 996, 1009 (1996).

29. SCOTT & STEPHAN, *supra* note 23 at 76.

and calculating the nuts and bolts required to fix the machine is costly and practically impossible. Here, if the cost of fixing the machine is high, the seller has an economic incentive not to fix the machine and argue that it did its best to fix it.

3. Solutions to Opportunism: Monitoring Through Comprehensive Contracting and Bonding

Scholars have offered various remedies [30] to mitigate contractual incompleteness and thus reduce opportunism, such as by delegating gap-filling responsibilities to a third party, [31] flexibility mechanisms, [32] relational contracts, [33] and so on. This Part introduces *inter alia* monitoring through comprehensive contracting and bonding to avoid opportunism.

First, parties can seek to minimize the degree of gaps by mimicking the design of a perfectly complete contract. They may engage in complex and comprehensive contracting[34] by approximating, yet never achieving, the ideal complete contract. To do so, the parties can devise mechanisms that encourage them to act in certain ways to reduce gaps. For instance, in our warranty scenario, the parties can insert observable information into the warranty provision, such as a worker's performance outcome instead of their effort, to ensure the seller tries to fix the machine. Alternatively, the

30. Aceves, *supra* note 28 at 1010; SIMON A. B. SCHROPP, TRADE POLICY FLEXIBILITY AND ENFORCEMENT IN THE WORLD TRADE ORGANIZATION 85 (2009).

31. Parties can delegate the task of filling contractual gaps to courts or tribunals. Courts presume that rational parties expect them to engage in gap-filling in a way that the parties would have consented to *ex ante*. This "would have wanted" approach is called the default rule of hypothetical consent. In other words, courts should fill the gap in a way that the Pareto-efficient Complete Contingent Contract (CCC: a contract that contains provisions for all possible contingencies that might arise in the course of the contract's performance) would have prescribed it. This approach is especially useful in the case of accidental incompleteness or ignorance. However, when it comes to situations of foreseeable incompleteness, the parties must provide the courts with detailed direction in the form of entitlement protection rules or default rules. In fact, the "would have wanted" approach has two different types of default rules: tailored and untailored. A "tailored default" seeks to provide contracting parties with "what they would have contracted for." An "untailored default," addresses what the majority of contracting parties would want. *See* Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597 (1990); Goetz & Scott, *supra* note 26.

32. The parties can draft flexibility mechanisms that specify concrete contingency measures that allow non-performance in pre-defined circumstances or that take the form of a general escape clause. Simply put, contractors insert clauses that justify the non-performance of the contract.

33. The parties can execute relational contracts by using preambular language to set out the spirit of the contract, which can serve as a reference point both for good faith performance and tribunals' interpretations.

34. The term "comprehensive contract" was first introduced by Hart, who noted that under a comprehensive contract "there will never be a need for the parties to revise or renegotiate the contract as the future unfolds." Just like the CCC, the comprehensive contract lays out a full plan of action *ex-ante*, specifying all substantive obligations by the parties. *See* OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 22 (1995).

parties could insert a monitoring device[35] to help the buyer check the seller's level of effort regularly. An agreement to assign the buyer a right to check the seller's video surveillance system during the warranty period would safeguard against the seller's ability to lie about its level of effort.

Bonding is another practical remedy to reduce opportunism.[36] The parties may agree to post a bond in their contracts, an option they would forfeit if they failed to abide by the contract's obligations. This solution incentivizes parties to work harder to fulfil their obligations to avoid forfeiting the posted bond. This often appears in employment contracts, where corporations pay for employees' children's schooling, but if employees resign, they must pay the schooling fees back. In this example, the schooling fee is the bond, and employees have a monetary incentive to be loyal to the corporation. Likewise, in our previous warranty example, the parties could agree upon the term that states that the seller can receive AS fees only if they successfully fix the machine. This will encourage the seller to make the best effort to fix the machine because otherwise, they cannot receive the bond—the AS fees.

III. TYPES OF INCOMPLETE IIAS

A. Incomplete Provisions in the Main Text

1. Missing Text

Missing text refers to IIAs with no substantive investment protection articles, which do not commit to any investment protection obligations. The China-Chile FTA is a good example of missing text.[37] Both parties spent years negotiating but failed to conclude any of the investment protection articles, except for a single renegotiation clause stating that, "unless otherwise agreed by the parties," they will negotiate trade in services and investment after the conclusion of the negotiations of the

35. Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 ANN. REV. L & SOC. SCI., 279, 288 (2006).

36. *See generally* PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION & MANAGEMENT (1st ed. 1992).; SE IL PARK ET AL., LAW AND ECONOMICS 186 (2nd ed. 2019) (available in Korean. Written by Se il Park of Seoul National University, the first law and economics professor in Korea and the author's father. For more information, please contact the author directly).

