CONTENTS

Articles

Abby Cohen Smutny

Fair, Equitable and Ambiguous: What Is Fair and Equitable Treatment in International Investment Law?
Jean Kalicki and Suzana Medeiros

The Development of the Regulations and Rules of the International Centre for Settlement of Investment Disputes
Antonio R. Parra

The Investor's Right to Waive Access to Protection under a Bilateral Investment Treaty
Anne K. Hoffmann

Cases

Saipem S.p.A. v. The People's Republic of Bangladesh (ICSID Case No. ARB/05/7)

Introductory Note
Martina Polasek

Page
1
24
55
69
95
Fair, Equitable and Ambiguous: What Is Fair and Equitable Treatment in International Investment Law?

Jean Kalicki and Suzana Medeiros*

I. THE FAIR AND EQUITABLE TREATMENT STANDARD IN INVESTMENT TREATY ARBITRATION

THE OBLIGATION FOR A HOST STATE TO PROVIDE foreign investors with fair and equitable treatment is contained in the vast majority of bilateral and multilateral investment treaties currently in force. Although the fair and equitable treatment standard has appeared in investment treaties for more than fifty years, until recently it was rarely invoked by investors as the basis for compensation claims. In the last ten years, however, this scenario has changed radically, with investors aggressively pursuing fair and equitable treatment claims as a result of State action, including action within the regulatory sphere. In the recent cases where fair and equitable treatment claims have been addressed directly by arbitral tribunals, many have concluded that the host State breached

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its obligations under the standard, but a considerable number of others have determined that it did not. In nine recent cases, the standard was found to be an independent source of liability even in circumstances where tribunals found no State liability for expropriation, which historically was the claim investors pursued as the lynchpin of their demands for compensation. These developments help explain recent attempts by investors to create an avenue for presenting fair and equitable treatment claims to international arbitration through most-favored nation clauses, where treaties otherwise would seem to limit arbitral jurisdiction to claims for expropriation.

Despite the growing importance of the fair and equitable treatment standard, its content and parameters remain ambiguous, uncertain, and subject to debate. Various factors contribute to this uncertainty and lack of uniformity.

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1 See, e.g., Metalclad v. Mexico, ICSID Case No. ARB(AF)/97/1, Award, Aug. 30, 2000; S.D. Myers v. Canada, UNCITRAL Case, First Partial Award, Nov. 13, 2000; Maffezini v. Spain, ICSID Case No. ARB/97/7, Award, Nov. 13, 2000; Pope & Talbot v. Canada, UNCITRAL Award, April 10, 2001; CME v. Czech Republic, UNCITRAL Case, Partial Award, Sept. 13, 2001; Temed v. Mexico, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003; MTD v. Chile, ICSID Case No. ARB/01/7, Award, May 25, 2004; Occidental v. Ecuador, LCIA Case No. UN3467, Award, July 1, 2004; CMS Gas v. Argentina, ICSID Case No. ARB/01/8, Decision, May 12, 2005; Saluka v. Czech Republic, UNCITRAL Partial Award, March 17, 2006; Azurix Corp. v. Argentina, ICSID Case No. ARB/01/2, Award, July 14, 2006; LG&E Energy v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability, Oct. 3, 2006; PSEG Global v. Turkey, ICSID Case No. ARB/02/5, Award, Jan. 19, 2007; Siemens A.G. v. Argentina, ICSID Case No. ARB/02/8, Award, Feb. 6, 2007; and Enron Corporation and Ponderosa Assets, L.P. v. Argentina, ICSID Case No. ARB/01/3, Award, May 22, 2007.

2 See, e.g., Genin v. Estonia, ICSID Case No. ARB/99/2, Award, June 25, 2001; Lauder v. Czech Republic, UNCITRAL Case, Final Award, Sept. 3, 2001; Mondex v. United States, ICSID Case No. ARB(AF)/99/2, Award, Oct. 11, 2002; ADF Group Inc. v. United States, ICSID Case No. ARB(AF)/00/1, Award, Jan. 9, 2003; Waste Management v. Mexico, ICSID Case No ARB(AF)/98/2, Award, April 30, 2004; GAM1 Investments v. Mexico, UNCITRAL Award, Nov. 15, 2004; Methanex Corp. v. United States, UNCITRAL Case, Final Award, Aug. 3, 2005; International Thunderbird Gaming v. Mexico, UNCITRAL Award, Jan. 26, 2006.

3 Of the cases identified in note 1, see S.D. Myers, Pope & Talbot, MTD, Occidental, CMS, Saluka, Azurix, LG&E, and PSEG.


5 The majority of commentators recognize the uncertainty and lack of uniformity surrounding the standard. See, e.g., Christoph Schreuer, Fair and Equitable Treatment in Arbitral Practice, 6 J.W.I.T. 357, 364 (2005) ("The standard of fair and equitable treatment is relatively imprecise"); Rudolf Dolzer and Margreet Stevens, Bilateral Investment Treaties 58 (1995) ("Nearly all recent BITs 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 this phrase"); Mark Kantor, Fair and Equitable Treatment: Echoes of FDR’s Court-Packing Plan in the International Law Approach Towards Regulatory Expropriation, 5 The Law and Practice of International Courts and Tribunals 231, 238 (2006) ("[A]rbitral awards do not demonstrate a consistent approach towards the scope of the F&ET obligation. Moreover, many of these awards do not even evidence agreement on the elements that must be demonstrated to..."")
First, the text of fair and equitable treatment provisions in investment treaties varies considerably. Second, the standard itself is expressed in abstract and subjective terms, such as fairness and equity. Third, the meaning given to the standard often depends on the specific circumstances of each case. Finally, and inherent in the arbitral system, the fact that decisions of one tribunal regarding the contours of the standard are not binding upon the next, even where treaty text is identical or similar, contributes to the lack of uniformity.

This article will explore the contours of this debate. First, we highlight the range of treaty language expressing obligations of fair and equitable treatment, and the range of different interpretations of the standard adopted recently by tribunals in BIT and NAFTA cases. Second, we note the debate over the standard’s source, *i.e.*, whether it reflects the traditional notion of a “minimum standard of treatment” that States are required to provide aliens under customary international law, or imposes an autonomous set of obligations, which may be different from those required by customary international law. Third, we address the debate over the content of the standard, which has been expressed in numerous ways ranging from interference with an investor’s “legitimate expectations” to a requirement of “manifestly arbitrary” State conduct, with attendant different implications for the breadth of a State’s “regulatory space.” Finally, we identify questions that have been raised about the proper measure of damages in cases finding a violation of fair and equitable treatment obligations.

