

# Fair and Equitable Treatment: An Evolving Standard

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## I. Introduction

As a result of globalization, states have realized that the attraction of foreign investment into their territories is a decisive element in their economic growth. States alone are not capable of generating sufficient economic activity to sustain a steady growth in their economy. This is true mainly among developing countries or capital-importing countries.

There is a concern among states as to the method of stimulating these investment flows into their countries. On the other hand, the in-

vestor's decision to make an investment depends on a secure and stable environment in the host state. On this basis, states have agreed upon a set of basic standards for the purpose of granting the investor the security he expects and assuring its continuance over time.

Some classical standards such as National Treatment or Non-Discrimination have become insufficient. The reason for this is based on the concern of investors that because those standards are contingent in nature, the protection granted to them may not reach their basic expectations since the treatment provided by the state to its own nationals – which is the basis of the latter standards – is deficient. Thus, although treated in a non-discriminatory way in relation to the host state's nationals, that treatment violates basic rights that are considered essential for an investment to develop effectively. The latter protection is not, therefore, a concern of capital-importing countries only, but also capital-exporting countries that desire to protect their investors worldwide.

In order to grant non-contingent protection to the foreign investor, states have, since the 1960's, agreed on bilateral initiatives to assure this protection. Bilateral investment agreements began to be signed by many states, constituting a worldwide network of investment agreements. These agreements established a set of standards to grant the foreign investor a safety net for his investment as well as a dispute settlement system that allows for any of the parties or their national investors to have access, in the majority of cases, to choose either the ICSID Tribunal or the UNCITRAL arbitration rules.

Other standards of protection are the Most-Favored Nation, No Expropriation without due Compensation and Fair and Equitable Treatment; this last one constituting the object of the present thesis.

The Fair and Equitable Treatment standard has become the centre of discussion in various forums, and most of all among arbitrators who have applied it. It constitutes one of the most important elements available to a foreign investor to protect his investment in a foreign country, because it provides him with a certain treatment that the host state must grant regardless of the treatment given to its own nationals.

While the standard is applied by arbitrators, the discussion regarding the true meaning of the standard has become a main focus in international investment law. Although most investment agreements grant this standard, they do not provide an indication as to what its exact meaning is and what the criterion is by which it must be applied.

Developed countries have become concerned about the real effect this protection will have on their nationals that invest in capital-

importing countries. Their worry is based on the fact that the standard has been given many different interpretations in arbitral cases (more prolifically within the scope of Nafta), which is acknowledged in many studies, such as the OECD's. However, this is not good news, considering that instead of promoting stability and certainty among investors, this situation produces exactly the opposite effect.

There have been, however, some initiatives from states to define the meaning of the standard through an interpretation of the agreements they have signed. Such is the case concerning Nafta, where the Free Trade Commission issued an interpretation equating the standard to the minimum standard of customary international law. Although an important initiative, it did not contribute to clarify the meaning of the standard as it will be analyzed below and, moreover, it lowered the protection granted to the investor.

In consideration of the importance of the latter dilemma and its repercussions on investment theory and practice, the present thesis aims to review the main discussion in regard to the meaning of the standard and its consequences on investment practice, proposing a conclusion that will contribute to interpreting the exact meaning that the standard has in international investment law at present.

## **II. Historical Overview. The Birth of a Non-Contingent Standard**

The most debated and analyzed issue regarding the Fair and Equitable Treatment standard is the one relating to its meaning. The evolution of the manner in which judges, arbitrators and scholars have addressed this standard is the decisive matter that will occupy us. However, and as an important feature that may even serve as an element of interpretation in the analysis of the latter, we must deal with the environment and atmosphere in which the standard was first considered to become a part of investment agreements and its historical evolution to this date.

As will be explained, the natural background that investors face in relation to the protection granted to their investments depended exclusively on the host state's attitude towards investors. The state has the sovereignty to decide the treatment to be granted to all investors in its territory, including alien-owned investments. However, commercial relationships between states have been accentuated, due to the increasing advance of globalization. States have understood that their economies

receive a great deal of benefit from trading with other states as well as investment flows in their own territories.

There was an acknowledgment by states that investment was beneficial to their economies and, therefore, investment should be stimulated. That is the moment in which international law begins to play a greater role. To stimulate investment in their territories, states realized that they must grant the foreign investor the same, and even greater protection, than that which is granted to their own citizens. The latter is accomplished through agreements signed between states in order to grant that protection. Moreover, for some, the standards that are recognized in these agreements have become part of customary international law obliging the whole community of states.

The standard of treatment that is generally granted to aliens by states has evolved and become stricter (property rights, human rights, general investment rights, and so on). “Il regime giuridico del trattamento degli stranieri ha subito nel tempo profonde trasformazioni: si é passati infatti da una fase in cui agli stranieri non era riconosciuta nemmeno la capacita giuridica a una, quella attuale, in cui si ha un’ assimilazione quasi totale degli stranieri ai nazionali.”<sup>1</sup>

International investment law has therefore increased in importance and has become the means by which states grant investors in their territory a stable and secure environment to develop their investment. Fair and Equitable Treatment, an important aspect of international investment law, has become increasingly important in the last 60 years. “Together with other standards which have grown increasingly important in recent years, the fair and equitable treatment standard provides a useful yardstick by which relations between foreign direct investors and governments of capital-importing countries may be assessed.”<sup>2</sup>

The first version of the standard was introduced by the Havana Charter<sup>3</sup> in 1948. The Havana Charter constituted an effort to establish an International Trade Organization. Article 11 (2) established that foreign investments should be assured “just and equitable treatment.”

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<sup>1</sup> M.R. Mauro, “Il trattamento degli investimenti stranieri”, in: G. Giappichelli, *Gli accordi bilaterali sulla promozione e la protezione degli investimenti*, 2003, 145 et seq. (146).

<sup>2</sup> S. Vasciannie, “The Fair and Equitable Treatment Standard in International Investment Law and Practice”, *BYIL* 70 (1999), 99 et seq. (99).

<sup>3</sup> The Havana Charter available under <<http://www.globefield.com/havana.htm>>.

After the Charter came a regional initiative. The Economic Agreement of Bogotá<sup>4</sup> of 1948 adopted a series of provisions concerning safeguards for foreign investors. The agreement referred to “equitable treatment” to be accorded to foreign capital.

Both initiatives failed to come into force due to a lack of support; however, they both stated a practice that was to be included in other agreements, especially bilateral investment agreements.

The latter were multilateral efforts which, due to their lack of support by states, do not constitute a decisive influence in the definition of the standard although they serve as an expression of the participating party’s point of view. However, at the bilateral level, there is an important precedent of BIT’s which actually came into force. These are the U.S. treaties on Friendship, Commerce and Navigation (FCN). They were agreed upon after World War I, but it was not until after World War II, and on the basis of what was instituted in the Havana Charter, that most FCN Treaties included the terms “equitable” and “fair and equitable treatment” as a safeguard against violations of the host state. An important exception to the inclusion of the standard in these agreements was the United States–China FCN Treaty. However, the standard was generally introduced in these treaties. The United States signed FCN Treaties with Belgium<sup>5</sup>, Luxembourg<sup>6</sup>, Greece<sup>7</sup>, Ireland<sup>8</sup>, Israel<sup>9</sup>, and Pakistan<sup>10</sup> all of which referred to the standard as “equitable

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<sup>4</sup> Economic Agreement of Bogotá 1948 available under <<http://www.oas.org/juridico/english/Sigs/a-43.html>>.

<sup>5</sup> Friendship, Commerce and Navigation between the US – Belgium available under <<http://www.marad.dot.gov/Programs/Treaties/Belgium.htm#bel>>.

<sup>6</sup> Friendship, Commerce and Navigation between the US – Luxembourg available under <<http://www.marad.dot.gov/Programs/Treaties/Luxembourg.htm#lux>>.

<sup>7</sup> Friendship, Commerce and Navigation between the US – Greece available under <<http://www.marad.dot.gov/Programs/Treaties/Greece.html#gre>>.

<sup>8</sup> Friendship, Commerce and Navigation between the US – Ireland available under <<http://www.marad.dot.gov/Programs/Treaties/Ireland.html#ire>>.

<sup>9</sup> Friendship, Commerce and Navigation between the US – Israel available under <<http://www.marad.dot.gov/Programs/Treaties/Israel.html#isr>>.

<sup>10</sup> Friendship, Commerce and Navigation between the US – Pakistan available under <<http://www.marad.dot.gov/Programs/Treaties/Pakistan.html#pak>>.

treatment.” On the other hand, FCN’s agreed upon with Ethiopia<sup>11</sup>, Germany<sup>12</sup>, Oman<sup>13</sup>, and the Netherlands<sup>14</sup> referred to “fair and equitable treatment.”

Later on, the standard was included in the Draft Convention on Investment Abroad, also called the Abs–Shawcross Draft, developed under the leadership of Hermann Abs and Lord Shawcross. Together with this Draft came along the Draft Convention on the Protection of Foreign Property (the OECD Convention) elaborated in 1967. Both drafts reflected the dominant trend among capital-exporting countries in relation to the standard. “The Draft Convention, although never opened for signature, represented the collective view and dominant trend of OECD countries on investment issues and influenced the pattern of deliberations on foreign investment in that period.”<sup>15</sup> This collective view among capital-exporting countries favored the agreement among them in relation to the Fair and Equitable Treatment standard.

Up to that moment, there was no argument in favor of establishing this standard as customary international law. Multilateral agreements have not been ratified by countries and the countries that do express their opinion in regard to the standard do not include the vast majority of countries, that is, developing countries. The consent of developing countries in relation to the standard is essential to construing the elements of customary international law. These countries constitute big natural resource providers and, therefore, without their *opinio juris* on the subject, no custom may be formed. There has been no clear consent between capital-importing and capital-exporting states on approval of a multilateral investment agreement that would include the standard.

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<sup>11</sup> Friendship, Commerce and Navigation between the US – Ethiopia available under <<http://www.marad.dot.gov/Programs/Treaties/Ethiopia.html#eth>>.

<sup>12</sup> Friendship, Commerce and Navigation between the US – Germany available under <<http://www.marad.dot.gov/Programs/Treaties/Germany.html#ger>>.

<sup>13</sup> Friendship, Commerce and Navigation between the US – Oman available under <<http://www.marad.dot.gov/Programs/Treaties/oman.htm#oma>>.

<sup>14</sup> Friendship, Commerce and Navigation between the US – the Netherlands available under <<http://www.marad.dot.gov/Programs/Treaties/Netherlands.html#net>>.

<sup>15</sup> OECD (ed.), *Fair and Equitable Treatment Standard in International Investment Law*, 2004, 2 et seq. (4).

The OECD Draft had a decisive effect on the bilateral investment agreements that were signed between capital-importing and capital-exporting countries, from the 1970's onward. At this time, the standard has assumed a determining place in BIT's.

The MIGA (Multilateral Investment Guarantee Agency) Convention<sup>16</sup> refers to the standard as a requirement in order for MIGA to guarantee a certain investment. There is no liability in the event the standard of treatment is not provided by a state. However, the fact that MIGA will analyze this to guarantee an investment is an incentive for foreign investors to locate their investment in countries which grant it and, therefore, an extra incentive for states to agree to provide it.

Another important effort on the issue corresponds to the Draft United Nations Code of Conduct on Transnational Corporations.<sup>17</sup> Both capital-exporting and capital-importing countries agreed that the Code should establish the Equitable Treatment standard for transnational corporations in the host state.

Later on, the MAI (Multilateral Agreement on Investment) negotiated in the OECD<sup>18</sup> also emphasized the fairness element, but together with the provisions of national treatment and most-favored nation. Although this draft and the OECD draft were negotiated by OECD members, if they had entered into force, they would have become available to non-members, which would have converted it into a multilateral draft agreement.

Other regional efforts came to light, some of which could imply to some degree "the acceptance of the standard among the mainly capital-importing states."<sup>19</sup>

Lomé IV<sup>20</sup> was ratified for a period of 10 years by 12 developed European countries and 68 developing countries from Africa, the Caribbean and the Pacific. They all accepted the possibility of according the obligation of each contracting party to guarantee fair and equitable

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<sup>16</sup> Convention establishing the Multilateral Investment Guarantee Agency (MIGA), 1985, available under <<http://www.miga.org/screens/about/convent/convent.htm>>.

<sup>17</sup> Draft United Nations Code of Conduct on Transnational Corporations, 1983, in: Vasciannie, see note 2.

<sup>18</sup> The OECD Draft Multilateral Agreement on Investment, 1998, available under <<http://www.oecd.org/dataoecd/46/40/1895712.pdf>>.

<sup>19</sup> Vasciannie, see note 2, (116).

<sup>20</sup> Lomé IV, available under <<http://www.tralac.org/pdf/lome.pdf>>.



treatment to nationals of other states that were parties to the convention, to reaffirm the importance of private investment. On the other hand, the 1987 ASEAN Treaty<sup>21</sup> between the governments of Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand for the Promotion and Protection of Investments provides for fair and equitable treatment in article IV.

Among other regional agreements that have come into force, Nafta is a major player in the definition of the standard. As analyzed above, Nafta has made a decisive contribution to the determination of the standard's meaning, especially through the Free Trade Commission's work. Nafta deals with all standards that are available in international practice for the purpose of promoting and protecting foreign investment, most of them instituted by developed countries.

Besides Nafta, another regional agreement making reference to the standard that is worth mentioning is the Colonia Protocol on Reciprocal Promotion and Protection of Investments<sup>22</sup> signed by Mercosur's Member States, which grants investors from each Mercosur country fair and equitable treatment.

Finally, an instrument that reflects capital-exporting views is the Energy Charter Treaty on the subject of investment. The Charter ensures fair and equitable treatment "at all times." And "though the Energy Charter is limited to one sector and to the European continent, it nevertheless derives broad significance from the fact that its parties include several states which are currently reliant on capital importation as a part of their basic strategy for economic development."<sup>23</sup>

The Energy Charter Treaty is considered to be one of the most advanced in terms of protection of the investor. "The ECT's investment regime has been largely adopted from Nafta Chapter XI and UK bilateral investment treaties (BIT's). It often codifies therefore – 'in a progressive direction,' contrary to positions taken by the 'Third World' and its proponents during the 'New International Economic Order' (NIEO) period – customary international law. Given the time of its drafting and the influences on it (the Nafta, the World Trade Organization, the EU's then draft Energy Directives, BIT practice), it is possibly

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<sup>21</sup> ASEAN Treaty for the Promotion and Protection of Investments, available under <<http://www.aseansec.org/6910.htm>>.

<sup>22</sup> Colonia Protocol on Reciprocal Promotion and Protection of Investments (Mercosur) available under <<http://www.cvm.gov.br/ingl/inter/mercosul/coloni-e.asp>>.

<sup>23</sup> Vasciannie, see note 2.

the most advanced text in terms of extensive investor protection.”<sup>24</sup> It definitely puts emphasis on incorporating better treatment through standards provided by international law, including standards originating in other international treaties.

The Energy Charter Treaty has relied much on other investment agreements and arbitral awards. For example, the protection of legitimate investor expectations, which has been taken into account in the Tecmed<sup>25</sup> and CME vs. Czech Republic cases<sup>26</sup>, in combination with the principle of transparency, has been recognized in arts 1 and 20 of the Energy Charter Treaty.

The aforesaid historic sequence demonstrates that treaty law is the major source for provisions dealing with the Fair and Equitable Treatment standard. Although there have been many multilateral investment efforts to establish a provision regarding the standard, BITs continue to be the main source of information on the standard. Finally, the possibility of considering it a part of customary international law, as will be analyzed, is remote.

### III. Fair and Equitable Treatment: The Modern Approach

#### 1. The Search for a Meaning

In a first approach in relation to the treatment applied to a foreign investor and his investment in a host state, it is possible to conclude that according to customary international law, the conditions under which that investment will develop are only those imposed by that state. Accordingly, the host state is sovereign in determining if it will accept the investment in its territory and subsequently, the conditions under which it will be made.

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<sup>24</sup> T.W. Wälde, “Energy Charter Treaty-Based Investment Arbitration. Controversial Issues”, *The Journal of World Investment & Trade* 5 (2004), 373 et seq. (376).

<sup>25</sup> Técnicas Medioambientales Tecmed S.A. vs. The United Mexican States, ICSID Case No. ARB (AF)/00/2 (Award, May 29, 2003), available under <<http://ita.law.uvic.ca/documents/Tecnicas-Spanish.pdf>>.

<sup>26</sup> CME (Netherlands) vs. Czech Republic, UNCITRAL Case (Award, March 14, 2003), available under <[http://ita.law.uvic.ca/documents/CME-2003-Final\\_001.pdf](http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf)>.