37. Free Trade Agreement Between the Government of the People's Republic of China and the Government of the Republic of Chile, Chile-China, Nov. 18, 2005, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2712/download. The renegotiation in the China-Chile FTA reads as follows: "Article 120 Future Work Program Unless otherwise agreed by the Parties, they will negotiate trade in services and investment after the conclusion of the negotiations of this Agreement." *Id.*

agreement. [38] The Trans-Pacific Strategy Economic Partnership Agreement ("TPSEPA") is another example of missing text. The four parties to the TPSEPA (Brunei, Chile, New Zealand, and Singapore) failed to agree on any provisions and promised to conclude the investment chapter within two years from the date of ratifying the treaty.[39]

Similarly, the China–Singapore FTA is yet another example of an IIA with missing text. The parties failed to include any new investment protection articles, but rather merely incorporated a previously ratified framework agreement. Upon the parties' request, they agreed to consult to further encourage the flow of investment between them.[40]

For the ASEAN–Japan Comprehensive Economic Partnership Agreement, there are no articles, except for Article 51, that deal with the matter, as follows: "Each Party shall endeavour to, in accordance with its laws, regulations and policies, create and maintain favourable and transparent conditions in the Party for investments of investors of the

38. *Id.*

39. Trans-Pacific Strategic Economic Partnership Agreement, art. 20.1, July 18, 2005, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/4845/download [hereinafter TPSEPA]. The renegotiation clause in the TPSEPA reads as follows: "Article 20.1: Investment Negotiations Unless otherwise agreed, no later than 2 years after entry into force of this Agreement the Parties shall commence negotiations with a view to including a chapter on investment in this Agreement on a mutually advantageous basis."

40. Free Trade Agreement Between the Government of the People's Republic of China and the Government of the Republic of Singapore, China-Sing., Oct. 23, 2008, Ministry of Commerce China, http://fta.mofcom.gov.cn/topic/ensingapore.shtml. The renegotiation clause in the China-Singapore FTA reads as follows:

> ARTICLE 84 Investment
>
> 1. Upon the conclusion of the investment agreement between ASEAN and China pursuant to Article 5 of the *Framework Agreement on Comprehensive Economic Co-operation between ASEAN and the People's Republic of China* (the "ASEAN-China Investment Agreement"), the provisions of that agreement shall, *mutatis mutandis*, be incorporated into and form an integral part of this Agreement unless the context otherwise requires.
>
> 2. Recognising that negotiations on the ASEAN-China Investment Agreement are ongoing, the Parties agree to co-operate to facilitate the early conclusion of that agreement.
>
> 3. For greater certainty, any rights, obligations, restrictions or exceptions contained in the ASEAN-China Investment Agreement that do not relate to either Party shall accordingly be inapplicable under this Agreement. Notwithstanding Article 112 (Relation to Other Agreements), in the event of any inconsistency between the ASEAN-China Investment Agreement and this Agreement, the provisions of this Agreement shall prevail.
>
> 4. At any time after the entry into force of this Agreement, upon request by either Party, the Parties shall consult with a view to further encouraging or facilitating the flow of investments between the Parties.

other Parties."[41]

In the China–Georgia FTA, the parties agreed with a single article stating as follows: "The Parties shall further assess and, if necessary, endeavour to conduct negotiations with a view to revising *the Agreement between the Government of the People's Republic of China and the Government of the Republic of Georgia Concerning the Encouragement and Reciprocal Protection of Investments*."[42] Simply put, the parties have agreed to revise the previously ratified and less ambitious treaty if necessary.

2. Missing Articles

Missing articles refer to IIAs that lack important liberalization articles. The recently concluded RCEP failed to include certain necessary articles. For instance, the parties failed to conclude provisions on investor-state dispute settlement procedures and the application of expropriation articles for taxation measures that constitute expropriation.[43] The RCEP members agreed to initiate renegotiation no later than two years after the date of entry into the RCEP Agreement.

In the investment chapter of the Korea–China FTA, the parties agreed to renegotiation on the following provisions: definition, scope and coverage, national treatment, most-favored-nation treatment, minimum standard of treatment, expropriation, transfer, performance requirements, senior management and boards of directors, non-confirming measures, investor-state dispute settlement, as well as other provisions. The parties agreed to initiate renegotiation no later than two years after the ratification date and endeavored to conclude the renegotiation within two years'

41. Agreement on Comprehensive Economic Partnership among Japan and Member States of the Association of Southeast Asian Nations, ASEAN-Japan, Mar. 28, 2008, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2570/download. The renegotiation clause in the Japan-ASEAN Economic Partnership Agreement reads as follows:

> ARTICLE 51 Investment
>
> 1. Each Party shall endeavour to, in accordance with its laws, regulations and policies, create and maintain favourable and transparent conditions in the Party for investments of investors of the other Parties.
>
> 2. The Parties shall, with the participation of Japan and all ASEAN Member States, continue to discuss and negotiate provisions for investment, with a view to improving the efficiency and competitiveness of the investment environment of Japan and ASEAN Member States through progressive liberalisation, promotion, facilitation and protection of investment […]

42. Free Trade Agreement Between the Government of the People's Republic of China and the Government of Georgia, China-Geor., May 13, 2017, Ministry of Commerce China, http://fta.mofcom.gov.cn/georgia/annex/xdzw_en.pdf.