II. THE RANGE OF TREATY LANGUAGE AND RECENT FORMULATIONS OF THE STANDARD BY TRIBUNALS

A. The Range of Treaty Language

As indicated above, one of the main factors that have contributed to the lack of certainty surrounding the fair and equitable treatment standard is the
variety of language adopted by investment treaties to express State obligations. For instance, some treaties expressly refer, in connection with fair and equitable treatment obligations, to the notion of a “minimum standard of treatment” in accordance with international law; others refer solely to international law without reference to a minimum standard; and still others state the fair and equitable treatment obligation without any reference at all to international law. In addition, some treaties include an obligation to provide full protection and security to investments in the same provision or sentence expressing the obligation to accord fair and equitable treatment, while others state both obligations separately, and still others contain no reference to full protection and security at all. Finally, some treaties include the obligation not to act in an arbitrary or discriminatory fashion as part of the undertaking to accord fair and equitable treatment, while others do not establish such connection, or refer to discrimination in a separate treaty provision. We set forth below some examples that illustrate the variety of treaty language:

1. NAFTA Chapter 11
   • NAFTA (1994), Article 1105(1), entitled “Minimum Standard of Treatment,” provides that “[e]ach 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.”

   • The 2004 U.S. Model BIT, Article 5(1), entitled “Minimum Standard of Treatment,” provides that “[e]ach Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.”
   • Article 5(2)(a) clarifies that “[f]or 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

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6 An analysis of the obligation of States to provide investors with full protection and security is outside the scope of this article.

7 As discussed further in Section III, the NAFTA Free Trade Commission issued a Note of Interpretation, dated July 31, 2001, interpreting Article 1105(1). In accordance with NAFTA Article 1131, this Interpretation is binding on all Chapter 11 tribunals.
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. [...]”

• Annex A provides further that “[t]he Parties confirm their shared understanding that ‘customary international law’ generally and as specifically referenced in Article 5 [Minimum Standard of Treatment] and Annex B [Expropriation] results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 5 [Minimum Standard of Treatment], 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.”

3. Bilateral Investment Treaties

• The Argentina—Spain BIT (1991), in its Article 4(1), provides that each Party shall accord in its territory fair and equitable treatment to investments made by investors of another Party. (This was the Treaty provision at issue in Maffeziini v. Spain.)

• The U.S.—Estonia BIT (1994), in its Article II(3)(a), provides for the “fair and equitable” treatment of investments and states that no investment shall be accorded treatment less favorable than that required by international law. Article II(3)(b) prohibits the Parties from impairing by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of investments. (This was the Treaty provision at issue in Genin v. Estonia.)

• The Netherlands—Czech and Slovak Republic BIT (1991), in its Article III(1), provides that “[e]ach Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those investors.” (This was the Treaty provision at issue in CME v. Czech Republic and Saluka v. Czech Republic.)

• The U.S.—Czech and Slovak Republic BIT (1991), in its Article II(2)(a), provides that “[i]nvestments 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.” Article II(2)(b) states that “[n]either Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance,
use, enjoyment, acquisition, expansion, or disposal of investments. For purposes of dispute resolution under Article III, VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a Party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party." Article II(2)(c) provides that "[e]ach Party shall observe any obligation it may have entered into with regard to investments." (This was the Treaty provision at issue in *Lauder v. Czech Republic*.)

• The Spain—Mexico BIT (1995), in its Article 4(1), establishes that "[e]ach Contracting Party will guarantee in its territory fair and equitable treatment, according to International Law, for the investments made by investors of the other Contracting Party." (This was the Treaty provision at issue in *Tecmed v. Mexico*.)

• The Malaysia—Chile BIT (1992), in its Article 3(1), states that "[i]nvestments 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 favourable than that accorded to investments made by investors of any third State." (This was the Treaty provision at issue in *MTD v. Chile*.)

• The U.S.—Ecuador BIT (1993), in its Article 3(a), provides that "[i]nvestments 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." Article 3(b) states that "[n]either Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments." (This was the Treaty provision at issue in *Occidental v. Ecuador*.)

• The U.S.—Argentina BIT (1991), in its Article II(2)(a), establishes that "[i]nvestments 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." Article II(2)(b) provides that "[n]either Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments." (This was the Treaty provision at issue in *CMS v. Argentina, Azurix v. Argentina, LG&E Energy v. Argentina, and Enron Corp. v. Argentina*.)

• The U.S.—Turkey BIT (1985), in its Article II(3), provides that "[i]nvestments shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in a manner consistent with international law. Neither Party shall in any way impair by arbitrary or
discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. Each Party shall observe any obligation it may have entered into with regard to investments." (This was the Treaty provision at issue in *PSEG Global v. Turkey*.)

- The Germany—Argentina BIT (1991), in its Article 2(1), provides that each Contracting Party undertakes to promote the investments of nationals or companies of the other Party and treat those investments justly and fairly. Article 2(3) states that neither of the Contracting Parties shall impair the management, operation and use of investments of nationals and companies of the other Contracting Party by arbitrary or discriminatory measures. (This was the Treaty provision at issue in *Siemens v. Argentina*.)

B. Formulations of the Standard by NAFTA and BIT Tribunals

Although many cases have addressed obligations to afford fair and equitable treatment to investors, there is far from any uniform definition of what this obligation entails. While there has been a greater uniformity in interpreting the standard by NAFTA tribunals since the Free Trade Commission issued its Note of Interpretation in 2001 (discussed below in Section III), there has been no similar convergence of interpretation in the BIT realm, where tribunals are interpreting and applying different treaty language and, for the most part, cannot rely on any clear guidance from the Contracting Parties. We set forth below twenty-three examples of how the standard has been interpreted by NAFTA and BIT tribunals, in the order in which these interpretations were articulated, and with reference to the Tribunal members rendering each such interpretation:

- *Metalclad v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, Aug. 30, 2000 (Eliahu Lauterpacht, President; Benjamin R. Civiletti and José Luis Siqueiros, Arbitrators). The Tribunal found that within NAFTA’s obligation to provide fair and equitable treatment was the obligation to ensure a transparent and predictable framework for business planning and investment. *Id.* para. 99. The Tribunal defined the State’s obligation of