However, in order to promote a certain economic policy, in this case the attraction of foreign investment, states usually limit this sovereign right. States commit, through treaties or investment agreements, to granting foreign investors certain standards of treatment that will stimulate investment in their territories. That is, “il diritto di uno Stato di controllare l’accesso degli stranieri, nonché dei loro investimenti, nel proprio territorio é illimitato, essendo tale diritto una conseguenza della sovranità territoriale.”<sup>27</sup> However, “la liberta assoluta che lo Stato ha nel decidere sul ‘ammissione dello straniero sul proprio territorio svanisce nel momento in cui l’accesso avviene, in quanto da quel momento in poi é imposto dal diritto internazionale allo Stato territoriale l’obbligo di garantire allo straniero un determinato trattamento e quindi il regime giuridico da applicare agli stranieri successivamente alla loro ammissione sul territorio dello Stato ospite.”<sup>28</sup>

Standards such as the National Treatment, Most-Favored Nation, Fair and Equitable Treatment and Prompt, Full and Adequate Compensation in the case of expropriation are fundamental standards which are present in almost all international investment agreements available to this date. The Fair and Equitable Treatment standard is contained in almost every agreement of this kind, especially bilateral investment treaties. “Nearly all recent BIT’s require that investments and investors covered under the treaty receive fair and equitable treatment in spite of the fact that there is no general agreement on the precise meaning of the phrase.”<sup>29</sup>

This standard provides a yardstick by which relations between foreign investors and host states must be measured. It constitutes a safety net of fairness for the investor.

Up to 2003, over 2,200 BIT’s had been signed, encompassing 176 countries.<sup>30</sup> The reference to the Fair and Equitable Treatment standard in those BIT’s has increased. Of the 335 BIT’s signed in the early 1990’s, only 28 did not expressly incorporate the standard, and this trend did

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<sup>27</sup> Mauro, see note 1, (146).

<sup>28</sup> Ibid.

<sup>29</sup> R. Dolzer/ M. Stevens, *Bilateral Investment Treaties*, 1995; C.C. Kirkman, “Fair and Equitable Treatment: Methanex vs. United States and the Narrowing Scope of Nafta article 1105”, *Law and Policy in International Business Review* 34 (2002), 343 et seq. (390).

<sup>30</sup> <<http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3150&clang=1>>.

not change with the increase of BIT's in the late 1990's.<sup>31</sup> To this date, the standard is referred to in most BIT's, including those of many Latin American countries that historically had adhered to the Calvo Doctrine, which aimed at putting the foreign investor in the same position as an investor who had the nationality of the host country, therefore leaving foreign investors with the sole option of resorting to the domestic court system of the host state.

Today, the system of BIT's has tended to form a unified system of law for foreign investments. "Customary international law governing the treatment of foreign investment has been reshaped to embody the principles of law found in more than two thousand concordant bilateral investment treaties. With the conclusion of such a cascade of parallel treaties, the international community has vaulted over the traditional divide between capital-exporting and capital-importing states and fashioned an essentially unified law of foreign investment."<sup>32</sup>

This latter process, however, is due to the bilateral treaty system only. No multilateral agreement has entered into force in this respect other than Nafta and the Energy Charter, which are regional agreements and as such, do not contribute extensively to a worldwide system of investment law for foreign investors.

There is a sense of redesign of customary law by these BITs through which states have repeatedly obliged themselves to accord foreign investment the treatment generally provided by these treaties (fair and equitable treatment, full protection and security, compensation for expropriation, etc.). As the United Nation's International Law Commission said: "An international convention admittedly establishes rules binding the contracting states only, and based on reciprocity; but it must be remembered that these rules become generalized through the conclusion of other similar conventions containing identical or similar provisions."<sup>33</sup>

The latter theory, which states that the main elements contained in these agreements may have become customary international law, is nonetheless challenged by the arguments of some who believe that if

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<sup>31</sup> UNCTAD (ed.), *Fair and Equitable Treatment*, UNCTAD Series on Issues in International Investment Agreements, 1999, 1 et seq. (22).

<sup>32</sup> S.M. Schwebel, "The Influence of Bilateral Investment Treaties on Customary International Law", *ASIL 9*, Proceedings of the 96 Annual Meeting, 2002.

<sup>33</sup> Report of the International Law Commission covering the work of its twelfth Session, Doc. A/4425, in: *ILCYB 2* (1960), 145 et seq.

this were true, there would be no need for states to keep including them in the agreements they sign. The most secure acknowledgement of the Fair and Equitable Treatment standard as customary international law may be through its equivalence to the international minimum standard. However, some others will argue that the reason why states still include these standards in investment agreements is because the standard has a stricter meaning than the international minimum standard. This will be discussed later on.

What has converted the Fair and Equitable Treatment standard into such a topic of discussion is its specific legal nature. It differs from other similar standards such as National Treatment or Most-Favored Nation because it does not have a clearly defined point of reference. As opposed to the latter standards, the Fair and Equitable Treatment standard constitutes an absolute and non-contingent standard of treatment, i.e., a standard whose exact meaning is determined by reference to specific circumstances. On the other hand, standards such as National Treatment and Most-Favored Nation are contingent and relative standards which are defined by reference to treatment accorded to other investments. This implies that capital-importing countries have a great deal of control in regard to what will define these standards. For example, in the case of the National Treatment standard, it will be the law of the host state, which will act as a reference in the determination of the standard of treatment that will be granted to the foreign investor.

This is not so in the case of the Fair and Equitable Treatment standard. This special standard cannot be defined by either one of the parties since its lack of reference to other treatments makes it an objective rule. However, the absence of that system of reference leaves the meaning of the Fair and Equitable Treatment standard open to enquiry.

The Fair and Equitable Treatment standard achieves great importance as a non-contingent standard since it constitutes a fixed point of reference for the parties concerned. Although National Treatment and the Most-Favored Nation standards are important principles that avoid discrimination against the foreign investor, they do not assure the investor a certainty in the treatment he will receive. The fact that they constitute contingent standards implies that they might at any moment change if their reference point is modified. The treatment accorded to the investor will therefore also change. "Some commentators also note that non-contingent standards are inherently inflexible: because they constitute a fixed rule, they can normally be changed only when there is

a change in the interpretation of that rule, or when the rule in the relevant treaty is amended.”<sup>34</sup>

It is therefore possible to conclude that: “From the perspective of the investor, the fair and equitable component provides a fixed reference point, a definite standard that will not vary according to external considerations, because its content turns on what is fair and reasonable in the circumstances. The fair and equitable standard will also prevent discrimination against the beneficiary of the standard, where discrimination would amount to unfairness or inequity in the circumstances. Simultaneously, national and MFN treatment, as contingent standards, protect each beneficiary of these standards by ensuring equality or non-discrimination for that beneficiary vis-à-vis other investments.”<sup>35</sup>

Moreover, the institution of the Fair and Equitable Treatment standard reflects the need for a stricter protection for investors. If we consider that contingent standards, for purposes of their definition, refer to a third treatment, maybe to the treatment granted to nationals (National Treatment) or to third countries (Most-Favored Nation Treatment), these may afford very little protection since this treatment of third parties may be very insignificant. Altogether, “A foreign investor may conceivably believe that, even where protection by the national and MFN standards is offered, the level of protection is insufficient because the host State may provide inadequate protection to its nationals or to investors from the most-favoured nation. In such cases, fair and equitable treatment helps to ensure that there is at least a minimum level of protection, derived from fairness and equity, for the investor concerned.”<sup>36</sup>

The fact that a state has agreed to incorporate this standard in investment agreements accorded with other states will send foreign investors an important message as to the kind of treatment, according to their own expectations, they will receive in the host state’s territory. “As a general proposition, the standard also acts as a signal from capital-importing countries: for if a host country provides an assurance of fair and equitable treatment, it presumably wishes to indicate to the international community that investments within its jurisdiction will be

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<sup>34</sup> A.A. Fatouros, “Government Guarantees to Foreign Investors”, *Columbia University Press* 1962, 138 et seq.; Vasciannie, see note 2, 107.

<sup>35</sup> UNCTAD, see note 31, 16.

<sup>36</sup> Ibid.

subject to treatment compatible with some of the main expectations of foreign investors.”<sup>37</sup>

However, foreign investors were not defenseless before the creation of the standard. Notwithstanding the birth of the Fair and Equitable Treatment standard, aliens in general have been protected by the “International Minimum Standard,” a rule of customary international law which governs the treatment of aliens, providing them with a set of basic rights which states must grant to them, regardless of their domestic legislation and practices. Violation of this rule engenders international responsibility.

In regard to the latter, it seems that the existence of this international minimum standard has posed the question of whether the inclusion of the Fair and Equitable standard to numerous investment treaties implies that it is a self-contained standard. “The fact that parties to BITS have considered it necessary to stipulate this standard as an express obligation rather than rely on a reference to international law and thereby invoke a relatively vague concept such as the minimum standard is probably evidence of a self-contained standard.”<sup>38</sup> The Fair and Equitable Treatment standard may have been introduced to grant the investor a greater deal of protection above that which is granted by the international minimum standard.

To others, the international minimum standard is tantamount to the Fair and Equitable Treatment standard. However, the latter may be questioned. As the international minimum standard constitutes a rule recognized by customary international law, the inclusion of the standard implies that the aim of the parties when including it in the specific agreement was to impose a stricter standard than that reflected in customary international law. This argument is contested by the fact that there are many cases in which customary law is recognized in treaties, which does not mean that the rule ceases to be a part of customary international law.

Historically, however, the status of the international minimum standard as part of customary international law has also been a matter of tension between developed and developing countries, with several countries challenging its existence. After World War II, the international minimum standard lost strength as an autonomous rule of cus-

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<sup>37</sup> Vasciannie, see note 2, 99.

<sup>38</sup> R. Dolzer/ M. Stevens, “The US Bilateral Investment Treaty Program”, *Stanford J. Int’l L.* 21 (1985), 23.

tomy international law. Yet the principle has maintained some presence in the protection of property and investments.

Today the international minimum standard is recognized as a rule of customary international law. It provides basic rights to the foreign investors. Its relationship with the Fair and Equitable Treatment standard will be analyzed in a subsequent Chapter.

#### **a. Fair and Equitable Treatment in Treaty Practice**

The manner in which the standard is dealt with in different international investment agreements is an important element in establishing its meaning. Although the standard is included in various multilateral treaties as examined in the Historical Overview Chapter, most of them have not come into force due to a lack of approval. Nonetheless, they will be analyzed together with regional investment agreements, bilateral investment treaties and other investment instruments in an attempt to reveal the state's practice in relation to the standard.

##### *aa. Agreement does not refer to the Standard*

To this date, only a few BIT's have not included the standard. "... at the bilateral level, the 1978 agreement between Egypt and Japan as well as the agreement between Italy and Romania may be mentioned as instances, among others, in which the standard is not expressly incorporated in inter-State investment relations."<sup>39</sup>

The absence of the standard in a treaty has important consequences. There is no certainty as to the possibility that the Fair and Equitable Treatment standard is a part of customary international law. Therefore, if the standard is not incorporated in the agreement, the investor will have no protection against unfair and inequitable conduct by the host state. Only the international minimum standard may be invoked by the alien to protect his investment.

##### *bb. The Hortatory Approach*

Although most investment agreements state the Fair and Equitable Treatment standard as obligatory for the parties, there are cases, generally in multilateral agreements, in which its inclusion is not binding.

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<sup>39</sup> UNCTAD, see note 31, 23.



There is an exhortation to apply it, but it is not obligatory for any of the parties.

This approach may be found in the MIGA Convention<sup>40</sup> and in the Havana Charter.<sup>41</sup> They are non-binding instruments, thus the reason for not making reference to the standard in a binding format. They both refer to the Fair and Equitable Treatment standard, but do not create an obligation for State parties to provide such treatment in relation to their investments.

The idea behind this approach is to create an incentive for parties to apply the standard of treatment.

*cc. Agreement Refers to the Fair and Equitable Treatment Standard*

aaa. Terminology

The manner in which the notion of fairness and equity to be granted to the investor is represented in a treaty may vary. A treaty may not necessarily refer to the treatment as “the Fair and Equitable Treatment standard.” Although the majority do, there are a number of agreements that refer to the standard as “just and equitable treatment” or simply “equitable treatment.” The fact that the use of a different adjective would imply a different standard is questioned, however, as Fatouros suggests: “this variation in the form of words seems to be of no great importance.”<sup>42</sup>

The reference to Fair and Equitable Treatment is included in all Friendship, Commerce and Navigation (FCN) treaties signed by the United States, the Abs-Shawcross<sup>43</sup> and OECD Drafts<sup>44</sup> (referred to in the Historical Overview Chapter), Nafta<sup>45</sup> and most BIT’s.

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<sup>40</sup> Convention establishing the Multilateral Investment Guarantee Agency (MIGA), see note 16.

<sup>41</sup> The Havana Charter, see note 3.

<sup>42</sup> Vasciannie, see note 2, 111.

<sup>43</sup> The Draft Convention on Investments Abroad, 1959, in: OECD, see note 15, (4).

<sup>44</sup> Draft Convention on the Protection of Foreign Property and Resolution of the Council of the OECD, 1967, in: OECD, see note 15, 4.

<sup>45</sup> North American Free Trade Agreement (NAFTA) available under <<http://www-tech.mit.edu/Bulletins/nafta.html>>.

The expression of the latter idea as “just and equitable” or “equitable” figures in the Economic Agreement of Bogotá<sup>46</sup> where article 22 states the following: “Foreign capital shall receive equitable treatment. The states therefore agree not to take unjustified, unreasonable or discriminatory measures that would impair the legally acquired rights or interests of nationals of other countries in the enterprises, capital, skills, arts or technology they have supplied.”<sup>47</sup> The reason the authors referred to the notion as equitable treatment is that at the time, the formulation of it as “Fair and Equitable Treatment” had not yet become the principal form of its expression.

On the bilateral level, the French model and various BIT’s involving Switzerland<sup>48</sup> refer solely to just and equitable treatment.

#### bbb. The Formulation of the Standard

The manner in which a treaty structures the standard and its association with other standards will be decisive in defining its meaning.

The latter structure differs from one treaty to another. And due to the vagueness of this structure, which provides no enlightenment in resolving the true meaning of the standard, different treaties and investment agreements have evolved throughout the years with the aim of handing over a greater set of tools for the purpose of using this standard in a more uniform way. It is not clear whether the idea of the parties is to completely elucidate the standard’s definition. The fact is that “The attempts to clarify the normative content of the standard itself have, until recently, been relatively few. There is a view that the vagueness of the phrase is intentional to give arbitrators the possibility to articulate the range of principles necessary to achieve the treaty’s purpose in particular disputes. However, a number of governments seem to be concerned that the less guidance is provided for arbitrators, the more discretion is involved, and the closer the process resembles decisions *ex aequo et bono*, i.e. based on the arbitrators notions of ‘fairness’ and ‘equity’.”<sup>49</sup>

The latter discretion seems, at this point, to have been a key element in the arbitrator’s function in relation to this standard, as will be analyzed below. This notwithstanding, it becomes clear from some Nafta

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<sup>46</sup> Economic Agreement of Bogotá, see note 4.

<sup>47</sup> Economic Agreement of Bogotá, see note 4, article 22.

<sup>48</sup> UNCTAD, see note 31.

<sup>49</sup> OECD, see note 15, 2.

awards (Pope and Talbot<sup>50</sup>; Mondev<sup>51</sup>) that “the standard is not an opening for personal value judgments of arbitrators (as much as they do naturally play a subterranean role in the awards) but requires that the standard be developed on the basis of an in-depth factual assessment interacting with standards of good governance conduct identified from authoritative and relevant, principally legal instruments.”<sup>52</sup>

The 1994 Model Draft of the United States establishes the following in relation to the standard:

“Each party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favourable than that required by international law.”<sup>53</sup>

The latter phrase leads to the belief that the fair and equitable treatment standard is additional to standards required by international law, thus implying a stricter standard. This approach followed by the United States would later be amended, to the point of restricting the standard to be equivalent solely to customary international law. The latter was reflected by the Interpretive Note issued by the Free Trade Commission within the scope of Nafta. Moreover, this view was later introduced to the United States 2004 BIT Model, which states the following:

“Article 5: Minimum Standard of Treatment

“1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition to or beyond that

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<sup>50</sup> Pope and Talbot Inc. vs. Government of Canada, UNCITRAL Case (Award, April 10, 2001), available under <<http://ita.law.uvic.ca/documents/PopeandTalbot-Merit.pdf>>.

<sup>51</sup> Mondev International LTD. vs. United States of America, ICSID Case ARB (AF)/99/2. (Award, October 11, 2002), available under <<http://ita.law.uvic.ca/documents/Mondev-Final.pdf>>.

<sup>52</sup> Wälde, see note 24, 385.