43. *See supra* note 2.

time.[44]

The ASEAN–China–Hong Kong FTA is another relevant example.[45] The parties decided to renegotiate their Schedules of Reservations in Annex I, procedures for the modification of Annex 1, application of Article 10 (Expropriation and compensation) to taxation measures that

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44. Free Trade Agreement Between the Government of the People's Republic of China and the Governmentt of the Republic of Korea, Annex 22A, China-S. Korea Jun. 1, 2015, Ministry of Commerce China, http://fta.mofcom.gov.cn/korea/annex/xdzw_en.pdf. The renegotiation clause in the Korea-China FTA reads as follows:

> Annex 22-A. Guidelines for Subsequent Negotiation
>
> B. Timeframes
>
> 8. The Parties shall commence the subsequent negotiations as soon as possible, but not later than two years following the date of entry into force of this Agreement.
>
> 9. The Parties shall endeavor to conclude the subsequent negotiations within two years from the date of the starting of the negotiations.
>
> D. Guidelines for Negotiations for Investment
>
> 14. The Parties shall revisit all the Articles in Chapter 12 (Investment) with a view to including pre-establishment phase of the investment covering all kinds of investment including supply of services through commercial presence.
>
> 15. The negotiation shall include the Articles addressing Definition, Scope and Coverage, National Treatment, Most-Favored- Nation Treatment, Minimum Standard of Treatment, Expropriation, Transfer, Performance Requirements, Senior Management and Boards of Directors, Non-Confirming Measures, Investor-State Dispute Settlement, and other provisions.
>
> 16. The Parties shall include, in the result of the subsequent negotiations, an Article on Performance Requirement with a view to incorporating high level commitment for both pre-establishment and post-establishment phase of the investment.
>
> 17. The Parties shall negotiate on issues such as relevant consideration for, and exceptions to the indirect expropriation in the subsequent negotiation.

45. Agreement on Investment Among the Governments of the Hong Kong Special Administrative Region of the People's Republic of China and The Member States of the Association of Southeast Asian Nations, art. 22, ASEAN-China, Dec. 11, 2017, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5655/download. The renegotiation clause of the ASEAN-China-Hong Kong agreement reads as follows:

> Article 22 Work Programme
>
> 1. The Parties shall enter into discussions on:
>
> (a) Annex 1 (Schedules of Reservations);
>
> (b) procedures for the modification of Annex 1 (Schedules of Reservations);
>
> (c) the application of Article 10 (Expropriation and Compensation) to taxation measures that constitute expropriation;
>
> (d) the definition of "natural person of a Party"; and
>
> (e) Article 20 (Settlement of Investment Disputes between a Party and an Investor).
>
> […]

constitute expropriation, definition of *natural person of a party*, and Article 20 (Settlement of investment disputes between a party and an investor). The parties agreed to complete the renegotiation within a year of ratifying the treaty.

B. Incomplete Provisions in a Reservation List[46]

1. Missing Reservation List

A missing reservation list refers to a situation in which the parties conclude the IIAs without a reservation list.

The ASEAN–Australia–New Zealand FTA exemplifies this. Here, the parties failed to conclude reservation lists and decided to conclude the lists within five years from the date of entry into force of their agreement, unless otherwise agreed. These discussions will be overseen by the Investment Committee, which is established pursuant to Article 17 (Committee on Investment) of the Investment Chapter of the ASEAN–Australia–New Zealand FTA. Interestingly, the parties agreed that national treatment shall not apply until their reservation schedules to this chapter have become effective.[47]

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46. As noted, a list of non-conforming measures under the negative list approach is called the reservation list. This dissertation focuses on the reservation list under the negative list approach since the list requires the insertion of domestic measures, whereas the positive list approach has no such requirements.

47. Agreement Establishing the ASEAN-Australia- New Zealand Free Trade Area, art. 16, Feb. 27, 2009, [2010], UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2589/download. The renegotiation clause in the ASEAN-Australia-New Zealand FTA reads as follows:

> Article 16 Work Programme
>
> 1. The Parties shall enter into discussions on:
>
> (a) schedules of reservations to this Chapter; and (b) treatment of investment in services which does not qualify as commercial presence in Chapter 8 (Trade in Services).
>
> 2. The Parties shall also enter into discussions with a view to agreeing on:
>
> (a) the application of most-favoured-nation treatment to this Chapter, including to those schedules of reservations; and (b) procedures for the modification of schedules of reservations.
>
> 3. The Parties shall conclude the discussions referred to in Paragraphs 1 and 2 within five years from the date of entry into force of this Agreement unless the Parties otherwise agree. These discussions shall be overseen by the Investment Committee established pursuant to Article 17 (Committee on Investment).

In the ASEAN–India Comprehensive Economic Cooperation Agreement ("CECA"), the parties agreed to enter into discussions to draft a reservation list and lay out procedures for its modification, indicating that it must be completed within three years from the date of ratification.[48]

Parties in Korea and Vietnam also failed to conclude reservation lists. They agreed to begin renegotiation immediately after the ratification of the treaty and complete renegotiation within one year from the ratification of the treaty.[49]

> 4. Schedules of reservations to this Chapter referred to in Paragraph 1 shall enter into force on a date agreed to by the Parties.
>
> 5. Notwithstanding anything to the contrary in this Chapter, Article 4 (National Treatment) and Article 12 (Reservations) shall not apply until the Parties' schedules of reservations to this Chapter have entered into force in accordance with Paragraph 4.

48. Agreement on Investment under the Framework Agreement on Comprehensive Economic Cooperation between the Association of Southeast Asian Nations and the Republic of India, art. 6, ASEAN-India, Nov. 12, 2014, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3337/download. The renegotiation clause in the Investment Chapter of the CECA reads as follows:

> Article 6 Work Programme
> 1. The Parties shall enter into discussions on:
> (a) Schedules of Reservations to this Agreement; and
> (b) Procedures for the modification of Schedules of Reservations.
>
> 2. The Parties shall conclude the discussions referred to in paragraph 1 of this Article, within three (3) years from the date of entry into force of this Agreement unless the Parties otherwise agree. These discussions shall be overseen by the Joint Committee on Investment established under Article 23 (Joint Committee on Investment).
>
> 3. Schedules of Reservations referred to in paragraph 1 of this Article shall enter into force on a date agreed to by the Parties.