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* An exception would be treaties incorporating the terms of the 2004 U.S. Model BIT, where the provision includes a more detailed explanation of the meaning of the fair and equitable treatment standard. See Section II A, *supra.*

* It is worth noting that some of these decisions have been challenged either through the ICSID annulment process or in national courts, and therefore the interpretations they set forth may not necessarily reflect the “last word” on the issue, even for purposes of a given case.
transparency as “to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of the other Party.” *Id.* para. 76. In applying the standard, the Tribunal made express reference to the investor’s right to receive notice and an opportunity to be heard at a city council meeting called to deliberate about its permit. *Id.* para. 91. The part of the *Metalclad* award concerning a State’s obligation of transparency was vacated by a 2001 decision of the Supreme Court of British Columbia, as follows: “In the present case, however, the Tribunal did not simply interpret the wording of Article 1105. Rather, it misstated the applicable law to include transparency obligations and it then made its decision on the basis of the concept of transparency.” *United Mexican States v. Metalclad Corp.*, 119 I.L.R. 646, 665, para. 70 (S. Ct. of B.C. 2001). The *Metalclad* award pre-dated the July 2001 FTC Interpretation.

- *S.D. Myers v. Canada*, UNCITRAL Case, First Partial Award, Nov. 13, 2000 (J. Martin Hunter, President; Bryan P. Schwartz and Edward C. Chiasson, Arbitrators). The Tribunal observed that a violation of NAFTA’s obligation of fair and equitable treatment exists “when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective,” and that such determination “must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders, [and] must also take into account any specific rules of international law that are applicable to the case.” *Id.* para. 263. The Tribunal also noted that in some cases, “the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied ‘fair and equitable treatment’; but the fact that a host Party has breached a rule of international law that is specifically designed to protect investors will tend to weigh heavily in favor of finding a breach of Article 1105 [of NAFTA].” *Id.* para. 264. Although the Tribunal observed that it “does not rule out the possibility that there could be circumstances in which a denial of the national treatment provisions of the NAFTA would not necessarily offend the minimum standard provisions,” a majority of the Tribunal determined that “on the facts of this particular case the breach of Article 1102 [national treatment] essentially establishes a breach of Article 1105 [fair and equitable treatment] as well.” *Id.* para. 266. This decision was also rendered prior to the FTC’s Interpretation.
• **Maffezini v. Spain**, ICSID Case No. ARB/97/7, Award, Nov. 13, 2000 (Francisco Orrego Vicuña, President; Thomas Buergenthal and Maurice Wolf, Arbitrators). The Tribunal found, in the context of the Argentina-Spain BIT, that "the lack of transparency with which [the] transaction was conducted is incompatible with [the State’s] commitment to ensure the investor a fair and equitable treatment." *Id.* para. 83.

• **Pope & Talbot v. Canada**, UNCITRAL Case, Award, April 10, 2001 (Lord Dervarad, President; Benjamin J. Greenberg and Murray J. Belman, Arbitrators). The Tribunal interpreted Article 1105 of NAFTA “to require that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in the NAFTA countries,” and rejected any threshold limitation for the standard “that the conduct complained of be ‘egregious,’ ‘outrageous’ or ‘shocking,’ or otherwise extraordinary.” *Id.* para. 118.10 In applying the standard, the Pope & Talbot Tribunal highlighted hostile treatment, harassment and coercion on the part of government authorities against an investor. *Id.* para. 181. This decision was rendered prior to the FTC’s Interpretation.11

• **Genin v. Estonia**, ICSID Case No. ARB/99/2, Award, June 25, 2001 (L. Yves Fortier, President; Meir Heth and Albert Jan Van Den Berg, Arbitrators). While the Tribunal observed in the context of the U.S.-Estonia BIT that “the exact content of [the] standard is not clear,” it interpreted the standard as barring conduct below an “international minimum standard” and declared that State actions that violate the

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10 The *Pope & Talbot* Tribunal expressly rejected the standard formulated by the United States-Mexico General Claims Commission in the *Neer* decision in 1926, which provides in relevant part as follows: “[T]he treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether the insufficiency proceeds from deficient execution of an intelligent law, or from the fact that the laws of the country do not empower the authorities to measure up to international standards, is immaterial.” *Neer v. Mexico*, Opinion, United States-Mexico General Claims Commission, Oct. 15, 1926, 21 A.J.I.L. 555, 556 (1927). Although the *Neer* case did not involve an investor but rather the investigation and prosecution of an alien by Mexican authorities, and certainly did not involve the concept of fair and equitable treatment, it became the departure point for later discussion on the standard of fair and equitable treatment.

11 In a subsequent decision on damages, the *Pope & Talbot* Tribunal stated that the ICSID has moved away from the *Neer* formulation in favor of a more contemporary approach, based on the *ELS/1 decision (United States v. Italy*, ICSID Reports 1989, at 15), according to which arbitrariness should be understood as "a willful disregard of due process of law, an act which shocks, or at least surprises a sense of judicial property." *Pope & Talbot*, Award in Respect of Damages, May 31, 2002, para. 63.
standard “would include acts showing a willful neglect of duty, an
insufficiency of action falling far below international standards, or even
subjective bad faith.” Id. para. 367. Although the Tribunal observed that
“[c]ustomary international law does not … require that a state treat all
aliens (and alien property) equally, or that it treat aliens as favourably as
nationals,” it found that any such discriminatory treatment would violate
the separate obligation of host States under the U.S.-Estonia BIT to
afford foreign investors treatment no less favourable than that provided
their own nationals. Id. para. 368.