<sup>53</sup> Treaty between the Government of the United States of America and the Government of ... concerning the Encouragement and Reciprocal Protection of Investment, reprinted in: UNCTAD, *International Investment Instruments* III, 195 et seq.

which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:

- (a) ‘fair and equitable treatment’ includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
- (b) ‘full protection and security’ requires each Party to provide the level of police protection required under customary international law.”

This model would later be used in the investment Chapters of the Free Trade Agreements between the United States and CAFTA (Central America)<sup>54</sup>, Chile<sup>55</sup>, Morocco<sup>56</sup> and Singapore.<sup>57</sup> Moreover, the Canadian 2004 BIT Model<sup>58</sup> also equates the standard to customary international law alone.

These agreements view the standard as a part of customary international law.

The United Kingdom’s model of bilateral investment agreements, in the same line as the US 1994 Model, also takes us to believe that the standard is self-contained. Article II (2) of the United Kingdom’s model states the following in relation to the standard:

“Investment of nationals or companies of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Neither Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of nationals or companies of the other Contracting Party. Each Con-

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<sup>54</sup> United States–CAFTA Free Trade Agreement, January 2004, available under <[http://www.ustr.gov/Trade\\_Agreements/Bilateral/DR-CAFTA/DR-CAFTA\\_Final\\_Texts/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/DR-CAFTA/DR-CAFTA_Final_Texts/Section_Index.html)>.

<sup>55</sup> United States–Chile Free Trade Agreement, June 2003, available under <[http://www.direcon.cl/tlc\\_eeuu\\_vd.php](http://www.direcon.cl/tlc_eeuu_vd.php)>.

<sup>56</sup> United States–Morocco Free Trade Agreement. June, 2004, available under <[http://www.ustr.gov/Trade\\_Agreements/Bilateral/Morocco\\_FTA/FInal\\_Text/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Morocco_FTA/FInal_Text/Section_Index.html)>.

<sup>57</sup> United States–Singapore Free Trade Agreement, May 2003, available under <[http://www.ustr.gov/assets/Trade\\_Agreements/Bilateral/Singapore\\_FTA/Final\\_Texts/asset\\_upload\\_file708\\_4036.pdf](http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/asset_upload_file708_4036.pdf)>.

<sup>58</sup> Canadian 2004 BIT Model available under <<http://ita.law.uvic.ca/documents/Canadian2004-FIPA-model-en.pdf>>.

tracting Party shall observe any obligation it may have entered into with regard to investments of nationals or investments of the other Contracting Party.”<sup>59</sup>

This article goes far beyond the 1994 US Model. Since “by including non-discrimination, reasonableness and respect for contractual obligations as elements of the fair and equitable standard, it accords with the plain meaning of fairness and equity.”<sup>60</sup>

An important contribution to the statement of the standard as self-contained is the Energy Charter. Article 10 (1) states the following: “Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favorable and transparent conditions for Investors of other Contracting Parties to make Investments in its area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favorable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.”<sup>61</sup>

This multilateral treaty provides for Fair and Equitable Treatment to investors not in regard to any other standard but as a self-contained standard. The importance of this Agreement is that although it is limited to one sector of the economy, it involves the view of many developing economies. This fact implies a more general and worldwide acceptance of the status of the standard as self-contained. This is a clear revision of the developing countries’ appreciation of the standard, apart from that which has been historically imposed upon them by developed countries through self-created BIT models.

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<sup>59</sup> Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of ... for the Promotion and Protection of Investment, reprinted in: UNCTAD (ed.), *International Investment Instrument III*, 185 et seq.

<sup>60</sup> Vasciannie, see note 2, (131).

<sup>61</sup> Energy Charter Treaty, 1995 available under <[http://www.environment.fgov.be/Root/tasks/atmosphere/klim/pub/int/echarter/eTreaty\\_en.htm#A10](http://www.environment.fgov.be/Root/tasks/atmosphere/klim/pub/int/echarter/eTreaty_en.htm#A10)>.

Moreover, the Australia and Thailand Free Trade Agreement<sup>62</sup> states, in article 909, that: “Each Party shall ensure fair and equitable treatment in its own territory of investments.” Once more, the standard is established as self-contained. This occurs in most investment agreements in which the United States is not involved. This leads us to believe that the general view of the standard is opposed to the stricter appreciation that has been acknowledged by the United States.

In general, at the multilateral level, almost all agreements refer to the standard in a manner in which it is conceived as a standard additional to the standard set by international law. The Draft OECD Multilateral Agreement on Investment of 1998<sup>63</sup> stipulates that “Each contracting Party shall accord fair and equitable treatment and full and constant protection and security to foreign investments in their territory. In no case shall a contracting Party accord treatment less favorable than that required by international law.”

Also, along the same lines, the 1992 World Bank Guidelines on Treatment of Foreign Direct Investment<sup>64</sup> establish in article III (2) that “each State will extend to investments established in its territory by nationals of any other State fair and equitable treatment according to the standards recommended in the Guidelines.”

In conclusion, the Fair and Equitable Treatment standard has gained strength due to an important set of economic transformations worldwide that have led states to understand that their own economies are linked to the rest of the world’s economies. In this sense, assuring foreign investment, especially in developing countries, has become an essential part of these countries’ economic policy.

The assurance of special treatment to foreign investors reflected in special standard provisions that have been included in investment agreements of all kinds, especially the new-generation agreements, follow this tendency to promote foreign investment in the territory of the parties to the agreement. There is an idea that setting these standards stimulates investment. However, countries like Chile have realized the opposite. After signing a handful of BIT’s, the government has learned that there is no reliable study that confirms that signing these investment agreements actually encourages investment. As a result, Chile has

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<sup>62</sup> Australia–Thailand Free Trade Agreement, October 2003, available under <[http://www.dfat.gov.au/trade/negotiations/aust-thai/tafta\\_chapter\\_9.html](http://www.dfat.gov.au/trade/negotiations/aust-thai/tafta_chapter_9.html)>.

<sup>63</sup> The OECD Draft Multilateral Agreement on Investment, see note 18.

<sup>64</sup> World Bank (ed.), *Legal Framework for the Treatment of Foreign Investment*, 1992.

suspended its policy of further BIT negotiations. Notwithstanding this, Chile has continued with the negotiation of Free Trade Agreements with various countries (such as the United States, Canada and so on), most of which include a Chapter on investment, suggesting that this fear of the government in relation to the neutral effects of BIT's is not yet that powerful.

Aside from the controversy, the Fair and Equitable Treatment standard has been viewed as a key element in the attraction of foreign investment. It is a non-contingent standard, that is, totally independent from third treatment references, allowing for foreign investors to be protected by a secure and objective safeguard in their activities in the host country.

Its meaning, though, continues to constitute the main difficulty in its assessment. Different formulations in different investment agreements and different interpretations by arbitrators have led to a variety of expressions in relation to its true meaning, which ultimately do not contribute to a secure environment for investment. There has been some intent to narrow the scope of its meaning. For example, Nafta's Free Trade Commission issued its Interpretive Note on the issue, equating the standard to customary international law, as will be analyzed later on. However, at this time, all efforts at interpretation are in the hands of arbitrators, who, in light of the facts, have not proven to be the best means to achieve the clarification of the standard.

## **2. Latest Tendencies in the Definition of the Standard**

The Fair and Equitable Treatment standard has become a major issue in international investment law. It has developed, in Nafta claims alone, into "the alpha and omega of investor arbitration under Chapter 11 of Nafta. Every pending claim alleges a violation of article 1105."<sup>65</sup> In light of this, the indetermination of a clear meaning of the standard is a serious issue. The vagueness in which the standard is conceived becomes a major obstacle for Tribunals when attempting to resolve disputes that have arisen in connection with an investment.

A first approach would suggest that this term be interpreted according to general principles of treaty interpretation outlined in the Vienna

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<sup>65</sup> Ch. H. Brower, "Fair and Equitable Treatment under Nafta's Investment Chapter", *ASIL* 9, Proceedings of the 96 Annual Meeting, 2002.

Convention on the Law of Treaties.<sup>66</sup> It will be interpreted in accordance with its plain meaning and in light of the object and purpose of the treaty. The negotiating history of the treaty should also be taken into account if the plain meaning is unclear. However, in practice, the specific facts of each case determine the way in which the principle is understood, where we find a lack of uniformity in the definition.

BIT's and other international investment instruments are usually vague in the definition of the standard. More recent treaties, such as Nafta (particularly in light of the Free Trade Commission's interpretation, as will be explained below) and the United States–Chile Free Trade Agreement, have made important progress in narrowing the scope of the definition of its meaning in their investment Chapters. Nonetheless, this latest tendency has not sufficed for Tribunals to develop a uniform jurisprudence on the meaning of the term. Although Tribunals rely more and more on other Tribunals' findings, there are still important differences in the approach. "There is a view that the vagueness of the phrase is intentional to give arbitrators the possibility to articulate the range of principles necessary to achieve the treaty's purpose in particular disputes."<sup>67</sup> However, this is a matter of concern for governments, as the more one resorts to the discretion of Tribunals, the greater the possibility of cases being resolved under equitable principles, thus undermining certainty for investors, which is the main objective of these investment instruments.

The main approaches that have been formulated regarding the meaning of the standard are (i) equating it to the international minimum standard that is present in international customary law; (ii) measuring it against international law, including all sources; (iii) considering it as an independent standard based on the plain-meaning approach; or (iv) considering it as an independent rule of customary international law.

This Chapter discusses the most important cases in the matter, analyzing the Tribunals' approach to the standard applicable in each case, and examining their contribution to the development of the standard thus far to date. Reference will also be made to Nafta and the United States–Chile Free Trade Agreements as examples of the latest innovations in the issue.

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<sup>66</sup> Vienna Convention on the Law of Treaties, available under <<http://www.un.org/law/ilc/texts/treaties.htm>>.

<sup>67</sup> OECD, see note 15, 2.



Of particular interest are the views of investors in regard to the standard, as well as that of host states. Investors generally argue the more expansive view, that is, conceiving the standard as a self-contained concept, which will extend far beyond the minimum standard approach that limits it to outrageous behavior by the host state, as was established in the Neer case<sup>68</sup> in the 1920's. On the other hand, the host state's argument will tend to limit its liability precisely to the Neer case understanding.

F.A. Mann considers, for example, that "the term fair and equitable treatment envisages conduct far beyond a minimum standard and affords protection to a greater extent and according to a much more objective standard than any previously employed form of words."<sup>69</sup> Although Mann later restructured his view, as we will see, he asked himself at the time about the usefulness of including the standard in a treaty if it was considered to be a part of customary international law. The other strongly held view stands for equating the standard to the minimum standard of international law, considering that although the standard is present in customary international law, "quite often treaties reiterate rules of customary international law without supposing to add to their content, particularly in instances where there exists disagreement over the existence of such a rule or its exact composition."<sup>70</sup>

The Nafta regime is the most prolific in awards dealing with the interpretation of the provisions of chapter 11 in relation to the standard. These will be analyzed in this chapter as well as other BIT awards that are also relevant in relation to the issue.

#### a. Bilateral Investment Treaties

As said before, up to 2003, more than 2,200 BIT's had been signed, encompassing 176 countries.<sup>71</sup> Of the 335 BIT's signed in the early 1990's,

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<sup>68</sup> Neer Claim, "United Nations Reports of International Arbitral Awards IV", 1926, (60), in: OECD (ed.), *The International Minimum Standard in Customary International Law*, Annex to Fair and Equitable Treatment Standard in International Investment Law, 2004, 26 et seq. (27).

<sup>69</sup> F.A. Mann, "British Treaties for the Promotion and Protection of Investments", *BYIL* 52 (1981), 241; S.G. Gross, "Inordinate Chill: Bit's, Non-Nafta MITs, and Host State Regulatory Freedom – An Indonesian Case Study", *Mich. J. Int'l L.* 24 (2003), 894 et seq. (935).

<sup>70</sup> Gross, see note 69.

<sup>71</sup> UNCTAD, see note 31.

only 28 did not expressly incorporate the standard, and the trend did not change with the increased reliance on BIT's in the late 1990's.<sup>72</sup> However, and notwithstanding the numerous references to this standard, there is a problem among these investment agreements that consists of a lack of a clear definition as to what its real meaning is.

On the other hand, Nafta represents a very special scenario. In relation to the issue of defining the standard, Nafta adopted a very unusual strategy. As will be analyzed below, article 1105 of Nafta relating to the minimum standard succinctly states that investments of another party shall receive treatment in accordance with international law, including fair and equitable treatment and full protection and security. However, due to the variety of rulings issued by arbitrators, each one containing a different view, the Free Trade Commission took action to define what should be understood by international law, thus restricting the standard's meaning. The Free Trade Commission, through its Interpretative Note, which is binding upon future arbitral Tribunals, stated that the obligation of a minimum standard of treatment accorded to investments of another Nafta party is "the customary international law minimum standard of treatment of aliens." Generally, the customary international law standard reflects basic rights of fairness and due process, both administratively and judicially.<sup>73</sup> There was a limitation of the amplex of the standard through this interpretative note, which in itself was greatly criticized, as will be seen below. "As we now know from the Interpretative Note, the Nafta parties regard article 1105 as no more protective than custom, a qualification apparently designed to confine host state responsibility to settings in which the offending conduct is unmistakably outrageous."<sup>74</sup>

The main idea was to prevent any investor resorting to other sources of international law that might impose stricter requirements to the treatment granted by the host state to foreign investors. The United States did not wish to incorporate independent treaty obligations to the concept (or more demanding domestic standards).

Nafta has become a source of various interpretations concerning the standard's meaning. From the emblematic and criticized Pope and Tal-

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<sup>72</sup> UNCTAD, *ibid.*, 22.

<sup>73</sup> Ved P. Nanda, "Fair and Equitable Treatment Under Nafta's Investment Chapter", *ASIL* 9, Proceedings of the 96 Annual Meeting, 2002.

<sup>74</sup> J.J. Coe, "Fair and Equitable Treatment Under Nafta's Investment Chapter", *ASIL* 9, Proceedings of the 96 Annual Meeting, 2002.

bot case<sup>75</sup> to those of *Metalclad*<sup>76</sup>, *Loewen*<sup>77</sup> and *Myers*<sup>78</sup> which will be analyzed below.

One of the most recent approaches to the standard of Fair and Equitable Treatment has been embodied in the US–Chile Free Trade Agreement.<sup>79</sup>

Chapter 10, which deals with investments, provides, in article 10.4, for the required standard of treatment, as follows:

“1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

2. For greater certainty, paragraph 1 prescribes the Customary International Law Minimum Standard of Treatment of aliens as the Minimum Standard of Treatment to be afforded to covered investments. The concepts of ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:

(a) ‘fair and equitable treatment’ includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

(b) ‘full protection and security’ requires each Party to provide the level of police protection required under customary international law.”

Subsequently, Annex 10 – A, entitled “Customary International Law,” states the following: “The Parties confirm their shared under-

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<sup>75</sup> *Pope and Talbot Inc. vs. Government of Canada*, see note 50.

<sup>76</sup> *Metalclad Corporation vs. The United Mexican States*, ICSID Case No. ARB (AF)/97/1, (Award, August 30, 2000), available under <<http://ita.law.uvic.ca/documents/MetacladAward-English.pdf>>.

<sup>77</sup> *Loewen Group, Inc. and Raymond L. Loewen vs. United States of America*, ICSID Case No. ARB (AF)/98/3 (Award, 26 June 2003), available under <<http://ita.law.uvic.ca/documents/Loewen-Award-2.pdf>>.

<sup>78</sup> *S.D. Myers Inc. vs. Canada*, UNCITRAL Case (Second Partial Award, 21 October 2002), available under <<http://ita.law.uvic.ca/documents/SDMeyers-secondPartialAward.pdf>>.

<sup>79</sup> *United States of America–Chile Free Trade Agreement*, 2004, available under <[http://www.direcon.cl/tlc\\_eeuu.php?sitio=00cc96ba7d750f11bd0edfae5f2894d](http://www.direcon.cl/tlc_eeuu.php?sitio=00cc96ba7d750f11bd0edfae5f2894d)>.

standing that 'customary international law' generally and as specifically referenced in Articles 10.4 and 10.9 results from a general and consistent practice of states that they follow from a sense of legal obligation. With regard to Article 10.4, the Customary International Law Minimum Standard of Treatment of aliens refers to all Customary International Law principles that protect the economic rights and interests of aliens."