49. Free Trade Agreement between the Government of the Republic of Korea and the Government of the Socialist Republic of Vietnam, art. 9.12, S. Korea-Vietnam, May 5, 2015, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3582/download. The renegotiation clause in the Korea-Vietnam FTA reads as follows:

> Art 9.12 : Non-conforming measures.
>
> 5. The Parties shall begin negotiations on Annexes I and II immediately after the entry into force of this Agreement with a view to concluding them within one year from the date of entry into force of this Agreement:
>
> 1. (a) Articles 9.3, 9.4, 9.9, and 9.10 shall not apply until Annexes I and II have entered into force; and
>
> 2. (b) The Parties shall make best endeavor to reflect the most advanced level of liberalization commitments in the Schedules of their agreements on investment at the time of the negotiations to ensure the overall balance of benefits of the Parties.

2. Missing or Unspecified Measures

IIAs with missing measures arise when parties omit specific information on domestic measures from the reservation list. For example, in the Japan and India FTA, the parties failed to specify domestic laws in the reservation list.[50] The measurement section of the reservation list merely indicates "any existing or current regulations or measures."

The Singapore and New Zealand Closer Economic Partnership (CEP) is another example.[51] Singapore carved out its policy space in the printing and publishing, manufacturing and repair of transport equipment, and power and energy sectors, but failed to identify domestic laws.

Likewise, in the TPP, in carving out marine capture fisheries, Malaysia only mentioned the "Fisheries Act 1985 [Act 317]" without specifying any sections or articles thereof. Failure to specify sections and articles of the Act allows readers to interpret the Fisheries Act in its entirety as being carved out of the IIA.

These types of unspecified measures in a reservation list may cause

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50. The missing measures in the reservation list in the Japan-India EPA reads as follows:

Sector All Sector	
Sub-Sector	National (Article 85) Most-Favored Nation treatment (Article 86) Prohibition of Performance Requirements (Article 89)
Description	Any existing measures framed by the State Governments/ Union territories/local governments are not subject to either National Treatment, Most-Favored nation Treatment or Prohibition of Performance Requirement obligation.
Reservation Measure	Any existing or current regulations or measures in force on the date of entry of this Agreement

51. Agreement Between New Zealand and Singapore on a Closer Economic Partnership, Annex 3.2, N.Z.-Sing., Nov. 14, 2000, NEW ZEALAND FOREIGN AFFAIRS & TRADE, https://www.treaties.mfat.govt.nz/search/details/t/2340. The renegotiation clause in the New Zealand-Singapore CEP reads as follows:

Sector:	Printing &Publishing Manufacture & Repair of Transport. Equipment Power/Energy
Types of Limitation:	National treatment (Article 29)
Legal Citation:	
Description:	More favourable treatment may be accorded to Singapore nationals and permanent residents in the above sectors.

blurred boundaries between states' investment protection and regulatory power. For instance, in India's reservation list in its Economic Partnership Agreement ("EPA") with Japan, it carved out regulations for the cigarette and tobacco industry. However, the domestic legislation has not yet been specified. Unfortunately, India's Industries Act of 1951 contains a variety of regulations for several industries.[52] The cigarette and tobacco industry is merely one of the thirty-eight industries listed in the schedule, including the chemical, drug, food, commercial goods, and electronics industries.[53] The failure to specify articles in the Act would allow a reader of the reservation list to interpret the Industries Act in its entirety as being carved out of the IIA.

Thus far, this Article has classified four types of incomplete IIAs. The next Section applies incomplete contract theory to incomplete IIAs.

IV. APPLYING THE INCOMPLETE CONTRACT THEORY TO INCOMPLETE IIAS

A. Reasons for Incomplete IIAs: High Transaction Costs

As mentioned above, the presence of incomplete IIAs is not necessarily indicative of failure, inefficiency, or error. There is no complete IIA because the parties cannot foresee every possible scenario that will arise between investors and host countries. Rather, as previously explained, leaving things undecided and renegotiating later is rational if today's transaction costs are high or tomorrow's are expected to be low.

What factors increase the transaction costs of completing IIAs? The first is the preference for protectionism; gradual or limited liberalization increases the transaction costs of completing IIAs. Following the failure of Washington Consensus policies (i.e., policies that focused primarily on privatization and liberalization), many host developing nations learned that market-oriented rules and regulations function only if their institutional capacities allow. In particular, they realized that establishing *appropriate* economic and legal policies (i.e., policies that reflect the local environment and sociopolitical culture) were critical to the success of further economic development.[54] Thus, instead of rapid market openings, Asian host developing countries are currently reforming their domestic

52. The Industries (Development and Regulation) Act, 1951, ch. 3 (India), https://legislative.gov.in/sites/default/files/A1951-65.pdf. The Industries Act has several regulations that include specific ones addressing direct management, liquidation, supply, and distribution.

53. *Id.* The scheduled list is attached in the last part of the text of the Act.