• **CME v. Czech Republic, UNCITRAL Case, Partial Award, Sept. 13, 2001**
  (Wolfgang Kühn, President; Stephen M. Schwebel and Jaroslav Hándl,
  Arbitrators) and **Lauder v. Czech Republic, UNCITRAL Case, Final Award,
  Sept. 3, 2001** (Robert Briner, President; Lloyd Cutler and Bohuslav
  Klein, Arbitrators). The CME Tribunal gave broad significance to the
fair and equitable treatment clause in the Netherlands-Czech Republic
BIT, and concluded that the Czech Government had breached its treaty
obligation of providing fair and equitable treatment. Id. paras. 611–612.
The CME Tribunal also found that the Respondent State had acted in
a discriminatory fashion, and considered irrelevant the Respondent’s
argument that the Media Council required other broadcasters in the same
way to revise their structure. Id. para. 611. Yet in a simultaneous case
brought by the owner of CME, Lauder, a different Tribunal found no
violation of the same standard on the same facts. Id. para. 293. The Lauder
Tribunal (citing a UNCTAD Report) observed that fair and equitable
treatment “is related to the traditional standard of due diligence and
provides a minimum international standard that forms part of customary
international law.” Id. para. 292. It also commented that in the context
of bilateral investment treaties, the standard is subjective and depends
heavily on a factual context, id., and that the fair and equitable treatment
standard “will also prevent discrimination against the beneficiary of the
standard, where discrimination would amount to unfairness or inequity
in the circumstances.” Id.

• **Mondev v. United States, ICSID Case No. ARB(AF)/99/2, Award, Oct.
  11, 2002** (Ninian Stephen, President; James Crawford and Stephen M.
  Schwebel, Arbitrators). The Mondev Tribunal was the first NAFTA tribunal
to apply the fair and equitable treatment standard after the July 2001
FTC Interpretation. The Tribunal examined the standard in the context
of denial of justice and concluded that in that context the best formula
for finding a violation of the standard was to ask the question whether “at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable.” Id. para. 127. The Tribunal gave considerable significance to the evolving nature of the standard and rejected an interpretation based solely on the Neer and like decisions decided in the 1920s. Id. para. 116. It also stated that “a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.” Id. The Mondev Tribunal observed that NAFTA tribunals do not have an unfettered discretion to decide for themselves, on a subjective basis, what is fair or equitable, but they are rather bound by the minimum standard as established in State practice and in the jurisprudence of arbitral tribunals. Id. para. 119.

- *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award, Jan. 9, 2003 (Florentino P. Feliciano, President; Armand de Mestral and Carolyn B. Lamm, Arbitrators). The Tribunal emphasized that “both customary international law and the minimum standard of treatment of aliens it incorporates are constantly in a process of development.” Id. para. 179. The ADF Tribunal agreed with Mondev that any general requirement to accord fair and equitable treatment must be disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary international law. Id. para. 184. In applying the standard, the Tribunal found unconvincing the investor’s argument that government procurement provisions were unfair; and also determined that a government authority’s refusal to follow and apply earlier case law was not in the circumstances of the case “grossly unfair or unreasonable”; that showing an act to be *ultra vires* under internal law “by itself does not render the measures grossly unfair or inequitable under the customary international law standard of treatment embodied in Article 1105(1),” for which something more than simple illegality or lack of authority under domestic law was required; and that an analysis of claims that a host State breached its duty to act in good faith adds “only negligible assistance in the task of determining or giving content to a standard of fair and equitable treatment.” Id. paras. 188–191.

- *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003 (Horacio A. Grigera Naon, President; José Carlos Fernandez Rozas and Carlos Bernal Verea, Arbitrators). The Tribunal first stated that the commitment to fair and equitable treatment in the Spain-Mexico
BIT is "an expression and part of the bona fide principle recognized in international law, although bad faith from the State is not required for its violation." *Id.* para. 153. The Tribunal then observed that compliance by the host State with a fair and equitable pattern of conduct is closely related to the principle of good faith under international law, and should exclude arbitrary State action. *Id.* para. 154. The Tribunal interpreted arbitrary conduct according to the ICJ’s ELSI standard as conduct contrary to the law because it shocks, or at least surprises, a sense of juridical propriety (ELSI decision, *United States v. Italy*, ICJ Reports 1989, at 15). *Id.* In applying the standard, the Tribunal stressed the investor’s right to be notified of the regulatory authority’s intention and the right to be heard regarding revocation of licenses. *Id.* para. 162. The Tribunal also found that coercion may be inconsistent with the fair and equitable treatment standard and objectionable from the perspective of international law. *Id.* para. 163.

- *Loewen v. United States*, ICSID Case No. ARB(AF)/98/3, Award, June 26, 2003 (Anthony Mason, President; Abner J. Mikva and Lord Mustill, Arbitrators). The *Loewen* Tribunal analyzed the fair and equitable treatment standard in respect of a claim of judicial action, *i.e.* a denial of justice. In examining the standard, the *Loewen* Tribunal found that bad faith or malicious intention is not an essential element of unfair and inequitable treatment or denial of justice amounting to a breach of international justice. *Id.* para. 132. The Tribunal indicated that manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety would be enough to violate the standard. *Id.* Although the Tribunal found, based on the facts of the case, that "the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment," *Id.* para. 137, it dismissed the fair and equitable treatment claim on the ground that Loewen had failed to pursue its domestic remedies and, consequently, it has not shown a violation of customary international law and a violation of NAFTA for which the Respondent State would be responsible. *Id.* para. 217.

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12 The *Loewen* Tribunal’s findings on exhaustion of local remedies should be viewed as limited to claims related to the judicial process as, according to the Tribunal, a failure to require exhaustion in that context "would encourage resort to NAFTA tribunals rather than resort to the appellate courts and review processes of the host state." *Id.* para. 162. According to the Tribunal, the local court system must have been tried and have failed for there to be a claim of denial of justice. In that context, therefore, the notion of exhaustion of local remedies is incorporated into the substantive standard, even though it is not more generally a procedural prerequisite to an international claim. *Id.* para. 168.
• **Waste Management v. Mexico**, ICSID Case No. ARB(AF)/00/3, Award, April 30, 2004 (James Crawford, President; Benjamin R. Civiletti and Eduardo Magallón Gómez, Arbitrators). After analyzing previous NAFTA decisions, the Tribunal stated that despite some differences of emphasis, a general standard for fair and equitable treatment is emerging under the NAFTA. *Id.* para. 98. According to the Tribunal, such a general standard (based on the decisions in *S.D. Myers, Mondey, ADF* and *Loewen*) suggests that the minimum standard of fair and equitable treatment is infringed if the State 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." *Id.* The Tribunal found that a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process would violate the standard. *Id.*

• **MTD v. Chile**, ICSID Case No. ARB/01/7, Award, May 25, 2004 (Andrés Rigo Sureda, President; Marc Lalonde and Rodrigo Oreamuno Blanco, Arbitrators). The Tribunal interpreted the standard in light of the Vienna Convention, and concluded that, according to the terms of Malaysia-Chile 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. *Id.* para. 113. The Tribunal also noted that the standard in the BIT was framed as a pro-active statement, rather than prescriptions for a passive behavior of the State or avoidance of prejudicial conduct to the investors. *Id.*