The Chile–United States Free Trade Agreement is inspired by the Nafta experience and hence, the investment Chapter resembles the one existing in Nafta. However, it innovates by providing a more detailed reference of the standard's meaning, also substantially reflecting in its text the evolution occurring in light of Nafta decisions. As opposed to article 1105 of Chapter 11 of Nafta, the Chile–United States Free Trade Agreement expressly provides that the minimum standard is in accordance with customary international law. Before the Free Trade Commission's Interpretative Note, Nafta only referred to international law in general, which of course includes customary international law, treaties, and other sources. Moreover, Annex 10 – A defines, for greater security, what is to be understood by customary law. This last definition might, at first glance, seem unnecessary because of the fact that the same result would be reached by interpreting the term under the Vienna Convention on the Law of Treaties. In any event, customary international law is already binding upon the parties, which makes the clarification in the latter Annex somewhat redundant.

Finally, it defines some aspects that must be included in the terms of Fair and Equitable Treatment and Full Protection and Security to narrow the scope of what must be understood by those terms.

As said, this Chapter reflects the experience of the United States in Nafta. It seems that the United States realized that BIT's are not only to protect their citizen investors worldwide but may also be used to protect itself from claims by foreign investors in their own territory. Most probably, equating this standard to any source of international law may be deemed by the United States to expand the formulation for them, specifically when they become the respondents in an investment claim. It is interesting to note that while the United States is in transition from a capital-exporting to a capital-importing state, it is adopting restricted criteria.

Other new-generation Free Trade Agreements that establish the obligation to afford the covered investment treatment in accordance with customary international law, including Fair and Equitable Treatment and Protection and Security, are the ones signed by the US with Austra-

lia (March 2004)<sup>80</sup>, Cafta (January 2004)<sup>81</sup>, Morocco (June 2004)<sup>82</sup>, and Singapore (May 2003).<sup>83</sup>

In fact, they are very similar to the US–Chile Free Trade Agreement. As an example, Chapter 11 of the US–Australia Free Trade Agreement is almost identical to the US–Chilean Investment Chapter. The only difference is that the US–Australia Free Trade Agreement does not make any reference to non-discrimination relating to losses suffered by investments in its territory owing to armed conflict or civil strife.

Due to the recent signature of these agreements, no arbitral conflicts have arisen to test the interpretation of their provisions. Nevertheless, an analysis will be made of the more important and recent cases that have been conducted on the basis of previously signed BIT's and investment agreements that include the Fair and Equitable Treatment standard.

### 3. Good Faith and Fair Expectations

#### a. *Técnicas Medioambientales Tecmed S.A. vs. The United Mexican States*<sup>84</sup>

The facts regarding this case consist in a claim submitted by Tecmed against the United Mexican States in relation to an investment made by that company in land, buildings and other assets of a controlled landfill of hazardous industrial waste. The claim is based on the refusal of the INE (Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico) to renew the operating license of the landfill, and the subsequent request by INE to submit a program for the closure of that landfill. The claimant alleged that the refusal to renew the operating permit constituted an expropriation of its investment and a violation of numerous articles of the BIT between the Kingdom of Spain and the United Mexican States, as well as a violation of Mexican law, all of which resulted in a loss of profits for the claimant

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<sup>80</sup> United States–Australia Free Trade Agreement. March 2004, available under <<http://www.dfat.gov.au/trade/negotiations/us.html>>.

<sup>81</sup> United States–CAFTA Free Trade Agreement, see note 54.

<sup>82</sup> United States–Morocco Free Trade Agreement, see note 56.

<sup>83</sup> United States–Singapore Free Trade Agreement, see note 57.

<sup>84</sup> *Técnicas Medioambientales Tecmed S.A. vs. The United Mexican States*, see note 25.

that would have derived from the economic and commercial operation of the landfill as an on-going business. The latter also implied the impossibility of recovering the cost of the acquisition of the landfill, its adaptation and preparation and the investments made for this kind of industrial activity.

In its claim, Tecmed alleges that the Mexican authority's failure to renew the license for its hazardous waste site contravened the Fair and Equitable Treatment standard.

The latter standard is established in the following provision: article 4 (1) of the BIT between the Kingdom of Spain and the United Mexican States, states as follows: "Each contracting party will guarantee in its territory, fair and equitable treatment, according to international law, for the investments made by investors of other contracting parties."

The Tribunal's award stated that the Fair and Equitable Treatment standard is an expression of the bona fide principle that is present in international law. The latter requires the Contracting Parties to provide international investments a treatment that does not affect the investor's basic expectations taken into account in order to carry out its investment. This treatment must be consistent, free from ambiguity, and transparent. The Tribunal finally sustained the claimant's argument in relation to the fact that INE's behavior frustrated the claimant's fair expectations and did not provide clear guidelines in order to allow the claimant to explore a way to maintaining the permit or direct its actions.

#### **b. MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Republic of Chile<sup>85</sup>**

In the year 1997, MTD Equity, a Malaysian company, entered into a foreign investment contract with the Chilean Foreign Investment Committee. The idea behind the investment was the development of a planned community, based on a Malaysian model, in Pirque, a suburb in the city of Santiago. For that purpose, a Chilean company, called MTD Chile S.A, was created, majority-owned by MTD Equity. After MTD had invested several million dollars in capital contributions, the investment process was interrupted by the Chilean authorities' refusal to re-zone the project. In fact, the Ministry of Housing and Urbanism

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<sup>85</sup> MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Republic of Chile, ICSID Case No ARB/01/7 (Award, 25 May 2004), available under <[http://ita.law.uvic.ca/documents/MTD-Award\\_000.pdf](http://ita.law.uvic.ca/documents/MTD-Award_000.pdf)>.

(MINVU) rejected the project on the grounds that it conflicted with existing urban development policy.

Due to the latter, MTD brought a claim against the Republic of Chile before the ICSID pursuant to the Malaysia–Chile BIT.

Although MTD’s claim was based on a number of arguments, the Arbitral Tribunal finally rejected them and condemned Chile on the sole argument of having breached the Fair and Equitable Treatment standard that it should have afforded to the Malaysian investor.

The Tribunal began its argument on this point by reference to the necessity of analyzing the issue of the Fair and Equitable Treatment standard in the manner most conducive to fulfilling the objective of the BIT to protect investments and create conditions favorable to investment (an interpretation mandated by the Vienna Convention on the Law of Treaties). “Hence, in terms of BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a pro-active statement – ‘to promote,’ ‘to create,’ ‘to stimulate’ – rather than prescriptions for a passive behavior of the State avoidance of prejudicial conduct of the investors.”<sup>86</sup>

Moreover, the Tribunal relies on the Tecmed case<sup>87</sup> (*Técnicas Medioambientales Tecmed S.A. vs. The United Mexican States*), which, when faced with a similar task, analyzed the standard in the sense that its meaning had to do with the actions of the host state not affecting the basic expectations of the investor, i.e., its actions should lack ambiguity, be enacted in a transparent and consistent manner and, therefore, allow the investor to acknowledge beforehand all the rules and regulations that will govern his investment.

In its award, the Tribunal also accepted MTD’s argument that allowed, under the provision of the Most-Favored Nation (“MFN”) Clause included in the Malaysian–Chile BIT, criteria to be applied in relation to the Fair and Equitable Treatment standard in other BIT’s signed by Chile. Paragraph 1 of article 3 (1) of the Malaysian–Chile BIT provides that: “1. Investments made by investors of either Contracting Party in the territory of the other Contracting Party shall receive treatment which is fair and equitable, and not less favorable than that ac-

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<sup>86</sup> MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Republic of Chile, see note 85, (34).

<sup>87</sup> *Técnicas Medioambientales Tecmed S.A. vs. The United Mexican States*, see note 25.

corded to investments made by investors of any third State.” Through this text, MTD claimed that the provisions of the BIT’s of Croatia and Denmark with Chile dealt with Chile’s obligation to grant permits subsequent to the approval of foreign investment and to fulfill contractual obligations that were part of the duty to provide Fair and Equitable Treatment.

According to MTD, Chile breached the Fair and Equitable Treatment standard provisions of the BIT when it “created and encouraged strong expectations that the Project, which was the object of the investment, could be built in the specified proposed location and entered into a contract confirming that location, but then disapproved that location.”

The Tribunal finally rejected the argument that the denial of the issuance of the zoning for the project by the Chilean authorities is an expropriation, but considered it to constitute unfair treatment by the state when it approved an investment against the policy of the state itself. “It was the policy of the Respondent and its right not to change it. For the same reason, it was unfair to admit the investment in the country in the first place.”<sup>88</sup>

The reference made by the Tribunal to the Tecmed case in order to define the standard’s meaning is decisive in its analysis. That case relies on and resolves the dispute on the basis of the good faith principle that is present in international law, although it made an attempt to formulate the standard as an autonomous interpretation. “In one case, however, Tecmed S.A. vs. The United Mexican States, the tribunal mentions that approach (as an autonomous treaty standard) as one of the alternative approaches but it goes on to judge the claim against the international law principle of good faith.”<sup>89</sup> In the MTD case, the standard is featured as a part of international law, including all sources.

However, it is interesting to note that in the Tecmed case, there is a reference made to “transparency.” Is it possible to include that concept in the meaning of the Fair and Equitable standard?

The inclusion of the transparency requirement in the concept of Fair and Equitable Treatment is not clearly established. In the Metalclad Corporation vs. United Mexican States case<sup>90</sup>, a Nafta case, the Su-

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<sup>88</sup> MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Republic of Chile, see note 85, 81.

<sup>89</sup> OECD, see note 15, 22.

<sup>90</sup> Metalclad Corporation vs. The United Mexican States, see note 76.



preme Court of British Columbia, which conducted a judicial review of the ICSID Tribunal's decision, found that the Tribunal had exceeded its jurisdiction by basing its findings on the treaty obligations of transparency. It stated that the Tribunal should not have defined the scope of obligations under article 1105 considering other provisions of the same treaty, one of which was the transparency requirement. It stated that the Tribunal had interpreted the article in a broad manner to include a transparency obligation, without proving that transparency was part of customary law (on the basis of the Supreme Court's consideration that the Fair and Equitable Treatment standard is equated to customary international law only).

Due to the latter, the argument of inclusion in the MTD case award of the transparency provision as part of the Fair and Equitable Treatment standard, through the application of the Tecmed case, is arguable. However, there are differing opinions on the subject. Some state that the concept of transparency overlaps the Fair and Equitable Treatment standard. "... transparency may be required, as a matter of course, by the concept of fair and equitable treatment ... This interpretation suggests that where an investment treaty does not expressly provide for transparency, but does for fair and equitable treatment, then transparency is implicitly in the treaty."<sup>91</sup>

The MTD case is currently in a state of annulment proceedings before an ad-hoc Committee.

#### **4. Stability of Legal and Business Framework**

##### **a. Occidental Exploration and Production Company vs. The Republic of Ecuador<sup>92</sup>**

Occidental Exploration and Production Company (OEPC), a company registered under the laws of the state of California, entered into a joint venture agreement with Petroecuador, a state-owned company. The objective of the agreement was the exploration and production of oil in Ecuador. The conflict arose when the SRI (Servicio de Rentas Internas)

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<sup>91</sup> UNCTAD, see note 31, 51.

<sup>92</sup> Occidental Exploration and Production Company vs. The Republic of Ecuador, UNCITRAL Arbitration, Case No. UN 3467, (Award, 1 July 2004), available under <[http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf)>.

denied the company the regular reimbursement of VAT tax paid by the company on purchases required for exploration and production under the agreement. This resolution of the SRI was based on their belief that VAT reimbursement was already accounted for in the participation formula under the agreement.

OEPC claimed that Ecuador had breached its obligations under the treaty and international law, particularly the obligations of: (i) Fair and Equitable Treatment; (ii) Treatment not less favorable than the treatment accorded to Ecuadorian exporters; (iii) No impairment, through arbitrary or discriminatory measures, of the management, use and enjoyment of OEPC's investment; and (iv) No expropriation, directly or indirectly, of all or part of that investment.

The Tribunal ruled based on the following:

Article II (3) (a) of the BIT between the United States of America and Ecuador provides the following:

“Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less favorable than that required by international law.”

Like in the MTD case, on the basis that the standard is not defined in the BIT, the Tribunal also grounded the determination of the standard's meaning in the application of the international law system of interpretation defined in the Vienna Convention on the Law of Treaties. It takes into account the preamble of the treaty that states that such treatment “is desirable in order to maintain a stable framework for investments and maximum effective utilization of economic resources.” The stability of the legal and business framework is thus an essential element of the Fair and Equitable Treatment standard. This need for stability is also a main issue in arbitral awards, such as the *Metalclad* and *Tecmed* cases, which deal with terms such as transparency, predictability, no ambiguity and so on. The Tribunal states in this case that these are all objective requirements that do not depend on whether the respondent acted in good or bad faith.

As expressed in the above-mentioned cases, the Tribunal considered the standard equitable to international law. International law requires a stable and predictable framework in the legal and business area, which the host state did not provide in this case. The Tribunal noted that the framework under which the investment operated had been changed by the actions of the SRI, which led it to conclude that the respondent had

breached its obligations to accord Fair and Equitable Treatment to the investor.

Although the interpretation by the Tribunal is consistent with other Arbitral Awards dealing with the same questions, the Tribunal did not take that into account in this particular case, the wording of the article referring to the standard in the respective BIT is different from that established by the BIT's involved in the Awards quoted earlier (Tecmed and Metalclad).

The wording of article II (3) (a) of the BIT between the United States of America and Ecuador connotes more the idea that the Fair and Equitable Treatment standard is additional, and not equivalent, to international law. This may lead more to the notion that such article adheres to a wider standard, clearly separating the concepts of international law from those of the standard itself.

The Tribunal has correctly applied the rule of interpretation of the Vienna Convention on the Law of Treaties, which establishes that: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." However, it seems that the ordinary meaning of this particular article does not equate the Fair and Equitable Treatment standard of international law. They seem to be different terms.

Murray J. Belman analyzes the issue and says that when BIT's use the formula also present in the US–Ecuador BIT, "the fairness requirement would thus be additive to the international law requirement."<sup>93</sup> Most observers conclude that that type of language establishes two different standards, the fairness requirement, plus the minimum standard under international law.

According to the foregoing, it is possible to argue that the parties to the agreement intended to conceive the Fair and Equitable Treatment standard as a more demanding standard, exceeding the criteria that are present in international law. However, in terms of the Tribunal's final award, the latter analysis does not distort the final condemnation of Ecuador. Its actions are still in violation of the standard. The analysis may only be relevant as a precedent for future cases.

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<sup>93</sup> M.J. Belman, "Fair and Equitable Treatment Under Nafta's Investment Chapter", *ASIL* 9, Proceedings of the 96 Annual Meeting, 2002.

## 5. Due Diligence and the Minimum Standard of Customary International Law

### a. Asian Agricultural Products Ltd. (AAPL) vs. Republic of Sri Lanka<sup>94</sup>

The case concerns an investment made by AAPL in the form of an equity interest in a Sri Lankan public company called Serendib Seafoods Ltd., which was established to engage in shrimp fishing. The Sri Lankan company had a farm which constituted its main production centre. That farm was destroyed during a military operation implemented by the security forces of Sri Lanka against local rebels.

As a result, AAPL claimed compensation from the government of Sri Lanka for the damages that it suffered as a consequence of the total loss of its investment.

In order to attribute international responsibility to the government of Sri Lanka, the claimant argued that under the BIT between the UK and Sri Lanka, there was an obligation of the parties to provide the investor of the other contracting party full protection and security.

In relation to the claimed standard, the Tribunal established that contrary to the allegation of AAPL, the Full Protection and Security standard cannot be construed to mean strict liability, as it truly refers to the violation of a general customary international standard of due diligence. This analysis is relevant to the interpretation of the meaning of the Fair and Equitable Treatment standard considering that the standard connotes the same level of treatment as the Full Protection and Security standard, as was pointed out by Judge Asante, in the Dissenting Opinion in this case.

The Tribunal acknowledged the fact that the Full Protection and Security standard may not be inferred to signify a standard that is higher than the International Minimum Standard. “The Tribunal is convinced that in the absence of a specific rule provided for in the treaty itself as *lex specialis*, the general international rules of law have to assume their role as *lex generalis*.”<sup>95</sup>

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<sup>94</sup> Asian Agricultural Products Ltd. (AAPL) vs. Republic of Sri Lanka, ICSID Case ARB/87/3, (Award, 27 June 27 1990), available under <<http://ita.law.uvic.ca/documents/AsianAgriculture-Award.pdf>>.

<sup>95</sup> Asian Agricultural Products Ltd. (AAPL) vs. Republic of Sri Lanka, see note 94.

**b. American Manufacturing & Trading (AMT) (US), Inc. vs. Republic of Zaire<sup>96</sup>**

The American Manufacturing and Trading Inc. claimed that the Republic of Zaire failed to fulfill the obligations instituted by the BIT signed by the United States of America and the Republic of Zaire. The origin of this failure lay in the destruction, by the armed forces of Zaire, of properties and facilities that belonged to Société Industrielle Zairoise (SINZA), a limited liability company 94 per cent owned by AMT.