54. *See* David Trubek, *Law and Development 50 Years On* (U. of Wisc. Legal Studies Research Paper, No. 1212, 2012); THE NEW LAW AND ECONOMIC DEVELOPMENT: A CRITICAL APPRAISAL (David M. Trubek & Alvaro Santos eds., 2006) (classifying law and development scholars into two groups: those who see law as an instrument of promoting development (law in development) and those who see law as an end in itself and thus, pursue development reforms (law as development)).

laws to match their local contexts for gradual liberalization.

When a government reforms its rules and regulations, line ministries and the team charged with negotiating the IIA have difficulty gathering data and pinpointing the laws that interact with the IIAs. Thus, they face difficulties in determining the laws that should be included in the reservation list, so that the IIA will not require further domestic changes.

Second, limited coordination and cooperation between the negotiation team and line ministries is another problem that increases transaction costs when completing IIAs. These involve simultaneous negotiations at both the international (i.e., government) and intra-national (i.e., domestic entity) levels.[55] The negotiation team is responsible for gathering requests and information from various entities, including line ministries, legislative bodies, and public citizens, to draft an IIA that satisfies all participating entities. Once the list is ready, the team attempts to persuade negotiating partners as to why the list should be carved out in the IIA. If the negotiating partner decides not to accept the list, then the negotiation team returns to the domestic consultation phase.

The cost increases when line ministries do not immediately respond to requests from the negotiation team.[56] Suppose the negotiation team requests that the Ministry of Land review the draft of an IIA and send them a reservation list regarding land measures. The Ministry of Land frequently postpones such feedback, delaying the negotiation process. Even if the negotiation team requires an urgent response in the middle of the negotiation phase, the Ministry may fail to provide an immediate response. Sometimes, ministries simply respond by stating that they agree with the reservation list stipulated in the previously concluded IIA. It then becomes the negotiation team's job to look up the reservation list of the previously concluded IIA and simply copy and paste it. Unfortunately, this may be inadequate because domestic measures from the previous IIA may have been updated or revised.

Line ministries are uncooperative because sending feedback on the IIA is not their primary responsibility. Each line ministry has its own prioritized tasks, and cooperation with the negotiation team is not its first priority. For instance, the Ministry of Land's primary function is to examine the domestic land market and draft appropriate policy solutions in response. Its main duty is not to modify a sentence or add another reservation to the reservation list of an IIA during negotiations. This duty

55. Robert D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 INT'L ORG. 427 (1988).

56. For more information on the necessity of managing a ministry's network, see R. Agranoff & M. Mcguire, *Managing Network Settings*, 16 POL. STUD. REV. 18 (1999)*;* DAVID L. BROWN, MANAGING CONFLICT AT ORGANIZATIONAL INTERFACES (1983). For more information on reasons for the lack of cooperation among ministries, see J. A. Weiss, *Pathways to Cooperation among Public Agencies*, 7 J. POL. ANAL. & MGMT. 94 (1987).

to draft the best reservation list is, in fact, a priority and interest of the negotiation team housed under the Ministry of Trade or Foreign Affairs and not the Ministry of Land or other ministries.

So far, this study has reviewed political, economic, and institutional reasons for the increased costs of completing a reservation list. It is important to note that the above reasons are related to asymmetric information problems between parties, which further increase transaction costs. For instance, completing the main text or reservation list requires information to review the coordination between domestic markets and ministries, which is only available to a country that aims for a carve-out. The negotiating partner often has little to no information regarding the necessity of the carve-out and related measures, which impedes the parties from completing an IIA. Suppose countries A and B are negotiating a reservation list, and A wants to carve out its land measure. To do this, country A must review its domestic markets and pinpoint a carved out domestic measure. However, if A faces a difficulty when trying to complete the reservation list (e.g., due to ongoing reforms or coordination problems among ministries), then B cannot do anything except wait until A solves its own problems and is ready with its domestic land measure. Reviewing domestic markets and preparing a domestic law with line ministries are all within the boundaries of A's private and undisclosed information, and there is nothing that B can do to accelerate and complete the IIA.

In sum, parties face various political, economic, and institutional hurdles that increase transaction costs, and asymmetrical information between parties further aggravates this problem.

B. The Problems Associated with Incomplete IIAs: Opportunism

Because of the aforementioned transaction costs, the parties leave gaps in IIAs, which encourages opportunism for the postponement of renegotiations. This Section explains the opportunistic behaviors of the parties involved, as pointed out in the four incomplete IIAs mentioned in Section II.

1. Missing Text

The *missing text* is an IIA without substantive articles. The main text merely includes a single renegotiation article containing a promise to renegotiate. This missing text allows host nations to opportunistically maintain previously concluded treaties to avoid further investment liberalization. Preserving the legal effect of previously concluded BITs is often an attractive option for many host nations, especially when they are

not ready for further liberalization. These host countries frequently initiate negotiations for various political reasons and outside pressures for liberalization and globalization, but their local markets may feel an extreme burden to receive further foreign investments. In such a case, host nations have an incentive to postpone renegotiation and stick to the previously concluded one, with less liberalization effect. In fact, many host nations that already concluded several BITs in the 1950s through the 1980s have recently signed bilateral or multilateral agreements to upgrade the previous ones. Such postponements of renegotiations allow host nations to enjoy the pre-committed level of liberalization and secure their policy spaces on a pre-existing level.