• **Occidental v. Ecuador**, LCIA Case No. UN3467, Award, July 1, 2004 (Francisco Orrego Vicuña, President; Charles N. Brower and Patrick Barrera Sweeney, Arbitrators). The Tribunal noted that "[a]lthough fair and equitable treatment is not defined in the [U.S.-Ecuador BIT], the Preamble clearly records the agreement of the parties that such treatment 'is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources'". *Id.* para. 183. In light of the preamble, the Tribunal concluded that "the stability of the legal and business framework is thus an essential element of fair and equitable treatment," *id.* and that stability of the legal and business framework should be considered as an objective requirement that does not depend on whether the Respondent has proceeded in good faith. *Id.* para. 186.
• **GAMI Investments v. Mexico, UNCITRAL Case, Award, Nov. 15, 2004** (W. Michael Reisman, President; Julio Lacarte Muró and Jan Paulsson, Arbitrators). The Tribunal found that “a government’s failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105 [of NAFTA],” as it will depend on the overall context. *Id.* para. 91. The Tribunal then asserted that the criterion should be that “[e]ach NAFTA Party must to the contrary accept liability if its officials fail to implement or implement regulations in a discriminatory or arbitrary fashion.” *Id.* para. 94. The Tribunal concluded that a claim of maladministration would likely violate the fair and equitable treatment standard if it amounted to an “outright and unjustified repudiation” of the relevant regulations, although even lesser failures might suffice to trigger Article 1105. *Id.* para. 103. On the facts of the case, it severely criticized the investor for not showing specific and quantifiable prejudice in connection with its fair and equitable treatment claim. *Id.* paras. 83, 84.

• **CMS Gas v. Argentina, ICSID Case No. ARB/01/8, Decision, May 12, 2005** (Francisco Orrego Vicuña, President; Marc Lalonde and Francisco Rezek, Arbitrators). In light of the preamble of the U.S.-Argentina BIT, the Tribunal found that “[t]here can be no doubt … that a stable legal and business environment is an essential element of fair and equitable treatment.” *Id.* para. 274. The Tribunal observed that treaty language, arbitral decisions, and scholarly writings show that fair and equitable treatment is inseparable from stability and predictability. *Id.* para. 276. The Tribunal found that a government’s intentional and bad faith adoption of measures to harm the investor can aggravate a situation, but is not an essential element of liability. *Id.* para. 280. Finally, the Tribunal stated that the standard of protection against arbitrariness and discrimination is related to that of fair and equitable treatment, and that “[a]ny measure that might involve arbitrariness or discrimination is in itself contrary to fair and equitable treatment.” *Id.* para. 290.

• **Methanex Corp. v. United States, UNCITRAL Case, Award, Aug. 3, 2005** (V.V. Veeder, President; W. Michael Reisman and J. William F. Rowley, Arbitrators). The Methanex Tribunal analyzed whether Article 1105 required a finding of discrimination between foreign and national investors. The Tribunal concluded that “the plain and natural meaning of the text of Article 1105 does not support the contention that the ‘minimum standard of treatment’ precludes governmental
differenciations as between nationals and aliens. Article 1105(1) does not mention discrimination.” *Id.* para. 14, Part IV, Chapter C. The Tribunal considered this conclusion supported by the FTC Interpretation. *Id.* para. 17, Part IV, Chapter C.

- **International Thunderbird Gaming v. Mexico**, UNCITRAL Case, Award, Jan. 26, 2006 (Albert Jan van den Berg, President; Agustín Portal Ariosa and Thomas W. Wälde, Arbitrators). The majority of the Tribunal first noted that the threshold for finding a violation of the minimum standard of treatment remains high. *Id.* para. 194. The majority then found that “acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law (are) those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards.” *Id.* The majority of the Tribunal also held that it was necessary to prove manifest arbitrariness and unfairness for a violation of the fair and equitable treatment to take place. *Id.* para. 197.13

- **Saluka v. Czech Republic**, UNCITRAL Case, Partial Award, Mar. 17, 2006 (Arthur Watts, President; L. Yves Fortier and Peter Behrens, Arbitrators). The Tribunal first stated that the fair and equitable treatment provision of the Netherlands-Czech Republic BIT did not allow it to decide the dispute on the basis of *ex aequo et bono* or subjective impressions. *Id.* para. 284. Rather, the Tribunal was bound to decide the dispute on the basis of the law, including the provisions of the Treaty interpreted according to the Vienna Convention. *Id.* paras. 284, 296. The Tribunal found that a foreign investor protected by the Netherlands-Czech Republic BIT may expect that the Czech Republic “will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (i.e. unrelated to some rational policy), or discriminatory (i.e. based on unjustifiable distinctions).” *Id.* para. 309. Moreover, the Tribunal stated, pursuant to the “fair and equitable treatment” standard, that “the host State must never disregard the principles of procedural propriety and due process and must grant the investor freedom from coercion or harassment by its own regulatory authorities.” *Id.* para. 308.

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13 Thomas W. Wälde issued a separate opinion, concurring with certain aspects of the Tribunal’s reasoning but objecting to the majority’s application of the principle of legitimate expectations in connection with Article 1105 of NAFTA. See note 33, infra.
• Azurix Corp. v. Argentina, ICSID Case No. ARB/01/12, Award, July 14, 2006 (Andrés Rigo Sureda, President; Marc Lalonde and Daniel Hugo Martins, Arbitrators). The Tribunal interpreted the fair and equitable treatment provision in the U.S.-Argentina BIT in light of the principles of treaty interpretation set forth in the Vienna Convention and held that “from the ordinary meaning of the terms fair and equitable and the purpose and object of the BIT…fair and equitable should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment.” Id. para. 360. The Tribunal also stated that “the text of the BIT reflects a positive attitude towards investment,” and that “the parties to the BIT recognize the role that fair and equitable treatment plays in maintaining a stable framework for investment and maximum effective use of economic resources.” Id. The Azurix Tribunal identified three main characteristics of the standard. First, bad faith and malicious intention of the host State are not necessary elements in the failure to treat investments fairly and equitably. Id. para. 372. Second, the conduct of the State has to be below international standards. Id. Third, the frustration of the investor’s legitimate expectations when it made the investment should be taken into account. Id.