This BIT stipulated the following in relation to the treatment of investments: “Investment of nationals and companies of either party shall be accorded fair and equitable treatment and shall enjoy protection and security in the territory of the other party. The treatment, protection and security shall be in accordance with applicable national laws, and may not be less than that recognized by international law ... Each party shall observe any obligation it may have entered into with regard to investment of nationals or companies of the other party” (article II (4)).

There is, in consequence, a direct reference in the BIT, to the equivalence between the Fair and Equitable Treatment and the Protection and Security standards and international law. An interesting point, though, is national law being considered by the BIT to be a relevant factor in the determination of the meaning of those standards. However, the Tribunal in this case deemed the analysis of the conformity of the Republic of Zaire’s actions to the international minimum standard of vigilance and care required by international law to be of greater importance.

The Tribunal stated that the practical criteria to determine the breach of the Protection and Security standard by the Republic of Zaire were analyzing whether it constituted a breach of the minimum standard recognized by international law. The Tribunal ultimately concluded that the Republic of Zaire failed to respect the minimum standard required by international law.

This award, as well as the one rendered in the *Asian Agricultural Products Ltd. (AAPL) vs. Republic of Sri Lanka*, provides us, through the analysis of a standard of the same status, the Protection and Security standard, with a view of the meaning of Fair and Equitable Treatment, which is, therefore, tantamount to the minimum standard found in international law.

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<sup>96</sup> American Manufacturing & Trading (AMT) (US), Inc. vs. Republic of Zaire, ICSID Case ARB/93/1 (Award, 21 February 1997) available under <<http://ita.law.uvic.ca/documents/AmericanManufacturing.pdf>>.

### c. **CME (Netherlands) vs. Czech Republic**<sup>97</sup>

Finally, in *CME (Netherlands) vs. Czech Republic*, the Tribunal stated that: “The standard for actions being assessed as fair and equitable are not to be determined by the acting authority in accordance with the standard used for its own nationals. Standards acceptable under international law apply”.<sup>98</sup>

## 6. Missing a Stricter Standard

### a. **Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil (US) vs. Republic of Estonia**<sup>99</sup>

A claim submitted by Mr. Alex Genin, Eastern Credit Limited Inc., and A.S. Baltoil against the Republic of Estonia gave birth to this case, which concerned the violation of the US–Estonia BIT in relation to an investment made by the claimants in the Estonian Innovation Bank, incorporated under the laws of Estonia.

Although the ICSID Tribunal dismissed the claim against the Republic of Estonia, it is interesting to note that the Tribunal recognized that the content of the standard was not clear. Yet, it understood it to be equal to the international minimum standard. In this sense, it said that “Acts that would violate this minimum standard would include acts showing a willful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.”<sup>100</sup>

On this basis, the Tribunal found that the government’s decision to revoke the investor’s banking license for seemingly technical reasons and without prior notice was not a breach of its BIT obligations. Chief among the factors leading to this conclusion was that Estonia’s actions were within its statutory authority, according to applicable procedural

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<sup>97</sup> *CME (Netherlands) vs. Czech Republic*, UNCITRAL Case (Award, 14 March 2003), available under <[http://ita.law.uvic.ca/documents/CME-2003-Final\\_001.pdf](http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf)>.

<sup>98</sup> *CME (Netherlands) vs. Czech Republic*, see note 97.

<sup>99</sup> *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin vs. Republic of Estonia*, ICSID Case No. ARB/99/2 (Award, 25 June 2001), available under <[www.worldbank.org/icsid/cases/genin.pdf](http://www.worldbank.org/icsid/cases/genin.pdf)>.

<sup>100</sup> *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin vs. Republic of Estonia*, see note 99, 91.

rules, and within reason under the circumstances. Thus, its actions “cannot be said to have been arbitrary or discriminatory against the foreign investors in the sense in which those words are used in the BIT.” Therefore, while the Tribunal found that the government’s decision “invites criticism, it does not rise to the violation of any provision of the BIT.”<sup>101</sup>

The Tribunal’s analysis, however, could have gone further. Article II 3 (a) of the US–Estonia BIT provides that: “Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.” It seems that once again, as already analyzed in the OPEC case, if we rely on the ordinary meaning of that article, and, moreover, if we analyze the object and purpose of the treaty, which is to promote, and assure a stable framework for investment, it seems that the intention of the parties was to establish article II as a more ample standard. This signifies that the Fair and Equitable Treatment standard could not be tantamount to the minimum standard established by international law and has, therefore, a more self-contained meaning that, when added to the minimum standard, creates a stricter standard to be followed by host states. In this case, the above analysis could have shifted the verdict.

As we can appreciate from the above-mentioned cases, the bulk of BIT cases that have dealt with the issue appear to equate the Fair and Equitable Treatment standard to the minimum standard of international law. This tendency is also true in Nafta cases, as will be analyzed below. “In the situations where a violation was found, evidence was presented showing bad faith, discriminatory intent, and/or *ultra vires* actions on the part of host-State government officials. In all other instances, including instances where host-State actions were not the model of clarity or fairness but which were legally justified and non-discriminatory, no violation was found.”<sup>102</sup>

#### **b. Nafta: Restricting the Standard**

In the area of jurisprudence relating to the Fair and Equitable Treatment standard, Nafta has been very prolific and evolutionary in the task of defining the standard.

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<sup>101</sup> Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin vs. Republic of Estonia, see note 99, 91.

<sup>102</sup> Gross, see note 69, 935.

Article 1105 of Nafta states the following:

“Article 1105: Minimum Standard of Treatment

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”

Currently, almost every submitted claim alleges a violation of article 1105. The latter is caused by the fact that Arbitral Tribunals are generally reluctant to admit claims related to indirect expropriation. The violation of the Fair and Equitable Treatment standard has, in fact, been deemed to constitute a third kind of expropriation. “NAFTA, BIT, and other tribunals have consistently rejected broadly phrased claims of indirect expropriation, refusing to extend the protection to incidental, incomplete interference with investment value. Thus, investors who feel that they have been in some way ‘wronged’ by a host-State and suffered a decrease in the value of their investment as a result, predictably articulate their claims under the rubric of unfair and inequitable treatment.”<sup>103</sup>

Nafta’s article 1105 considers the Fair and Equitable Treatment standard as a part of international law. In this sense, it does not differ much from the view of BIT Tribunals, as stated before:

“...while Nafta article 1105 provides two standards within its text that could be used to obtain relief for an injured investment (‘fair and equitable standard’ and ‘full protection and security’), one can also look at customary international law and the principles of international law for sources of content for the minimum standard of treatment.”<sup>104</sup>

However, as opposed to the BIT regime, the standard under Nafta underwent an evolution in the definition of the meaning (and a setback regarding the treatment to be granted to foreign investors) that had its origin in a special Nafta organ’s interpretation that intended to define it more clearly. Given the multiple and diverse interpretations issued by Nafta Tribunals, the Free Trade Commission issued a binding interpretation on 21 July 2001 that restricted the meaning. That interpretation stated the following: “Article 1105 (1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of an-

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<sup>103</sup> Gross, *ibid.*, 935.

<sup>104</sup> T. Weiler, “Substantive Law Developments in Nafta Arbitration”, *Mealey’s International Arbitration Report* 16 (2004), 18.



other party. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." Thus, the Fair and Equitable Treatment standard was measured against customary international law and was, therefore, viewed as part of the minimum standard required by customary international law.

The interpretation by the Free Trade Commission had the effect of lowering the standard's protection capacity. Restricting it to the international minimum standard that is present in customary international law limits it to assuring the investor a set of basic rights established by international law that states must grant aliens, regardless of the treatment granted to their own nationals. Restricting the meaning to the standard of customary international law only limits the interpretative capacity of Tribunals to define it as a stricter standard to be followed by host states. The state will only be responsible for outrageous and shocking governmental conduct.

This interpretative function granted to the Free Trade Commission restricts the interpretative flexibility assigned by Chapter 11 to ad hoc arbitration. However, the Commission's task is an important one due to its capacity to create uniform criteria through its interpretative powers.

Notwithstanding the latter, the Free Trade Commission's interpretation has been criticized. C.H. Brower criticizes the notes of the Commission as follows: "It seems evident that the phrase 'fair and equitable treatment' is intentionally vague, designed to give adjudicators the power to articulate the range of principles necessary to achieve the treaty's purpose in particular disputes. By refining 'fair and equitable treatment' to prohibit only the most extraordinary forms of government misconduct, one robs tribunals of their creative charge to develop the law." Moreover, he states that "the members of the Free Trade Commission arguably have exceeded their mandate to interpret article 1105 in accordance with the applicable rules of international law ... Those rules cannot reasonably sustain an interpretation that collapses 'fair and equitable treatment' into everything short of the most unimaginable forms of government misconduct. In fact, the Nafta parties' tight-fisted interpretation seems more consistent with their routine demand that tribunals construe Chapter 11 strictly to minimize intrusions into sovereignty."<sup>105</sup>

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<sup>105</sup> Brower, see note 65.

If one considers that article 1131 of Nafta instructs tribunals to decide issues in accordance with the applicable rules of international law, including the principles set forth in the Vienna Convention on the Law of Treaties, and any rules of international law applicable in the relations between the parties, it is clear that the intention of the parties when negotiating Nafta was to surrender to the Arbitral Tribunal flexibility in interpreting the vague terms of the Treaty in each specific case. Although the Free Trade Commission has an important power through its capacity to interpret the Nafta rules, the interpretation that was rendered concerning article 1105 is believed by many to constitute a true amendment of the treaty, which would imply that the Commission has exceeded its functions.

The Free Trade Commission must interpret treaty rules in accordance with the applicable rules of international law. When interpreting a vague term, it must carry out this function taking into account its ordinary meaning and the context of Chapter 11, which is to increase investment opportunities. The interpretation of the Commission may have clearly exceeded its mandate by restrictively interpreting the standard, when it really should have interpreted it in light of the aforementioned criteria.

The Commission's interpretation, which equated the standard to customary international law, imposes a standard that is below the one established by courts in developed countries. It seems that internationally speaking, developed countries desire to give a minimum protection to their investors abroad, and at the same time they do not want to be obliged by themselves, on an international level, to stricter standards of behavior in relation to foreign investors. "Until recently, the world of investment arbitration knew fairly clear lines between host and investor states. Nations such as Libya and Mexico were the respondent host states, while the United States and Canada were the countries of the investor claimants. Today, however, the United States and Canada under NAFTA have tasted the flavor of being respondent host states in investment arbitrations, with concomitant negative side-effects for economic self-governance."<sup>106</sup>

The Free Trade Commission's Interpretive Note has, nonetheless, brought out another series of issues that need to be clarified. "The FTC Interpretation has not completely clarified the scope of article 1105, however. In tying fair and equitable treatment to the international

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<sup>106</sup> G. Aguilar/ W.W. Park, "The New Face of Investment Arbitration: Nafta Chapter 11", *Yale J. Int'l L.* 28 (2003), 365 et seq.

minimum standard, new debate has begun as to the meaning of the international standard. Investors will certainly argue that it has evolved considerably since the US–Mexico Claims Tribunal’s decision in *Neer* in 1926, when a State’s behavior had to be shocking, egregious and outrageous in order for an alien to have a cause of action against a State for compensation. Investors will argue that fair and equitable treatment as an independent standard has evolved into a rule of customary international law.<sup>107</sup>

The Note issued by the Commission was issued after the *Pope and Talbot* Tribunal had determined that Canada had violated the standard, but before it could award damages. Canada alleged that the Tribunal could not award damages for a breach of article 1105 because Canada and its partners had effectively overruled the previous finding. The Tribunal criticized the Note on the basis of considering it an amendment of *Nafta* that was implemented through the wrong mechanism. However, the Tribunal decided to rely on the Note to keep Canada from resorting to a guaranteed judicial review of its award.

Finally, one must also consider that many BIT’s do not restrict the standard of customary international law, which allows for the treatment reflected therein to be applied to the *Nafta* parties resorting to the Most-Favored Nation principle.

The following are the cases heard by Arbitral Tribunals under *Nafta*, which will provide an overview of the pre- and post-Free Trade Commission Note era.

## 7. The Initial Broad Interpretation

### a. *Pope and Talbot Inc. vs. Government of Canada*<sup>108</sup>

This case constitutes the most comprehensive and ample interpretation of article 1105 by a *NAFTA* Tribunal to date since it introduced the vision of Fair and Equitable Treatment as a self-contained treaty standard.

The *Pope and Talbot* case involved a US lumber exploitation company that brought a claim against the Canadian government in March 1999, alleging Canada’s enactment of export quotas and other measures in its implementation of the United States–Canada Softwood Lumber

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<sup>107</sup> Kirkman, see note 29, 390.

<sup>108</sup> *Pope and Talbot Inc. vs. Government of Canada*, see note 50.

Agreement. After the proceedings had begun, in a verification review episode, Canada's Softwood Lumber Division made especially aggressive requests for Pope and Talbot corporate data, not long after that firm filed its notice of arbitration. It was also alleged to have discriminated against Pope and Talbot's Canadian subsidiary in British Columbia, in violation of NAFTA, specifically articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment), 1106 (Performance Requirements), and 1110 (Expropriation).

The Tribunal found that Canada's Softwood Lumber Division of the Department of Foreign Affairs and International Trade failed to provide Pope and Talbot fair and equitable treatment.

What makes this case so interesting and sets it apart from the rest is the opinion rendered by the Tribunal when applying article 1105 of Nafta, in that the Fair and Equitable Treatment standard was additive to international law and not actually included in it. In other words, the investor under NAFTA was entitled to the international law minimum, plus the fairness elements. Against Canada's argument that limited the scope of the standard equating it to customary law on the basis of the Neer case, the Tribunal arrived at the conclusion that the standard should be conceived in a much broader perspective. The Tribunal considered the BIT provisions, many of them signed by the same Nafta parties, which often required Fair and Equitable Treatment in addition to the treatment required by international law. "The Tribunal's acceptance of the 'additive' approach was based on its conclusion that the 'bilateral commercial treaties negotiated by the United States and other industrialized countries' – upon which Article 1105 was based – represented an evolution of investor rights to include the fairness elements, no matter what else their entitlement under international law [and] ... free of any threshold that might be applicable to the evaluation of measures under the minimum standard of international law."<sup>109</sup> The Tribunal could not conceive that the parties intention was to grant its investors a minimum standard, that is, a standard that was below the standards granted under BIT's to which the same parties had submitted.

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<sup>109</sup> International Decision Pope and Talbot, Inc. vs. Canada, available under <<http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp>>. Nafta Chapter 11 Arbitration Tribunal, 2000-2002. D.A. Gantz, *Protection of Foreign Investment under the NAFTA Chapter 11-UNCITRAL Arbitration Rules-National Treatment-Performance Requirements-Fair and Equitable Treatment-Expropriation-Damages-Allocation of Costs*, edited by D. Caron, *AJIL* 2003.

Therefore, considering that under the Most-Favored Nation clause the parties would be entitled to this better treatment established in BIT's, the Tribunal stated that there was no sense in denying it to them. It did not, however, determine how high the standard to be met by the government was.

The Tribunal was also persuaded by the arguments of F.A. Mann. As previously stated, Mann considered that the standard had a more far-reaching meaning that exceeded customary international law. Mann is cited as the main dissident among the authors who have given their opinion on this subject. He said that it is "misleading to equate the fair and equitable with the minimum standard: this is because the terms fair and equitable treatment envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words ... The terms are to be understood and applied independently and autonomously." However, he later changed his view and stated that "In some cases, it is true, treaties merely repeat, perhaps in slightly different language, what in essence is a duty imposed by customary international law; the foremost example is the familiar provision whereby states undertake to accord fair and equitable treatment to each other's nationals and which in law is unlikely to amount to more than a confirmation of the obligation to act in good faith, or to refrain from abuse or arbitrariness."<sup>110</sup>

During the proceedings, the Free Trade Commission Note was issued. The Tribunal considered whether the Commission, in issuing the interpretation, had acted within its powers under article 1131 (2) or was, instead, using the interpretation as a guise to amend the treaty, permitted only under article 2202, which required the approval of each of the three governments in accordance with their own constitutional procedure.

The Tribunal finally agreed with the interpretation that established that article 1105 "requires each Party to accord to investments of investors of the other Parties the fairness elements as subsumed in, rather than additive to, customary international law." However, although the interpretation was mandatory, the Tribunal did not reverse the award. According to the Tribunal, the original award in favor of the claimant under article 1105 would be revocable only if "the concept behind the fairness elements under customary international law is different from

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<sup>110</sup> F.A. Mann, "The Legal Aspects of Money", in: OECD, see note 15, 510.

those elements under ordinary standards applied in NAFTA countries.”<sup>111</sup>

The Tribunal rejected Canada’s allegation based on the understanding that the violation had to be “egregious” and “outrageous,” according to a static concept of customary international law. As Mexico and Canada had admitted, there had been evolution in customary international law concepts since the 1920’s (Neer case). It is a feature of international law that customary international law evolves through state practice. International agreements constitute the practice of states and contribute to building the grounds of customary international law. In conclusion, the Tribunal did consider the Free Trade Commission’s interpretation. However, it did not reverse its findings considering that even though customary international law was applicable alone, it had evolved since the Neer case, and, therefore, was not limited to an outrageous conduct of the host state.