2. Missing Articles

Missing articles, which occur when host nations conclude only on certain articles, also give rise to opportunistic behaviors by host nations. First, as with the missing text scenario, host nations would have the option to retain articles of a previously concluded IIA. They could opportunistically retain such articles and postpone further liberalization by enjoying greater policy space. Suppose a nation fails to conclude an expropriation article and decides to renegotiate. They then have the option to renegotiate or retain the expropriation article of the previously concluded IIA by postponing the renegotiation. If the previously concluded IIA has an expropriation clause with some policies carved out, it provides a greater incentive to the host nations to postpone the renegotiation of such an article, unless they believe that they could successfully carve out such a policy again in the current negotiation.

The ISDS presents another issue for which host nations might want to postpone renegotiation. The Korea–ASEAN FTA and the recently concluded RCEP have decided to renegotiate ISDS provisions. In fact, host nations lack sufficient knowledge and background in ISDS provisions and have little experience in managing ISDS proceedings.[57] Handling ISDS is burdensome for many host nations because they lack legal expertise in handling billion-dollar claims. They appear to prefer the simplified version of the ISDS provisions (from the previously concluded BITs) and seem to wait until they face the first few investor-state disputes. Handling these disputes will allow them to gather legal expertise in ISD proceedings and develop preferred forms of ISDS provisions.

57. *See* Lauge N. Skovgaard Poulson, *Bounded Rationality and the Diffusion of Modern Investment Treaties*, 58 INT'L STUD. Q. 1, 12 (2014).

3. Missing or Unspecified Measures

Missing or unspecified measures may encourage parties to enjoy a broad carve-out arising from unspecified domestic laws. For instance, in India's reservation list in its EPA with Japan, India may opportunistically enjoy a broad carve-out from unspecified domestic measures. India carved out regulations for the cigarette and tobacco industry, but the domestic law was not stated as the "Industries Act of 1951 in India," which contains a variety of regulations[58] for several industries. As discussed earlier, the cigarette and tobacco industry was merely one of the thirty-eight industries listed in the schedule; others included the chemical, drug, food, commercial goods, and electronics industries.[59] The failure to specify articles in the Act would allow a reader of the reservation list to interpret the Industries Act in its entirety as being carved out of the IIA. This broad carve-out may benefit India to some extent because it allows India to maintain its rights over protective measures. The benefit depends on the degree to which India requires strong protectionism within the thirty-eight industries listed in the schedule. Industries may still require discriminatory subsidies from the government to remain competitive within the international market.

4. Missing Reservation List

The problem of missing reservation lists occurs when the parties decide to include the main text without any reservation lists. This problem gives the parties an incentive to postpone the legal enforceability of treaties. In the New Zealand–Malaysia FTA,[60]for instance, both parties agreed that NT, MFN, and non-conforming measures would not apply until the parties' schedule of non-conforming measures were entered into force. In other words, even if the main text was concluded and ratified, important investment protection clauses, such as NT or MFN, would not be legally

58. The Industries (Development and Regulation) Act, 1951, ch. 3 (India), https://legislative.gov.in/sites/default/files/A1951-65.pdf.

59. *Id.*

60. Free Trade Agreement between the Government of New Zealand and the Government of Malaysia, N.Z. – Malay., Oct. 26, 2009, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2583/download. The renegotiation clause in the Malaysia-New Zealand FTA reads as follows:

> Article 10.17 Work Programme
>
> 1. The Parties shall enter into negotiations on Schedules of non-conforming measures within three months of entry into force of this Agreement, unless the Parties otherwise agree.
> […]

enforceable until the parties conclude the renegotiation of the reservation list.

In fact, this may encourage the parties to opportunistically postpone or defer the conclusion of renegotiation to maintain previously ratified BITs with less liberalization. Pre-existing BITs are due until both parties complete the reservation list renegotiation and ratification. This is another incentive for parties to drag down the renegotiation process and create a preparatory environment to accept an MFN or NT with a higher degree of liberalization. In other words, if either New Zealand or Malaysia believes that the MFN or NT is not yet ready, they have an incentive not to conclude the renegotiation of the reservation list. Neither party has an obligation to maintain the NT or MFN protection against incoming foreign investors until they complete the renegotiation of the reservation list.

C. Aggravating Opportunism: A Less Comprehensive Renegotiation Clause

A less comprehensive renegotiation clause can aggravate opportunism issues, as stated above. A renegotiation clause without a tight renegotiation schedule and term that requires strong legal obligations encourages parties to delay the renegotiation process. For instance, the investment chapter in the CECA between India and Singapore includes a renegotiation clause aimed at fixing the gaps in the reservation list. However, the parties have yet to complete their renegotiations, although more than fifteen years have lapsed. The CECA simply states that a party "may" request the other to review the reservation list and reduce the gaps, without using the term "shall," to impose a strong obligation or put a renegotiation timeline to the process.[61] Similarly, India signed an EPA

61. Comprehensive Economic Cooperation Agreement Between India and Singapore, art. 6, India – Sing., Jun. 29, 2005, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2707/download. The Renegotiation clause in the CECA reads as follows:

> ARTICLE 6.17: REVIEW OF COMMITMENTS AND EXCEPTIONS
>
> 1. If, after this Agreement enters into force, a Party enters into any agreement on investment with a non-Party, it shall give consideration to a request by the other Party for the incorporation herein of treatment no less favourable than that provided under the aforesaid agreement. Any such incorporation should maintain the overall balance of commitments undertaken by each Party under this Agreement.
>
> 2. As part of the reviews of this Agreement pursuant to Article 16.3:
>
> (a) India undertakes to review its Schedule of Specific Commitment as set out in Annex 6A with a view to increasing its list of committed sectors and reducing the terms, limitations, conditions and qualifications on national treatment with regard to the establishment, acquisition or expansion of investments; and
>
> (b) Singapore undertakes to review the status of the exceptions set out in its Schedule in Annex 6B

with Japan in 2011, and for the past nine years, it has not updated its IIA reservation list with Japan. The EPA merely imposes that each party "shall endeavor" to reduce gaps in the reservation list, without any strong legal obligations or renegotiation schedules.[62]

Due to these less comprehensive renegotiation clauses, India may behave like the seller in our warranty scenario. The seller promised a warranty provision where it would do its utmost to fix a specific machine, but if the cost of fixing the machine actually arose, it had an incentive not to fix the machine and instead, claim it did its best to fix the machine. Likewise, India could argue that it did its best to fulfill the term "shall endeavor" to fix the machine but never actually fix it. This is consistent with a statement by India's negotiators in the RCEP negotiations. They stated that they were trying their best to complete their reservation list in the previously concluded FTAs but were not ready due to ongoing legal reforms. They concluded that IIAs maintain their reputation and signal to the international community that they are moving toward liberalization. However, in reality, they still face legal reform issues and thus are unable to complete the reservation list. In other words, India argued that it satisfied its obligation to fix the reservation list because the text only requires that it "shall endeavor," even if it could not fix it, and the transaction costs were still high, even at the renegotiation phase. In sum, India's high transaction costs due to ongoing legal reforms impeded the country from sorting out its domestic law and completing its reservation list, encouraging it to opportunistically postpone its renegotiation based on a less stringent renegotiation clause.

with a view to reducing the exceptions or removing them.

3. In any other case, a Party may, upon reasonable notice, request the other Party for a review of its commitments/exceptions:

(a) In the case of India as set out in Annex 6A - its list of committed sectors and reducing the terms, limitations, conditions and qualifications on national treatment with regard to the establishment, acquisition or expansion of investments; or

(b) In the case of Singapore as set out in Annex 6B – its exceptions with a view to reducing or removing them.

Any review pursuant to such a request should maintain the overall balance of commitments undertaken by each Party under this Agreement.

62. Economic Partnership Agreement between Japan and India, art. 9, Japan – India, Feb. 16, 2011, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2627/download. A Renegotiation clause in the India-Japan EPA reads as follows

Article 90. Reservations and Exceptions

5. Each party shall endeavor, where appropriate, to reduce or eliminate the exceptions specified in its schedules in Annexes 8 or 9 respectively.

D. Solutions to Opportunism in Incomplete IIAs: Monitoring Through Implementation Committee by A Comprehensive Renegotiation Clause and Bonding

Comprehensive contracting is not a perfect remedy, but it may encourage parties to actively participate in renegotiation to remove gaps. The comprehensive renegotiation clause could strongly impose a need for the parties to reduce the gaps by using the term "shall" and inserting a tight renegotiation timeline. Moreover, the parties can establish a monitoring device, such as a Committee on Investment or Implementing Committee, to encourage them to avoid or opportunistically delay the renegotiation. For example, the AANZFTA's five-year term for the conclusion of renegotiations binds the parties to complete the reservation list within five years from the date of ratification of the treaty. [63] Without a phrase like "shall endeavor" in the renegotiation clause, the parties cannot argue that they made their best efforts to complete the treaty but failed to do so. The term "shall" imposes a strong obligation on the parties to complete the renegotiation.

Most importantly, the parties to the renegotiation are overseen by the Investment Committee, established pursuant to Article 17 and known as The Committee on Investment; hence, the parties annually meet and discuss their progress toward removing gaps. The main purpose of the Investment or Implementing Committee is not to renegotiate, but to review the ratified treaty's implementation. These Committees are held annually to review the implementation of previously agreed and ratified treaties. However, if the parties innovatively link these Committees with the renegotiation clause, they would then have an obligation to annually review and monitor the renegotiation, in addition to their original task of reviewing the implementation of the treaty. In fact, many renegotiation clauses in IIAs fail to link those with Investment or Implementing Committees; therefore, the investment chapter's working group individually renegotiates the IIAs according to their own schedules, which is prone to procrastination. In this regard, linking committees with the renegotiation is an apt method of monitoring the renegotiation process and avoiding any postponement in negotiation.

The Korea–ASEAN FTA is another example of a comprehensive renegotiation clause using the term "shall" and linking it to the Implementing Committee.[64] It sets a five-year timeline to complete the

63. *See supra* note 47 and accompanying text.

64. The ASEAN – Republic of Korea Investment Agreement, art. 27, ASEAN-S. Korea, Jun. 6, 2009, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/3339/download. The renegotiation clause in the Korea-ASEAN Investment Agreement reads as follows:

renegotiation and establishes a working group on investments under a joint committee. Renegotiation should be completed within five years of its commencement. The parties used the terms "shall enter" to complete their IIA, and the renegotiation was overseen by the implementing committee established under Article 5.3 of the Framework Agreement.