• LG&E Energy v. Argentina, ICSID Case No. ARB/02/1, Decision on Liability, Oct. 3, 2006 (Tatiana B. de Maekelt, President; Francisco Rezek and Albert Jan van den Berg, Arbitrators). The Tribunal first noted that because the fair and equitable treatment standard has a generic nature and its interpretation varies with the course of time and with the circumstances of each case, “it becomes difficult to establish an unequivocal and static concept” for it. Id. para. 123. The Tribunal then interpreted the standard according to the principles of treaty interpretation enshrined in the Vienna Convention and with reference to other sources of international law, and concluded that “the fair and equitable standard consists of the host State’s consistent and transparent behavior, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor.” Id. para. 131.

• PSEG Global v. Turkey, ICSID Case No. ARB/02/5, Award, Jan. 19, 2007 (Francisco Orrego Vicuña, President; L. Yves Fortier and Gabrielle Kaufmann-Kohler, Arbitrators). The Tribunal first observed that the fair and equitable treatment standard “has acquired prominence in investment arbitration” particularly when the facts of the dispute do
not clearly support a claim for expropriation, *Id.* para. 238, and that "[b]ecause the role of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable." *Id.* para. 239. In applying the standard in the context of the U.S.-Turkey BIT, the Tribunal listed a series of government acts that gave rise to a breach, such as the administration's negligence in the handling of contract negotiations with the investor, abuse of authority by government authorities with respect to demands for contract renegotiation, numerous changes in relevant legislation and inconsistencies in the administration's practice. *Id.* para. 252. The Tribunal, however, failed to find evidence of bad faith or any kind of conspiracy by the Respondent State to take away legitimately acquired rights. *Id.* para. 245. The Tribunal concluded that the aggregate of these situations demonstrated that the State failed to ensure a stable and predictable business environment for investors to operate, which it found to be a breach of the obligation to provide fair and equitable treatment. *Id.* para. 253. Based on the same facts, however, the Tribunal rejected a separate finding of liability on account of arbitrariness or discrimination. *Id.* paras. 261–262.

- *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/08, Award, Feb. 6, 2007 (Andrés Rigo Sureda, President; Charles N. Brower and Domingo Bello Janeiro, Arbitrators). The Tribunal interpreted the fair and equitable treatment standard in light of its ordinary meaning and object and purpose of the Treaty, following principles of the Vienna Convention, and concluded that the standard "denote[s] treatment in an even-handed and just manner, conducive to fostering the promotion and protection of foreign investment and stimulating private initiative." *Id.* para. 290. The Tribunal noted that the parties to the Treaty show by their intentions and objectives a positive attitude towards investment. *Id.* The Tribunal rejected the notion that a State breaches its obligation of fair and equitable treatment only when it has acted in bad faith. *Id.* para. 300.

- *Enron Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Award, May 22, 2007 (Francisco Orrego-Vicuña, President; Albert Jan van den Berg and Pierre-Yves Tschanz, Arbitrators). The Tribunal first noted that the Respondent was correct in arguing that the fair and equitable treatment standard was neither too clear nor too

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14 Arbitrator Domingo Bello Janeiro wrote a separate opinion regarding damages.
precise. Id. para. 256. The Tribunal interpreted the U.S.-Argentina BIT in light of the Vienna Convention, and found that a key element of fair and equitable treatment is the requirement of a stable framework for the investment. Id. para. 260. The Tribunal noted, however, that "the stabilization requirement does not mean the freezing of the legal system or the disappearance of the regulatory power of the State." Id. para. 261. Finally, the Tribunal observed that the principle of good faith is not an essential element of the standard of fair and equitable treatment and therefore violation of the standard would not require the existence of bad faith. Id. para. 263.

III. THE DEBATE OVER THE STANDARD'S SOURCE: A REFLECTION OF THE "MINIMUM STANDARD OF TREATMENT" UNDER CUSTOMARY INTERNATIONAL LAW OR AN AUTONOMOUS STANDARD?

There has been considerable debate concerning whether the fair and equitable treatment standard reflects the traditional notion of a "minimum standard of treatment" that States are required to provide aliens under customary international law, or whether it imposes an autonomous standard that may be more exacting. The distinction involves the difference between an "objective" test of State conduct (what types of State conduct have traditionally been proscribed, through State practice and opinio juris, as below the minimum "floor" to which aliens are entitled, such that such proscriptions have risen to the level of customary international law) and a more amorphous "subjective" test, which would not be limited to such previously proscribed categories of conduct but would also embrace a tribunal's own perceptions of "fairness" and "equity" in the particular circumstances of a case.

This debate reached prominence in the context of NAFTA. Some of the first NAFTA tribunals adopted a concept of fair and equitable treatment that was perceived as encompassing guarantees above and beyond the minimum standard of treatment required under customary international law (see, e.g., the Metalclad, S.D. Myers and Pope & Talbot decisions). Perhaps reacting to this approach, the NAFTA Free Trade Commission15 issued a Note of Interpretation dated 31 July 2001, stating among other things that fair and equitable treatment, as referred to in NAFTA Article 1105(1), should not be interpreted as requiring "treatment

15 The Free Trade Commission is a body composed of the Trade Ministers of the three State Parties to the NAFTA (United States, Canada and Mexico) with the power to adopt binding interpretations of provisions of the Treaty. See NAFTA Article 1131(2).
in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.”\(^\text{16}\) The Free Trade Commission interpretation can be understood as a matter of textual interpretation, in light of the fact that Article 1105(1) of NAFTA directly refers in its heading to a “Minimum Standard,” and includes in its text a reference to fair and equitable treatment “in accordance with international law.” NAFTA tribunals have consistently complied with the Free Trade Commission’s Interpretation, as they are required to do under the terms of the Treaty.\(^\text{17}\) The FTC Interpretation has been understood as incorporating current international customary law, at least as it stood at the time that NAFTA came into force in 1994, rather than any earlier version of the standard of treatment, such as the landmark decision of Neer v. Mexico, Opinion, United States-Mexico General Claims Commission, Oct. 15, 1926.\(^\text{18}\)

The convergence of approach in the NAFTA context does not, however, suggest a similar movement in BIT arbitrations. First, of course, Contracting Parties to BITs are not bound by interpretations of terms issued by bodies established under other treaties, such as the NAFTA Free Trade Commission.\(^\text{19}\) Moreover, unlike the NAFTA, many BIT provisions lack any reference to a “minimum standard of treatment” or to fair and equitable treatment's being interpreted by reference to customary international law, such that there may be limited guidance as to the intention of the Contracting Parties. Lacking

\(^{16}\) As explained by the ADF Tribunal, para. 178, where the treatment accorded by a State to its own nationals under its domestic law falls below the minimum standard of treatment required under customary international law, non-nationals become entitled to better treatment than that which the State accords under its domestic law.