The Tribunal in this case made important contributions to the interpretation of a key standard of Nafta. The Tribunal conducted an extensive analysis in relation to its views on defining the standard, whether or not these interpretations were strictly necessary to decide the case before it.

Until the Free Trade Commission issued its notes, the Tribunal’s decision was greatly criticized. It was evident to many that by applying the rules of interpretation established in the Vienna Convention on the Law of Treaties, article 1105 of Nafta could not be interpreted so as to put the fairness concept aside from international law, thus broadening the spectrum of the standard. When the Commission’s Interpretive Note came out, the Tribunal, although criticizing it as an amendment instead of an interpretation, adhered to it, even though it maintained Canada’s responsibility due to the evolution of customary law.

Notwithstanding all the foregoing, there is a practical element that must be taken into consideration for this and other cases. It seems that the widening of the standard is now in process and will not stop. Through the Most-Favored Nation clause, investors will be entitled to claim the application of the standard as it is conceived in many BIT’s, in which the fairness element is conceived in addition to the international standard. The US Model Bilateral Investment Treaty of 1987 has already instituted the new standard. Countries such as Canada, the United Kingdom, Belgium, Luxembourg, France and Switzerland have

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<sup>111</sup> Gantz, see note 109.

followed the model. It seems that the trend has already started to be imposed, and although many treaties equate the standard to customary international law, it seems that through the Most-Favored Nation clause, more Pope and Talbot's that refer to other BIT's will come to the fore. This is also the case of MTD, where the Tribunal accepted the application of other BIT's that were signed by Chile and that granted better treatment to the investor.

## 8. Applying the Free Trade Commission's Interpretive Note

### a. *Mondev International LTD. vs. United States of America*<sup>112</sup>

Lafayette Place Associates was a Massachusetts limited partnership owned by Mondev International LTD., a real estate company incorporated under the laws of Canada. Lafayette Place Associates had brought a lawsuit against the City of Boston and the Boston Redevelopment Authority for breach of a contract to develop a shopping mall in Boston, finally winning the trial. However, the State's Judicial Court reversed the judgment in 1998. Due to the latter, Mondev International LTD. submitted a claim against the United States of America before the ICSID, based on the US's breach of Chapter 11 of Nafta. Specifically, the company claimed the US breached the provisions on National Treatment, Minimum Standard of Treatment, Expropriation and Compensation.

The Tribunal analyzed the implications of the Free Trade Commission's notes and stated that whether or not an amendment to Nafta, it accepted it. It also clarified that article 1105 referred to a standard existing under customary international law and not to standards established by other treaties of the three Nafta parties (in this part it deviates from the Pope and Talbot case). "If there has been an intention to incorporate by reference extraneous treaty standards in article 1105 and to make Chapter 11 arbitration applicable to them, some clear indication of this would have been expected."<sup>113</sup>

However, the Tribunal states that "In holding that article 1105 (1) refers to customary international law, the FTC interpretation incorporates current international law, whose content is shaped by the conclusion of more than two thousand bilateral investment treaties and many

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<sup>112</sup> *Mondev International LTD. vs. United States of America*, see note 51.

<sup>113</sup> *Mondev International LTD. vs. United States of America*, see note 51.

treaties of friendship and commerce. Those treaties largely and concordantly provide for 'fair and equitable' treatment, and for 'full protection and security' for the foreign investor and his investments."<sup>114</sup> The latter reflects the conviction of the Tribunal in relation to the equivalence of the standard to the minimum standard of treatment in customary international law but in its evolutionary form, in the understanding of customary international law as it is conceived today, that is, conveying the practice of all investment treaties existing to this date.

The Tribunal states that customary international law includes current international law and, therefore, the practice contained in the numerous investment treaties. The question is whether there is *opinio juris* to back up the inclusion of that state practice in BIT's as customary international law. Can we determine that there is customary international law by the practice conveyed in BIT's when the meaning of the standard provided in each differs precisely from the rest? It seems that state practice is not yet uniform in a way that constitutes customary international law.

The problem, as mentioned above, is that these treaties have not yet uniformly defined the meaning of the standard and, moreover, lack *opinio juris* to establish a common feature that would define customary international law for that effect. The award in this sense did not prove that the two thousand bilateral investment treaties to which it makes reference are constitutive of customary international law.

#### **b. Loewen Group, Inc. and Raymond L. Loewen vs. United States of America<sup>115</sup>**

The "Loewen case" originated in the commercial dispute between two competitors in the funeral home and funeral insurance business in Mississippi. Mr. Jeremiah O'Keefe filed a claim before the Mississippi State Court against the Loewen Group, Inc., a Canadian chain of funeral homes. After the trial, which was allegedly marked by the use of xenophobic language, the jury awarded US\$ 500,000,000 against the Loewen Group. The respondent intended to appeal but was confronted with the application of an appellate bond requirement which the Mississippi Supreme Court refused to lower. The respondent was forced to settle with the claimant.

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<sup>114</sup> *Mondev International LTD. vs. United States of America*, see note 51.

<sup>115</sup> *Loewen Group, Inc. and Raymond L. Loewen vs. United States of America*, see note 77.



In consideration of the above, the respondent resorted to the ICSID, alleging a violation of Chapter 11 of Nafta committed primarily by the State of Mississippi in the course of the litigation and, moreover, denial of justice in violation of article 1105 of Nafta.

On the issue relating to an eventual violation of the Fair and Equitable Treatment standard, the Tribunal resorted to the Free Trade Commission's interpretation. The Tribunal stated the following: "The effect of the Commission's interpretation is that fair and equitable treatment and full protection and security are not free-standing obligations. They constitute obligations only to the extent that they are recognized by customary international law. Likewise, a breach of article 1105 (1) is not established by a breach of another provision of Nafta. To the extent, if at all, that Nafta Tribunals in *Metalclad, S.D. Myers and Pope and Talbot* may have expressed contrary views, those views must be disregarded." The Tribunal concluded that "bad faith or malicious intention" was not required. "Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough ... " Although the Tribunal stated that the whole trial in the local courts and their verdict were improper and discreditable, and cannot be squared with minimum standards of international law and Fair and Equitable Treatment, the Trial Court conduct did not amount to a violation of the standard by the United States because it was not established that the US had failed to make adequate remedies reasonably available to the claimants.

It is interesting to note that the Tribunal deems the Fair and Equitable Treatment standard as such only to the extent that it is recognized by customary international law. What the Free Trade Commission really means by its interpretation is that the standard's meaning is equitable to customary international law. If the standard is incorporated in a treaty, it exists for the parties and its existence has no need to be proven as a rule of customary international law. From the moment when article 1105 makes reference to the standard, there can be no doubt that the standard exists.

## 9. Proof of Customary International Law

### a. ADF Group Inc. vs. United States of America<sup>116</sup>

The case relates to the construction of the Springfield Interchange Project, a highway located in North Virginia. The original Interchange went through a series of changes in the original design and structure of its highways and structures to improve its safety and efficiency. The construction was awarded to a contractor named Shirley Contracting Corporation. This contractor in turn called for bids for the construction of certain parts of the project. The part regarding the supply of steel was awarded to ADF International Inc. for which a subcontract was signed between them. The claim submitted by ADF related to damage resulting from federal legislation that required federally funded state highway projects to use only domestically produced steel.

The findings of the Tribunal in relation to the standard determined first the obligatory nature of the Free Trade Commission's interpretation. It rendered its award on the basis that Fair and Equitable Treatment is a reference to the customary international law minimum standard. It also recognized that it has an evolving nature. For this purpose, it cited the award rendered in the *Mondev* case.

The Tribunal stated the following: "We are not convinced that the investor has shown the existence, in current customary international law, of a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited contexts) to accord fair and equitable treatment and full protection and security to foreign investments. The investor, for instance, has not shown that such a requirement has been brought into the corpus of present day customary international law by the many hundreds of bilateral investment treaties now extant. It may be that, in their current state, neither concordant state practice nor judicial or arbitral case law provides convincing substantiation (or, for that matter, refutation) of the investor's position."

The Tribunal dismissed the investor's claim in relation to a breach of the standard by the respondent. However, the same observation made in the *Loewen* case must apply here. Is it necessary to demonstrate the existence of the standard in customary international law or is it just that customary international law is equated to the standard?

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<sup>116</sup> ADF Group Inc. vs. United States of America, ICSID Case No. ARB (AF)/00/01, (Award, 9 January 2003), available under <[http://ita.law.uvic.ca/documents/ADF-award\\_000.pdf](http://ita.law.uvic.ca/documents/ADF-award_000.pdf)>.

## 10. Transparency and Predictability

### a. *Metalclad Corporation vs. The United Mexican States*<sup>117</sup>

The company called Coterin attempted to construct and operate a hazardous waste landfill in La Pedrera in the valley of Guadalcázar, Mexico. This was authorized by the Federal Government of Mexico and the National Ecological Institute. Three months after these authorizations, Metalclad Corporation entered into an agreement to purchase Coterin together with all its permits. The Mexican authorities granted Metalclad a state land-use permit to construct the landfill subject to the requirements that the project be adapted to the specifications and technical requirements indicated by the corresponding authorities.

Shortly after the purchase of Coterin by Metalclad, the Mexican authorities commenced a public campaign to denounce and prevent the operation of the landfill. Metalclad had begun the construction of the landfill believing it had all the authority necessary to construct and operate it. In October 1994, the Municipality ordered the cessation of all building activities due to the absence of municipal permits.

Although Metalclad completed the construction, it was not able to open and operate it. The construction permit was finally denied. Finally, in addition to the latter, the authority issued an ecological decree declaring a natural reserve that included the landfill location. Metalclad resorted to the ICSID.

In what relates to the standard, the findings of the Tribunal were the following: Transparency, which is dealt with in some provisions of Nafta, is a component of the Minimum Standard Treatment guaranteed under article 1105. The Tribunal established that Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. It understood the term to include the idea that all relevant legal requirements for the initiation, completion and successful operation of an investment should be capable of being readily known to all affected investors of a party and that there should be no room for doubt or uncertainty.

However, the latter findings were revoked by the Supreme Court of British Columbia, which established that the Tribunal had exceeded its jurisdiction. For the Court, the Tribunal interpreted article 1105 far too broadly, including transparency. It did not, from the point of view of

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<sup>117</sup> *Metalclad Corporation vs. The United Mexican States*, see note 76.

the Court, determine that transparency is a principle of customary international law.

## 11. Unjust and Arbitrary Treatment under International Law

### a. *S.D. Myers Inc. vs. Canada*<sup>118</sup>

*S.D. Myers Inc.* was a US company whose business was the remediation of PCB waste. Using a Canadian affiliate (*Myers Canada*), *S.D. Myers Inc.* solicited orders for the destruction of Canadian-owned PCBs at its U.S. facilities. The company's project was to import electrical transformers and other equipment containing PCB waste into the US from Canada. However, the latter was banned by the Canadian authorities. *S.D. Myers Inc.* initiated action against Canada under UNCITRAL arbitration rules alleging a violation of arts 1102, 1105, 1106 and 1110.

In the analysis that the Tribunal made of the standard, it concluded that article 1105 had to be read as a whole. This meant that the terms Fair and Equitable Treatment and Full Protection and Security must be read in conjunction with treatment according to international law. "The Tribunal considers that a breach of article 1105 occurs only when it is shown that an investor has been treated in such an unjust and arbitrary manner that the treatment rises to a level that is unacceptable from the international perspective, bearing in mind the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders."<sup>119</sup>

The *Myers* Tribunal pointed out that to qualify conduct as a breach of article 1105, the treatment must fail to conform to international law. Two examples are Fair and Equitable Treatment and Full Protection and Security, but they are not alone. If a certain treatment is perceived as unfair, it may still not constitute a breach of article 1105 unless it is not in accordance with international law.

The Tribunal further stated that "*Myers*, *Metalclad* and *Pope and Talbot* case findings proceed on the basis that a breach of article 1105 can be found for acts that would not be found to have breached the minimum standard of treatment of customary international law. They also suggest that acts that would survive a legal challenge in a sophisti-

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<sup>118</sup> *S.D. Myers Inc. vs. Canada*, see note 78.

<sup>119</sup> *S.D. Myers Inc. vs. Canada*, see note 78.

cated and, by international standards, fair domestic legal system can be impugned under article 1105. Myers accepted that article 1105 contains a customary international law standard that in order to attract state responsibility requires a state to engage in an act that is unacceptable from the international perspective. The NAFTA parties have stated that Myers correctly recognized that Article 1105 contains a customary international law standard, but that the majority then incorrectly found that a breach of a conventional international law rule gave rise to a breach of customary international law. Each party has stated that the dissent was correct.”<sup>120</sup>

## 12. An Outright and Unjustified Repudiation of Regulations

### a. *Gami Investments, Inc. vs. The United Mexican States*<sup>121</sup>

GAM (Grupo Azucarero Mexico S.A.), a Mexican holding company, acquired sugar mills from the government of Mexico in the late 1980's and early 1990's under a privatization program. In 2001, GAM was Mexico's fourth largest sugar producer. In 1996, 1997 and 1998, GAMI Investments Inc. (GAMI), a US investment corporation, acquired a series of GAM shares, which represented a total of 14.18 per cent.

The Government of Mexico failed in various ways to fulfill its regulatory functions under the regime established pursuant to the Sugarcane Decree of 1991. Export requirements were not enforced; the establishment of production ceilings required by law were not materialized and, as a result, sugar was dumped on the domestic market. Mills were caught between low prices for their products and the regulated high costs of their primary raw material (sugarcane). The latter meant a crisis for the entire industry and the filing of a suspension of payments by GAM. Moreover, the government expropriated all of GAM's sugar mills through an expropriation decree in 2001.

GAMI initiated UNCITRAL proceedings against the government of Mexico, exercising the option available to it under Nafta. GAMI

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<sup>120</sup> J.C. Thomas, “Fair and Equitable Treatment Under Nafta's Investment Chapter”, *ASIL* 9, Proceedings of the 96 Annual Meeting, 2002.

<sup>121</sup> *Gami Investments, Inc. vs. The United Mexican States*, UNCITRAL Case, (Award, 15 November 2004), available under <<http://www.state.gov/documents/organization/38789.pdf>>.

claimed that due to the Mexican Government's actions that caused GAM's business to suffer, the value of GAMI's shares were affected.

GAMI's claims were the following: (A) Failing to accord GAMI's investment Fair and Equitable Treatment and full protection and security in accordance with international law; (B) Treating GAMI and its investments less favorably than it treated Mexican investors and their investments in like circumstances; and (C) Violating article 1110 of Nafta, that is, indirectly expropriating GAMI's shares in GAM in a manner inconsistent with the requirements of article 1110.

The Tribunal explained that in addition to not demonstrating a violation of article 1105, GAMI did not prove a specific and quantifiable prejudice of the maladministration of the sugar program. Therefore, the Tribunal would not have been able to award damages in any event, even if it had found a violation of article 1105.

Nevertheless, the Tribunal explained in its award its conclusions that GAMI also failed to establish its claim under article 1105.

GAMI claimed that Mexico had failed to implement and enforce its own internal laws and that this failure was "flagrant and arbitrary." It mentioned that Mexico had infringed the standard set down in the Tecmed case. Moreover, it referred to the Waste Management II case<sup>122</sup>, quoting the following:

"Taken together, the S.D. Myers, Mondev, ADF and Loewen cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard, it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant." The Waste Management II case also noted that the violation does not require proof of a kind of outrageous treatment referred to in the Neer case.

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<sup>122</sup> Waste Management, Inc. vs. United Mexican States (Number 2), ICSID Case No. ARB(AF)/00/3, available under <[http://ita.law.uvic.ca/documents/laudo\\_ingles.pdf](http://ita.law.uvic.ca/documents/laudo_ingles.pdf)>.

Mexico, for its part, did not question the latter, but believed that the Nafta Tribunal had no power to control the application of national law by national authorities. The Tribunal said that international law does not appraise the content of regulatory programs. The inquiry is whether the state abided by or implemented that program. The Tribunal's duty is rather to appraise whether and how pre-existing laws and regulations are applied to the foreign investor. There must be an identification of the type of maladministration that could rise to the level of a breach of international obligations. "A claim of maladministration would likely violate article 1105 if it amounted to an outright and unjustified repudiation of the relevant regulations ... It is the record as a whole – not dramatic incidents in isolation – which determines whether a breach of international law has occurred."<sup>123</sup> GAMI was not able to show any outright and unjustified repudiation of the relevant regulations.