However, these comprehensive clauses are effective only when they outweigh the transaction costs of inserting the clause. The parties' internal status regarding ongoing legal reforms or institutional capacities can affect the expected consequences of a comprehensive renegotiation clause. India would still want to use "shall endeavor" to avoid strict deadlines and maintain protectionism and gradual liberalization. [65] Comprehensive renegotiation clauses may result in significant costs if the nation's domestic markets are not ready to receive foreign investment.

Similarly, a failure in intra-governmental coordination may affect the expected costs of inserting a comprehensive clause. If developing nations, such as India or many ASEAN members, require an extended duration of time (i.e., several years) to analyze their domestic law before they can send feedback to the negotiation team, the negotiation team would prefer the renegotiation clause to contain the words "shall endeavor," to avoid any strict commitments. In sum, a comprehensive clause encourages parties to reduce gaps, but the clause is economically justified only when the benefits outweigh the costs of applying it.

Bonding is another device that discourages parties from engaging in opportunism. Parties may agree to post a bond that they can forfeit if either party does not abide by the contract's terms. When applying this logic to our context, the parties could promise not to apply a pre-agreed

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Article 27(Work Programme)

1. The Parties shall enter into discussions on:
   (a) Article 4 (Most-Favoured-Nation Treatment);
   (b) TRIMs-plus elements to Article 6 (Performance Requirements);
   (c) Schedules of Reservations to this Agreement;
   (d) Procedures for modification of Schedules of Reservations that will apply at the date of entry into force of the Schedules of Reservations to this Agreement;
   (e) Annex on Expropriation and Compensation;
   (f) Annex on Taxation and Expropriation; and
   (g) Article 18 (Investment Dispute Settlement between a Party and an Investor of any other Party).
2. The Parties shall conclude the discussions referred to in paragraph 1, within five years from the date of
   entry into force of this Agreement unless the Parties otherwise agree. These discussions shall be. overseen by the Implementing Committee established under Article 5.3 of the Framework Agreement.

65. The author of this article personally participated in the RCEP negotiation and India has been arguing for this in the negotiation process. According to India's negotiator in the RCEP, they placed a partial commitment clause in their IIAs because they still feel that they are not ready to commit to higher liberalization just to complete all the terms in the treaty.

investment protection clause, such as MFN or NT, until they reduce gaps in their reservation list. Simply put, one party could forfeit its pre-consensus articles if the other party did not reduce the gaps. In the Hong Kong–ASEAN FTA,[66] the parties decided that the MFN and NT obligations would not apply until they completed their reservation lists. AANZFTA contains a similar renegotiation clause.[67] The parties agreed to delay the NT provision's application until after the reservation list was completed. These triggering provisions could pressurize ASEAN to complete a reservation list. Likewise, the Korea–Vietnam FTA agreed that MFT, NT, performance requirements, senior management, and boards of directors do not apply until Vietnam completed their reservation lists.[68]

This bonding mechanism is a powerful tool to pressurize parties because delayed renegotiations lead to delayed liberalization and market opening. The major purpose of concluding an IIA is to attract foreign investment. Such a delay is expensive for all parties concerned. Although this is an empirical issue, the expected amount of foreign direct investment inflow will be disrupted to a certain extent during the renegotiation process. Domestic participants (e.g., stakeholders, media, legislative bodies) who support market opening may criticize the slow renegotiation process. A delay also puts pressure on line ministries because those responsible for the completion of the reservation list block market openings across all economic sectors. The negotiation team can leverage this to motivate the respective line ministries to expedite the process.

V. CONCLUSION

This Article has applied incomplete contract theory to explain causes, problems, and solutions of incomplete IIAs. It emphasizes that the analysis can be extended to an FTA or other multilateral trade agreements that contain chapters on goods, intellectual property rights, labor, the environment, government procurements, investment, and services such as financial, telecommunication, and electronic commerce services. For instance, ASEAN countries and Japan commenced a Comprehensive Economic Partnership Agreement in April 2005, and after 11 rounds of negotiations, they failed to include any article; instead, they included one renegotiation clause in their trade-in-services chapter.[69] In fact, each

66. *See supra* note 45 and accompanying text.

67. *See supra* note 47 and accompanying text.

68. *See supra* note 49 and accompanying text.

69. Comprehensive Economic Partnership Agreement Between Japan and the Republic of India, Japan-India, Feb. 16, 2011 (unpublished), http://www.mofa.go.jp/region/asia-paci/india/epa201102/pdfs/

chapter of an FTA or other agreement has incomplete or defective parts that should have been specified in the negotiation phase but were not. All such parts can be subjected to the analysis that we conducted in this study.

The incomplete treaty problem is a widely known phenomenon among many treaty negotiators but has garnered little attention in academic literature. Applying a legal and economic approach to these incomplete treaties may result in valuable findings for practitioners and researchers in academia.

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ijcepa_ba_e.pdf. The renegotiation provision in the ASEAN-Japan CEPA reads as follows:

> Article 50 Trade in Services
>
> 1. […]
> 2. The Parties shall, with the participation of Japan and all ASEAN Member States, continue to discuss and negotiate provisions for trade in services with a view to exploring measures towards further liberalisation and facilitation of trade in services among Japan and ASEAN Member States and to enhance cooperation in order to improve the efficiency and competitiveness of services and service suppliers of Japan and the ASEAN Member States. […].