\(^{17}\) See, e.g., Mondelez, paras. 100-125; Metalclad, paras. 61-65; ADF, paras. 175-178; Loewen, paras. 124-128; Waste Management, paras. 90–91; Methanex, paras. 20–24; and International Thunderbird, paras. 192-193.

\(^{18}\) See, e.g., Mondelez para. 123 (noting that “the content of the minimum standard today cannot be limited to the content of customary international law as recognized in arbitral decisions in the 1920s”); ADF, para. 179 (“In considering the meaning and implications of the 31 July 2001 FTC Interpretation, it is important to bear in mind that the Respondent United States accepts that the customary international law referred to in Article 1105(1) is not ‘frozen in time’ and that the minimum standard of treatment does evolve. The FTC Interpretation of July 31, 2001, in the view of the United States, refers to customary international law ‘as it exists today.’ It is equally important to note that Canada and Mexico accept the view of the United States on this point even as they stress that ‘the threshold [for violation of that standard] remains high.’ Put in slightly different terms, what customary international law projects is not a static photograph of the minimum standard of treatment of aliens as it stood in 1927 when the Award in the Neer case was rendered. For both customary international law and the minimum standard of treatment of aliens it incorporates, are constantly in a process of development.”); International Thunderbird, para. 194 (“The content of the minimum standard should not be rigidly interpreted and it should reflect evolving international customary law.”)

\(^{19}\) See Schreuer, supra note 5, at 363–64.
such guideposts, tribunals in BIT cases generally reason in terms of the particular wording of the treaties before them, in light of the principles of treaty interpretation set forth in the Vienna Convention on the Law of Treaties. A wide variety of outcomes has resulted, given the textual variations between BITs in general and the different interpretative approaches adopted by different arbitral tribunals. We set forth below examples of some of the statements made by different BIT tribunals, regarding the potential relationship of fair and equitable treatment obligations to—or their autonomy from—the requirements of customary international law:

  The Tribunal understood the standard as being to “require an ‘international minimum standard’ that is separate from domestic law, but that is, indeed, a minimum standard.” *Id.* para. 367. The Tribunal also found that “[a]cts 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.” *Id.*

  The Tribunal found that fair and equitable treatment provides a “minimum international standard which forms part of customary international law.” *Id.* para. 292.

- *Teemed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003
  The Tribunal found that the scope of the undertaking of fair and equitable treatment under the relevant BIT provision is that resulting either from an “autonomous interpretation,” taking into account the ordinary meaning of the terms, or from “international law and the good faith principle.” *Id.* para. 155.

- *MTD v. Chile*, ICSID Case No. ARB/01/7, Award, May 25, 2004
  The Tribunal found that because there was no reference in the BIT to customary international law in connection with fair and equitable treatment, it was obliged to apply the standard autonomously, in light of the BIT language and in accordance with principles of treaty interpretation set forth in the Vienna Convention. *Id.* paras. 111–112.

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20 See Articles 31 and 32, providing for interpretation in accordance with the ordinary meaning of the treaty’s terms in their context and in light of the object and purpose of the treaty.
• *Occidental v. Ecuador*, LCIA Case No. UN3467, Award, July 1, 2004
  The Tribunal noted an express reference in the treaty's provision on fair and equitable treatment that "in no case shall the investment be accorded treatment less favorable than that required by international law," and found in light of this reference that "the Treaty standard is not different from that required under international law concerning both the stability and predictability of the legal and business framework of the investment." *Id.* para. 188.

• *CMS Gas v. Argentina*, ICSID Case No. ARB/01/8, Decision, May 12, 2005
  The Tribunal observed that in the context of that particular case, the choice between requiring a higher treaty standard and that of equating it with the international minimum standard was not relevant, as under the treaty at issue the standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, was not different from the international law minimum standard and its evolution under customary international law. *Id.* para. 284.

• *Saluka v. Czech Republic*, UNCITRAL, Partial Award, March 17, 2006
  The Tribunal found that the fair and equitable treatment standard as established in the Netherlands-Czech Republic BIT is an autonomous standard and must be interpreted in light of the object and purpose of the Treaty, so as to avoid conduct by the Respondent State that clearly provides disincentives to foreign investors. *Id.* para. 309.

• *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Award, July 14, 2006
  The Tribunal noted that the language of the U.S.-Argentina BIT, which combines the obligation to provide fair and equitable treatment with the obligation not to accord investments treatment less than required by international law, should be interpreted as providing a floor in order to avoid a possible interpretation of these standards below what is required by international law. *Id.* para. 361. The *Azurix* Tribunal, however, did not consider this conclusion of material significance for its application of the standard, as "[t]he question whether fair and equitable treatment is or is not additional to the minimum treatment requirement under international law is a question about the substantive content of fair and equitable treatment and, whichever side of the argument one takes, the answer to the question may in substance be the same." *Id.* para. 364.
• **Siemens A.G. v. Argentina**, ICSID Case No. ARB/02/08, Award, Feb. 6, 2007 The Tribunal noted that although the Germany-Argentina BIT at issue contains no reference to international law or to a minimum standard, in applying this Treaty, it was “bound to find the meaning of these terms under international law bearing in mind their ordinary meaning, the evolution of international law and the specific context in which they are used.” *Id.* para. 291. The Tribunal also stated that “[t]he question whether fair and equitable treatment is or is not additional to the minimum treatment requirement under international law is a question about the substantive content of fair and equitable treatment.” *Id.* para. 293.