But, would something less than repudiation still be actionable under article 1105?

GAMI alleged an abject failure to implement a regulatory program indispensable to the viability of foreign investments that relied upon it. So far, the Arbitral Tribunal would have accepted GAMI's allegations. However, GAMI was not able to prove that the specific failure of the sugar program was attributable to the government of Mexico. "It is on this point that the Tribunal concludes GAMI had not made its case."

In conclusion, the view of arbitrators concerning the meaning of the standard differs from one ruling to another. There is no clearly defined opinion. A unique initiative that helped to unify the criteria was the Free Trade Commission's Note; however, it reduced the level of protection, and therefore did not constitute progress in this matter.

#### **IV. Fair and Equitable Treatment: The Formulation of a Standard**

##### **1. The International Minimum Standard Approximation. A Door to Customary Law**

When states agree upon the Fair and Equitable Treatment standard and include it in an investment agreement, they are dealing with the fairness

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<sup>123</sup> Gami Investments, Inc. vs. The United Mexican States, see note 121.

and equity concept that is already present in their own legal systems, which they view as a common standard. However, and for the purpose of attaining the status of a common standard at the level of international obligations, an important deal of uniformity in relation to its significance is decisive, which will be achieved through the determination of its main elements.

One of the main theories that exists to define the Fair and Equitable Treatment standard is the one that considers the standard to be a part of the international minimum standard required by international law, which, for many states, is a part of customary international law, as will be discussed below.

The latter conclusion derives from a set of sources in which there is a capital-exporting state perspective on the issue. And although at the doctrinal level, this is an approximation on which there is important literature, it is salient to point out that “it cannot readily be argued that most states and investors believe fair and equitable treatment is implicitly the same as the international minimum standard.”<sup>124</sup> There is not a general acknowledgment of countries in relation to this approach at the empirical level, as we will establish.

#### **a. The International Minimum Standard**

The international minimum standard is a rule of customary international law which governs the treatment of aliens by providing for a minimum set of principles which states, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property.<sup>125</sup> Moreover, “the international minimum standard sets a number of basic rights established by international law that states must grant to aliens, independent of the treatment accorded to their own citizens.”<sup>126</sup>

The violation of this standard may engender international responsibility for the host state.

The international minimum standard is related to the protection of foreign nationals or aliens in general, and has, due to the remarkable growth in international investment instruments, mainly BIT's, gained an important representation in the area of investment.

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<sup>124</sup> UNCTAD, see note 31, 13.

<sup>125</sup> OECD, see note 68, 26.

<sup>126</sup> OECD, see note 68, 26.



This standard had been already recognized by Vattel in the 18th century and was referred to during the 19th and 20th centuries. The decisive ruling regarding this standard was the Neer Claim<sup>127</sup> which defined the type of treatment of an alien that would constitute international delinquency (“outrage, bad faith, wilful neglect of duty, an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency”).

Since the 20th century, however, the standard’s existence was challenged by Latin American countries and other developing countries that asserted the rule of national treatment instead. After World War II, the significance of this standard as an autonomous rule of customary international law has persisted only to the extent of the protection of foreign property and investments (in its relationship to the Fair and Equitable Treatment standard).

#### **b. Fair and Equitable Treatment: Part of Customary International Law?**

The relationship between the Fair and Equitable Treatment standard and the international minimum standard of customary international law has been regarded by some investment agreements as equivalent terminology. For others, the standard is a part of the international minimum standard of customary international law. However, and with the exception of Nafta (through its Free Trade Commission’s interpretation of the issue) and those investment instruments that expressly equate the Fair and Equitable Treatment standard to the international minimum standard, such as the US and UK BIT Model, “the vast majority of those containing such clause (Fair and Equitable), about 88 percent, make no mention of international law in connection with it ... In my sample of that approximately 12 percent that mention international law in connection with fair and equitable treatment, almost half designate international law only as a floor, implying that fair and equitable treatment may require more, but never less, than international law.”<sup>128</sup> Moreover, “bearing in mind that the international minimum standard has itself been an issue of controversy between developed and developing states for a considerable period, it is unlikely that a majority of states would have accepted the idea that this standard is fully reflected

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<sup>127</sup> Neer Claim, see note 68, 60.

<sup>128</sup> Coe, see note 74.

in the fair and equitable standard without clear discussion ... both standards may overlap significantly with respect to issues such as arbitrary treatment, discrimination and unreasonableness, but the presence of a provision assuring fair and equitable treatment in an investment instrument does not automatically incorporate the international minimum standard for foreign investors.”<sup>129</sup>

As a basis for the analysis, it must be noted that the equating of the Fair and Equitable Treatment standard to the international minimum standard of customary international law involves the standard of treatment provided by the state parties being below the one that may be provided if we consider the standard to be a self-contained one. When the Free Trade Commission in Nafta issued its Interpretative Note, it prohibited only the most extraordinary forms of government misconduct (a conclusion that comes from the Neer case<sup>130</sup> which relies on egregious, outrageous and shocking conduct). The latter was an interpretation for the specific case of Nafta that must be applied in that context. Nevertheless, in the general area of investment agreements, it becomes difficult to believe that considering the evolution in the investment attraction policy in most states, all those agreements in which the equating of the Fair and Equitable Treatment standard to the international minimum standard is not expressly stipulated, the intention of the state parties was to minimize the treatment that must be granted by the host state in order to commit this most “outrageous” conduct. Such was the Pope and Talbot<sup>131</sup> arbitral Tribunal’s conclusion, prior to the Free Trade Commission’s note, which although fairly criticized on some issues, in consideration of the Model BIT of 1987 of the United States, which afforded a higher level of protection to the investor, expressed a very valid opinion in the sense that the true intention of the state parties was to accord a higher level of treatment to the investor. The latter conclusion is even more relevant if we take into account that through the Most-Favored Nation clause included in investment agreements, the investor may demand this high degree of conduct from the host state since it is more favorable treatment.

Currently and “more contemporarily, an ICSID Tribunal recently stated that in order to amount to a violation of [a] BIT [guarantee of fair and equitable treatment], any procedural irregularity would have to amount to bad faith, wilful disregard of due process of law or an ex-

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<sup>129</sup> Vasciannie, see note 2, 144.

<sup>130</sup> Neer Claim, see note 68, 60.

<sup>131</sup> Pope and Talbot Inc. vs. Government of Canada, see note 50.

treme insufficiency of action such that the act in question amounted to an arbitrary act that violates the Tribunal's sense of juridical propriety. While some Tribunals might not take a position quite as extreme, it does appear that something close to this standard is generally applied."<sup>132</sup> This is an arbitral award (Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin vs. Republic of Estonia) on the basis of a self-contained standard. However, on the other hand, Nafta arbitrators had to deal with the standard equated to the international minimum standard of treatment of customary international law as expressly stated in the treaty. States have acknowledged that the interpretation that was imposed by the Free Trade Commission did not equate Fair and Equitable treatment to customary international law as defined in the Neer case. In fact, it referred to what customary international law means at this time, i.e., in its evolved form.

Did the findings of the arbitrators in the above case comply with the definition of this standard as stated by the Free Trade Commission, or did they exceed it? To what extent has customary international law evolved? What is the limit between customary international law as it has evolved to this date and a wholly self-contained standard?

In this sense, "while tribunals differ as to whether they refer to a minimum international standard, the bulk of the BIT and NAFTA cases which have dealt with the issue appear to apply a standard close to a minimum international standard. In the situations where a violation was found, evidence was presented showing bad faith, discriminatory intent, and/or ultra vires actions on the part of host-state government officials. In all other instances, including instances where host-state actions were not the model of clarity or fairness but which were legally justified and non-discriminatory, no violation was found."<sup>133</sup> The latter is a fact, Tribunals tend to apply a standard close to the international minimum standard; despite this, many awards, due to the vagueness of the agreement on the issue, have exceeded it.

In the Metalclad case<sup>134</sup>, the Tribunal found a violation of article 1105 (1) due to a lack of transparency in the Mexican legal process. In reviewing the award of the Tribunal, the Supreme Court of British Columbia considered that "the Tribunal has inaccurately read transparency

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<sup>132</sup> Gross, referring to the Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin vs. Republic of Estonia case, see note 69.

<sup>133</sup> Gross, see note 69.

<sup>134</sup> Metalclad Corporation vs. The United Mexican States, see note 76.

provisions of Nafta Chapter 18 into Chapter 11 and that transparency is not a requirement under customary international law.”<sup>135</sup>

Moreover, “it is clear that the Tribunal proceeded on the basis that the scope of Article 1105 extended beyond norms that have become an accepted part of customary international law. This is evident insofar as its decision does not invoke customary international law as the basis for imposing transparency requirements on Mexico; rather, in its view, these requirements flowed from conventional international law, namely the NAFTA ... The Tribunal had misstated the applicable law to include transparency obligations and it then made its decision on the basis of the concept of transparency.”<sup>136</sup>

The *Metalclad*<sup>137</sup>, *Myers*<sup>138</sup> and *Pope and Talbot*<sup>139</sup> awards “proceed on the basis that a breach of article 1105 can be found for acts that would not be found to have breached the minimum standard of treatment at customary international law.”<sup>140</sup>

Moreover, in the *Maffezini* case<sup>141</sup>, Spain was held responsible for violating the treatment clauses in its BIT with Argentina when it conducted a loan transaction without enough transparency so as to be fair and equitable to the investor, although the applicable BIT did not refer to international law; therefore, there was no discussion of international custom by the Tribunal.

In general, “an analysis of the opinions of the arbitral Tribunals, which have attempted to interpret and apply the ‘fair and equitable treatment’ standard, identified a number of elements which, singly or in combination, they have treated as encompassed in the definition of the ‘fair and equitable standard’: due diligence and due process, including non-denial of justice and lack of arbitrariness, transparency and good faith. There is a common understanding among OECD countries that due diligence and due process, including non-denial of justice and lack

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<sup>135</sup> Nanda, see note 73.

<sup>136</sup> C. Tollefson, “*Metalclad vs. United Mexican States Revisited: Judicial Oversight of Nafta’s Chapter Eleven Investor–State Claim Process*”, 11 *Minnesota Journal of Global Trade* (2001/2002), 183 et seq.

<sup>137</sup> *Metalclad Corporation vs. The United Mexican States*, see note 76.

<sup>138</sup> *S.D. Myers Inc. vs. Canada*, see note 78.

<sup>139</sup> *Pope and Talbot Inc. vs. Government of Canada*, see note 50.

<sup>140</sup> Thomas, see note 120.

<sup>141</sup> *Emilio Agustín Maffezini vs. The Kingdom of Spain*, ICSID Case No. ARB/97/7, (Award, 13 November 2000), available under <<http://ita.law.uvic.ca/documents/Maffezini-Award-English.pdf>>.

of arbitrariness, are elements well grounded in customary international law which could be accepted as part of the definition of fair and equitable treatment. There are differing views as of the role of transparency as a new or a possible element of a fair and equitable standard linked to evolving customary law. Most OECD countries' agreements define it as an obligation under a separate provision. OECD countries seem to consider good faith to be more a principle underlying the general obligation rather than a distinct obligation to investors pursuant to the 'fair and equitable treatment' standard.<sup>142</sup>

In the scope of Nafta, the interpretation granted by the Free Trade Commission has not been helpful in clarifying things. "Now that in the light of the Notes of Interpretation, a customary international law standard is to be applied by arbitral Tribunals in interpreting minimum standards of treatment, how will 'fair and equitable treatment' be construed? The basic concepts, of course, are fairness and due process, but as article 1105 stands, its language surely is not a model of clarity. Also, as we have seen, no consistent body of jurisprudence has thus far been developed by arbitral Tribunals. As the Metalclad Tribunal and the British Columbia court's decision diverge in interpreting the pertinent concepts, there is no certainty as to how future Tribunals will construe the phrase. No reliance can therefore be placed on precedent, for the rationale for Tribunal Awards is often conflicting and lacks coherence."<sup>143</sup>

The Free Trade Commission's intention, through the issuance of its notes, was to restrict the flexibility of arbitral Tribunals. However, the international minimum standard's own vagueness as a term did not allow even that since Tribunals, have in practice, exceeded their intentional terms.

The whole divergence between most Tribunals' decisions seems to confirm that the term is still subject to their own interpretations according to the facts of each case. To many, it seems that tribunals should maintain the opportunity to construe their text. Relying on the principle behind the investment agreement, which is to grant protection to the foreign investor, the restriction of the standard's meaning to customary international law and, therefore, the restriction of the Tribunals' own functions, does not help in this respect. "Interpretation must begin

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<sup>142</sup> OECD (ed.), *Fair and Equitable Treatment Standard in International Investment Law: Draft Concluding Observations*, 2004, 3.

<sup>143</sup> Nanda, see note 73.

with the rules that appear in the Vienna Convention, but it cannot end with the Notes of Interpretation.”<sup>144</sup>

In conclusion, although some investment agreements do equate the Fair and Equitable Treatment to the international minimum standard in customary international law, it cannot be concluded that this is the general meaning that the standard has adopted in international law. Even Nafta Tribunals that were restricted in their interpretation exceeded customary international law, which leads us to conclude that the meaning is still mainly in the hands of each Tribunal, eventually applying a plain-meaning approach to it.

### c. Conversion into a Customary International Rule?

Lastly, is it possible to conclude that the Fair and Equitable Treatment standard has been transported into customary law? “Perhaps a useful working hypothesis is that though originally only a conventional standard, fair and equitable treatment may be poised to enter and thus enlarge custom.”<sup>145</sup>

The consequence of the standard becoming part of customary international law is its application to those states which have not made reference to the standard in their own investment agreements.

Considering that rules governing foreign investment between states are set out mainly in treaties, most references to the Fair and Equitable Treatment standard may be found there. The question in relation to it becoming a part of customary international law may have its origin in these treaties that make reference to the standard. “It is a matter of theory that the standard of fair and equitable treatment has become a part of customary international law. This possibility arises from the fact that, in some instances, where a treaty provision is norm-creating in character, this provision may pass into customary law once certain criteria are satisfied.”<sup>146</sup>

The latter, however, has proven not to be the case. There is a lack of a real demonstration by states of their willingness (*opinio juris*) to incorporate the standard in customary international law. The latter is revealed in the multilateral as well as bilateral conduct of states.

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<sup>144</sup> Brower, see note 65.

<sup>145</sup> Coe, see note 74.

<sup>146</sup> UNCTAD, see note 31, 17.

At the multilateral level, most of those investment agreements that make reference to the standard (Havana Charter,<sup>147</sup> Abs-Shawcross Draft and the OECD Draft) failed to come into force. Although a certain *opinio juris* from states could derive from pronouncements issued when negotiating these instruments, it is unlikely that it would suffice to constitute customary international law. The latter is a consequence, for example, of the OECD Draft or other investment agreements such as Nafta, representing only the opinion of capital-exporting countries, therefore not being able to constitute a customary international rule generally worldwide in range, but rather merely reflecting a regional consensus, hence not including a broad consensus among the rest of the states.

In the bilateral sphere, there is a clear indication of the possibility of the wide number of BIT's containing the standard to provide evidence of conforming customary international law on the basis of the general practice and possible *opinio juris* that is reflected among them. Moreover, the Most-Favored Nation clause further extends the impact of the standard. However, the reality is that those agreements may be only an expression of general practice. There is a lack of *opinio juris* by developing countries that have accepted the inclusion of the standard more for political or economical reasons that may be imposed by developed countries than on the basis of conviction. "Individual developing countries, hoping that an infusion of foreign investments may generate growth, are inclined to accept bilateral investment treaties in the terms proposed by capital-exporting countries."<sup>148</sup>

Moreover, an unequal bargaining power may contribute to this. The aforementioned may be seen for example in the negotiating of a compensation formula in the event of expropriation. "Many developing countries conclude BIT's to promote economic development despite their formal opposition to the Hull doctrine. This inconsistency in the behavior of developing states in bilateral treaties has been described by some authors as double standard or paradoxical behavior on their part. Therefore in this state of conflicting norms and paradoxical behavior on the part of developing countries, it is hardly possible to say that any *opinio juris* has arisen by the State practice on BIT's by which one can conclude that BIT norms are binding on all states."<sup>149</sup>

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<sup>147</sup> The Havana Charter, see note 3.

<sup>148</sup> Vasciannie, see note 2, 126.

<sup>149</sup> A. Al Faruque, "Creating Customary International Law Through Bilateral Investment Treaties: A Critical Appraisal", *IJIL* 44 (2004), 292 et seq. (313).

Nevertheless, “as the number of bilateral investment treaties between developing states increases, however, the point concerning inequality of bargaining power may lose some of its vigour, for developing country support for the fair and equitable standard in their relations inter se could prompt the perception that the developing countries concerned regard the standard as having acquired customary status.”<sup>150</sup>

It seems, nonetheless, that although we could consider that there is a general practice concerning the standard, there is clearly a lack of *opinio juris* thus far to date.

The practical conclusion is that if the Fair and Equitable Treatment standard is not referred to in the investment agreement, it will not be applicable in protection of the foreign investor. There is a need for an explicit provision of the standard in an agreement.

Notwithstanding the latter conclusion, there is a thought that should not be left out. The Fair and Equitable Treatment standard has its own expression in municipal law. The idea behind this standard can be found in municipal law in the form of respect for the fair and legitimate expectations granted by the government to an investor as well as the principle of good faith that should constitute the framework in which economic relations must develop. If we consider that these principles are applied in each country and that there is a conviction of each one of them in regard to constituting law, we may be able to argue that the standard has effectively become customary international law. The concern regarding the protection of the legitimate expectation granted by a government to an investor has transgressed municipal law, and in international law, has become connected with the Fair and Equitable Treatment standard.

## 2. A Self-Contained Standard?

The Fair and Equitable Treatment standard conceived as a self-contained standard relies on the idea that the standard of treatment is given its plain meaning, that is, each word contained in the standard must be analyzed on the basis of its own general definition. Therefore, the assessment to be carried out to determine the content of the standard, which will be afforded to the foreign investor, is based on the proper meaning of the terms “fair” and “equitable.” Still, this is only

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<sup>150</sup> Vasciannie, see note 2, 159.



the basis on which the determination will be made. Other elements will be taken into account, most importantly, the facts and special features of the case. The plain meaning approach “is no doubt entirely consistent with canons of interpretation in international law.”<sup>151</sup>

A treatment will thus be fair “when it is free from bias, fraud or injustice; equitable, legitimate ... not taking undue advantage; disposed to concede every reasonable claim”; and by the same token, equitable treatment is that which is characterized by equity or fairness ... fair, just, reasonable.”<sup>152</sup>

An important ruling concerning this theory was issued in the Pope and Talbot case<sup>153</sup>, which established that the fairness element in article 1105 is additional to the requirements of international law. This conclusion was based not on the wording of article 1105 itself since the Tribunal recognized that, in fact, the article suggested otherwise, rather the interpretation was based on the consideration of BIT’s signed by the United States both before and after Nafta, which granted a higher standard of treatment to the investor.

On the other hand, the Pope and Talbot case considered that if we take into account the Most-Favored Nation clause, it becomes absurd to deny an investor the better treatment granted in other investment agreements, considering that through this clause, the investor will have access to this improved treatment. The Pope and Talbot Tribunal<sup>154</sup> considered that the standard set by Nafta was equal to that granted by BIT’ s that preceded Nafta. The Tribunal did not approve the idea that the intention of the parties would have been to deny the investors under Nafta the better treatment existent under BIT’s.

The plain-meaning approach entails a series of advantages, such as “the considerable advantages of uniformity.” After all, why should “fair and equitable treatment” mean something different depending on which BIT applies?<sup>155</sup> This is not a minor issue. It seems that this approach would surely improve the uniformity of the interpretation of the standard issued by Arbitral Tribunals. If we consider the standard in its plain meaning, arbitral rulings would become more uniform and vary only in a degree according to the facts of each case. It seems much easier

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<sup>151</sup> *Id.*, see note 2, 103.

<sup>152</sup> *Id.*, see note 2, 103.

<sup>153</sup> Pope and Talbot Inc. vs. Government of Canada, see note 50.

<sup>154</sup> Pope and Talbot Inc. vs. Government of Canada, see note 50.

<sup>155</sup> Coe, see note 74.

to rely on the general meaning granted to a word than to determine what special standards of customary international law are equivalent to the Fair and Equitable Treatment standard. The decision, considering the case's facts, must simply be based on whether the conduct at issue is fair and equitable or unfair and inequitable.

Another approach to the issue is the view of F.A. Mann, who considered that the obligation of Fair and Equitable Treatment constitutes the overriding obligation. This overriding obligation includes other standards, such as the Most-Favored Nation Clause and National Treatment standards. These standards are, in his view, granted to ensure that the Fair and Equitable Treatment standard is not impeded. However, the latter is a minority position. Generally, the Most-Favored Nation and National Treatment standards are independent of the Fair and Equitable Treatment standard.

Notwithstanding the latter, Mann states that "it is misleading to equate the fair and equitable standard with the international minimum standard: this is because the terms 'fair and equitable treatment' envisage conduct that goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words. A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all circumstances the conduct in issue is fair and equitable or unfair and inequitable. No standard defined by other words is likely to be material. The terms are to be understood and applied independently and autonomously."<sup>156</sup>

However, to others, "fair and equitable treatment is not to be assessed according to customary international law, but rather represents an expanded, contemporary understanding of customary international law."<sup>157</sup>

If we analyze the facts, we will appreciate that even those arbitral rulings that based their findings on an investment agreement that equates the standard to the international minimum standard, clearly exceeded the terms of that investment agreement, granting the standard a meaning that is beyond the international minimum standard as it is acknowledged at this time. It seems that Tribunals are more confident in

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<sup>156</sup> OECD, see note 15, 23.

<sup>157</sup> P.G. Foy/ R.J.C. Deane, "Foreign Investment Protection under Investment Treaties: Recent Developments under Chapter 11 of the North American Free Trade Agreement", *ICSID Review – FIJL* 16 (2001), in: OECD, see note 15, 23.

making use of the rules of interpretation of international law and define the standard in consideration of the treaty's objectives and the facts of the case. In conclusion, they have applied the theory of the Fair and Equitable Treatment standard as a self-contained standard. The reason for this is that most investment agreements, as stated in the preceding Chapter, do not make the Fair and Equitable Treatment standard interchangeable with the international minimum standard, while in those that do, it is not equated to the international minimum standard of customary international law (with some exceptions).

An important view is that of R. Dolzer and M. Stevens, who say that "the fact that parties to BIT's have considered it necessary to stipulate this standard as an express obligation rather than rely on a reference to international law and thereby invoke a relatively vague concept such as the minimum standard is probably evidence of a self-contained standard. Further, some treaties refer to international law in addition to the fair and equitable treatment, thus appearing to reaffirm that international law standards are consistent with, but complementary to, the provision of the BIT."<sup>158</sup>

The consideration of this theory is nevertheless not without difficulties. A plain-meaning approach may become subjective and lack precision. However, "in some circumstances, both the states and the foreign investors may view lack of precision as a virtue, for it promotes flexibility in the investment process." Therefore, it seems that many existent arbitral rulings have headed towards this self-contained standard theory anyway. It might require some extra arbitral rulings to totally define the meaning's standard on the basis of the theory's elements. Professor P. Julliard refers to this: "... the interpretation of the fair and equitable treatment, an imprecise notion – 'notion aux contours imprécis' – will be progressively developed through the 'praetorian' work of the arbitral tribunals."

Notwithstanding all the latter, when defining the meaning of the Fair and Equitable Treatment standard, Arbitral Tribunals must take into account the real intention of parties when signing an investment agreement, which is to grant reliable protection to the foreign investor to stimulate investment in their territory. This will certainly avoid equating it to the international minimum standard, which takes away a real and efficient protection.

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<sup>158</sup> Dolzer/ Steven, in: OECD, see note 15, 23.

Professor Muchlinski states that: “The concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests. It is, therefore, a concept that depends on the interpretation of specific facts for its content. At most, it can be said that the concept connotes the principle of non-discrimination and proportionality in the treatment of foreign investors.”<sup>159</sup>

It must be concluded that the Fair and Equitable Treatment standard still remains a vague and undetermined concept that needs further developing by Arbitral Tribunals. The point, however, is to determine the starting point on the basis of which these Arbitral Tribunals must rule in the future. Will we accept the rules of interpretation of international law and decide based on the facts, the best protection to be granted to the foreign investor, or will we limit its delimitation to a standard, such as the international minimum, that grants a very basic protection to the investor which already exists in customary international law? Unless the agreement specifically orders the Arbitral Tribunal to equate the standard with the international minimum standard, the answer is a self-contained standard approach. It seems that the current evolution in the investment area regarding the protection of foreign investors provides a clear statement: for the sake of the liberalization of investments, investor protection must not regress. This is the intention behind investment agreements, and the interpretation of all standards established therein (including the Fair and Equitable Treatment standard) must be oriented in that direction.

## V. Conclusions

The Fair and Equitable Treatment standard, present in international investment law, has gained importance as a mechanism against unfair and unequal behavior of host states against foreign investors. It has arisen as a fundamental response to a new type of expropriation (different from the traditional direct and creeping types of expropriation) that could be enacted against the investor.

This new type of expropriation amounts to a behavior of the host state that does not involve a physical taking of property (direct expro-

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<sup>159</sup> P. Muchlinski, “Multinational Enterprises and the Law”, in: OECD, see note 15, 635.

priation) or conduct that makes it impossible to make proper use of the property (creeping expropriation). It consists of a certain treatment by the host state that would eventually impair the investor's ability to develop the investment, thus affecting his property rights in regard thereto. For example, a lack of transparency by the host state which does not allow the investor to learn of all regulations that must be complied with, resulting in the above-mentioned impairment.

The Fair and Equitable Treatment standard is often invoked by foreign investors before arbitral tribunals, who claim that although they are not affected by the traditional forms of expropriation, they are incapable of developing their investment due to a host state's conduct.

The main conflict in relation to this standard is the vagueness in which it is conceived. Views issued by scholars and arbitrators, as well as the expression of what is contained in investment agreements, demonstrate that there is no uniformity in the matter, a situation that is present to a greater degree in various cases that have dealt with the issue of determining its true meaning.

The OECD<sup>160</sup> states in this regard that "because of the differences in its formulation, the proper interpretation of the 'fair and equitable treatment standard' is influenced by the specific wording of the particular treaty, its context, negotiating history or other indications of the party's intent."

Some investment treaties specifically link the standard with the minimum standard of customary international law. If this were always the case, there is no doubt that this would be the interpretation to assign to the standard. However, in the case of other agreements, which constitute the majority, no such link is made, implying that the standard may be considered to signify a lot more than the minimum standard of customary international law. There is a common consensus as to what the defining elements are in the minimum standard of customary international law (which, by the way, evolves continuously). Nevertheless, whenever there is no express equating to the minimum standard, there is no general agreement as to what we may consider the Fair and Equitable Treatment standard to mean.

In consequence, and although we must await further rulings by Arbitral Tribunals to better shape the standard, we must assume that thus far, the majority of investment agreements do not equate the standard to the minimum standard of customary international law, and, there-

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<sup>160</sup> OECD, see note 15, 2.

fore, are not bound by that interpretation. Moreover, arbitral rulings have exceeded in their interpretation the general elements that constitute that minimum standard of customary international law (for example, reference to transparency), which leads us to believe that they had the intention of elevating the level of protection to the foreign investor and not limiting it to customary international law.

Although investment agreements that equate the standard to the international minimum standard are obliged to make that interpretation, and although there are some arbitral rulings that establish this nexus, these sparse cases do not suffice to transform that interpretation into the general approach to the meaning of the standard. We must take into account international rules of interpretation, the intent of the parties, all of which leads us to realize that a plain-meaning approach must be applied. In relation to the standard's meaning, "il suo contenuto non sembrerebbe essere determinabile in maniera assoluta e definitiva, essendo esso un principio astratto e relativo; il trattamento giusto ed equo assume però un significato concreto quando é inserito in un contesto giuridico particolare."<sup>161</sup>

It is true, there is a general concern that this approach may not help in dealing with the arbitrariness that may appear when there is no direct guidance for arbitrators. However, this is a view that will be readily corrected through jurisprudence, which has so far established some recurrent elements that are a part of the standard, such as due diligence, due process, non-denial of justice and transparency.

The real intention of the parties when signing an investment agreement is, in most cases, to grant the best protection to the investor, allowing the free-flow of investment into its territory. The most important benefit of a plain-meaning approach is that it allows the standard to be interpreted according to the real intention of the parties. In other words, grant the best protection to the investor, which implies the fairest and most equitable conduct by the host state in regard to the specific facts of the case. Equating the standard to the minimum standard of customary international law is lowering the protection to the most basic elements of customary international law. "In tal senso esso potrebbe essere inteso come il principio di buona fede del diritto interno, per cui l'obbligo di concedere un trattamento giusto ed equo imporrebbe alle Parti di tenere un comportamento conforme agli obiettivi dell'accordo e quindi, alle Parti contraenti dei BIT's un comportamento che non osta-

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<sup>161</sup> Mauro, see note 1, 193.

coli la promozione e la protezione degli investimenti stranieri.”<sup>162</sup> In consequence, the aim of protecting foreign investment is the fundamental issue to be taken into account in the interpretation of the standard. Moreover, “It is in a more general way a functional minimum standard of treatment of private business, quite different, however, from the traditionally known legal minimum standard of the so-called civilized nations.”<sup>163</sup>

Finally, whatever the evolution of the growing jurisprudence of Investor-state Tribunals, called upon to explore the meaning of fair and equitable treatment may be, other questions in regard to the standard will surely arise. For example, what will be the criteria to determine the compensation to be granted to the affected investor in the event a violation of the standard is detected? Can we apply the elements that arbitrators use to determine the compensation for a direct expropriation (Hull Formula)? Can we equate the violation of the Fair and Equitable Treatment standard to a direct type of expropriation and, therefore, apply fair market value criteria in order to compensate the affected investor?

In this sense, the Chilean model of BIT<sup>164</sup> establishes that where the market value or property compensation cannot be ascertained, compensation may be determined in accordance with “generally recognized equitable principles of valuation, taking certain factors into account.”

Although this is certainly not a clear rule, at least it is dealt with. But what are the criteria when there is no conventional or treaty guidance? The issue becomes even more problematic if we consider that developing and developed countries have a different perspective as to whether the Hull Formula must be applied.

In the case of *MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Republic of Chile*,<sup>165</sup> in which the only argument by which the state of Chile was charged was a violation of the Fair and Equitable Treatment standard, the Tribunal recognized that the BIT between Malaysia and

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<sup>162</sup> Mauro, see note 1, 191.

<sup>163</sup> S. Preiswerk, “New Developments in Bilateral Investment Protection”, cited in Mauro, see note 1, 191.

<sup>164</sup> Agreement between the Government of the Republic of Chile and the Government of ... on the Reciprocal Promotion and Protection of Investments, UNCTAD International Investment Compendium III, 143 et seq., in: Vasciannie, see note 2, 149.

<sup>165</sup> *MTD Equity Sdn. Bhd. and MTD Chile S.A. vs. Republic of Chile*, see note 85.

Chile does not establish the equivalent to the criteria of prompt, adequate and effective compensation for expropriation in the case of breaches of the BIT on other grounds. In this case, the parties agreed to apply the criteria of the Chorzow Factory case ruled by the PCIJ that states “that compensation should wipe out all consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that had not been committed.”<sup>166</sup>

Although this is a reasonable and just criterion, could it be applied in those claims in which there is no agreement between the parties and no reference is made to it by the investment agreement? Could the term “adequate” compensation in the Hull Formula amount to wiping out all consequences of the illegal act? Moreover, does the fair market value apply or not?

In the *Marvin Feldman vs. Mexico* case, the Tribunal acknowledged that “Nafta does not provide further guidance as to the proper measure of damages or compensation for situations that do not fall under article 1101 (expropriation); the only detailed measure of damages specifically provided in Chapter 11 is in article 1101 (2-3) ‘fair market value,’ which necessarily applies only to situations that fall within that article 1101.”<sup>167</sup> Considering that there is no criteria to adhere to, the Tribunal finally determined damages on a discretionary basis.

Finally, in relation to the amount of compensation to be granted to an investor that has suffered a violation of the Fair and Equitable Treatment standard, a discussion will certainly arise in regard to the possibility that the compensation be calculated in regard to the fair market value of the whole investment, considering that such a violation made it impossible for the investor to develop his investment, which, in practice, is equivalent to confiscating property.

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<sup>166</sup> Case concerning the Chorzów Factory, available under <[http://www.worldcourts.com/pcij/eng/decisions/1927.07.26\\_chorzow/](http://www.worldcourts.com/pcij/eng/decisions/1927.07.26_chorzow/)>.

<sup>167</sup> *Marvin Feldman vs. Mexico*. ICSID Case No. ARB (AF) /99/1, (Award, 16 December 2002), available under <[http://ita.law.uvic.ca/documents/feldman\\_mexico-award-english](http://ita.law.uvic.ca/documents/feldman_mexico-award-english)>.