• **Enron Corporation and Ponderosa Assets, L.P. v. Argentina**, ICSID Case No. ARB/01/3, Award, May 22, 2007 The Tribunal observed that, in some circumstances where the international minimum standard is sufficiently elaborate and clear, fair and equitable treatment might be equated with it; but in more vague circumstances, the fair and equitable treatment standard may be more precise than customary international law. *Id.* para. 258. The Tribunal concluded that, at least in the context of the U.S.-Argentina BIT at issue, the fair and equitable treatment standard could also require treatment additional to, or beyond that of, customary law. *Id.*


Tribunals have taken divergent approaches not only to the source of the “fair and equitable treatment” standard, but also to its substantive content. Some tribunals have referred to the investor’s “legitimate expectations” as a core factor in deciding claims, and found violations based on a State’s interference with regulatory and contractual arrangements upon which the foreign investor originally was induced to invest. Other tribunals have adopted an approach that requires a demonstration of “manifestly arbitrary” State conduct to support a finding of liability.

* A. *The Role of the Investors’ “Legitimate Expectations”*

Tribunals applying the “legitimate expectations” approach to fair and equitable treatment analysis have not agreed on a complete list of State acts and
representations that might reasonably and legitimately give rise to investors’ expectations. However, some observations may be made about the approaches taken by various tribunals.

First, tribunals have noted that the precise level of treatment required from State authorities to give rise to a violation of an investor’s legitimate expectations will differ from case to case, depending upon the underlying facts and the language of the investment treaty at issue.\(^{21}\) For instance, the Tribunal in the recent case LG&E Energy, para. 130, warned that “the investor’s fair expectations cannot fail to consider parameters such as business risk or industry’s regular patterns.” The importance of national context helps to underscore why certain types of government conduct may be found to constitute treaty violations in one case but not in another, and why tribunals are frequently at pains to emphasize the specific national and historical context against which their analysis is applied. In Genin, para. 370, for example, the Tribunal accepted Estonia’s explanation that annulment of the investor’s license was pursuant to statutory obligations to regulate the Estonian banking sector, that “heightened scrutiny of the banking sector” was justified by the particular circumstances of political and economic transition prevailing in Estonia at the time, and that in the context of such circumstances, “[s]uch regulation by a state reflects a clear and legitimate public purpose.”\(^{22}\)

Second, the requirement of consistent and transparent State conduct has been considered by some tribunals to be related to the protection of the investor’s legitimate expectations.\(^{23}\) The Tribunal in Tecmed, para. 154, for example found that

\[\text{[t]he foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.}\]


\(^{22}\) The Genin Tribunal, para. 372, however, expressed its hope that the “Bank of Estonia will exercise its regulatory and supervisory functions with greater caution regarding procedure in the future.” It also observed that “the awkward manner by which the Bank of Estonia revoked EIB’s license, and in particular the lack of prior notice of its intention to revoke EIB’s license and of any means for EIB or its shareholders to challenge that decision prior to its being formalized, cannot escape censure.” Id. para. 381.

\(^{23}\) See, e.g., Schreuer, supra note 5, at 374; Fietta, supra note 21, at 388.
[...] The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments.24

Third, tribunals adopting the "legitimate expectations" approach have given great weight to representations made by the host State that arguably induced the investor's reliance. For instance, the Tribunal in Waste Management, para. 98, stated that in applying the 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 Tribunal in PSEG Global, paras. 241, 243, stated that "[l]egitimate expectations by definition require a promise of the administration on which the Claimants rely to assert a right that needs to be observed," and that a general request made by a government to attract new investments should not be understood as a promise by that government to any particular investor. And in another recent decision, the Tribunal in LG&E Energy, para. 130, stated that an investor's fair expectations "may not be established unilaterally by one of the parties."25

Tribunals have also given great weight to the objective state of the law as it stood at the time the investor made its investment.26 The Tribunal in GAMI, para. 191, pointed out that "[t]he Tribunal makes no determination on this issue because in this case the Disputing Parties acted on the basis of the law as it then appeared to exist." The Tribunal in Saluka, para. 301, likewise stated that "[a]n investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable," and the Tribunal in LG&E Energy, para. 130, stated that an "investor's fair expectations ... are

24 See also Tecmed, para. 167 ("[C]onsidering the issues "in light of the fact that throughout a relationship of such nature, necessarily prolonged in time, the Claimant was entitled to expect that the government's actions would be free from any ambiguity that might affect the early assessment made by the foreign investor of its real legal situation or the situation affecting its investment and the actions the investor should take to act accordingly.").

25 The Tribunal in ADF, para. 189, concluded that any expectations that the investor had with respect to the relevancy or applicability of the case law it cited were not created by any misleading representations made by authorized officials of the Respondent State, but rather by legal advice received by the investor from private counsel.

based on the conditions offered by the host State at the time of the investment.” More recently, the Tribunal in Enron, para. 262, found that “[w]hat seems to be essential, however, is that these expectations derived from the conditions that were offered by the State to the investor at the time of the investment and that such conditions were relied upon by the investor when deciding to invest.”

Finally, tribunals adopting the “legitimate expectations” approach have referred to several other characteristics of this principle in connection with the fair and equitable treatment standard. For instance, the LG&E Tribunal, para. 130, emphasized that the investor’s legitimate expectations must exist in a form enforceable by law; and that in the event of infringement by the host State, a duty to compensate the investor for damages arises except for those caused in the context of a state of necessity. The Saluka Tribunal (discussed in further detail in Section B, below), para. 303, stated that the expectations of foreign investors certainly include the observation by the host State of well-established fundamental standards as good faith, due process, and non-discrimination.

The focus on the investor’s expectations by many investment treaty tribunals has given rise to the question whether the State’s non-performance of a contract entered into with an investor may itself constitute a violation of the obligation to afford fair and equitable treatment, since contract breach by definition disappoints the investor’s legitimate expectations. Acceptance of this argument could elevate contractual breaches to the level of treaty breaches. This question is the subject of hot debate.27

B. The Requirement of “Manifestly Arbitrary” State Conduct

Some tribunals and commentators criticize approaches focused on the investor’s “legitimate expectations,” and instead emphasize the importance of preserving a State’s sovereignty and autonomy in regulatory matters, though

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27 Commentators recognize that this issue is highly controversial and has not yet found definitive answer in arbitral practice. See, e.g., Schreuer, supra note 5, at 380 (noting that “[O]n the one hand, a simple breach of contract is part of normal business risk, and an investor may have to anticipate such an occurrence without recourse to a treaty remedy. On the other hand, a willful refusal by a government authority to abide by its contractual obligations, abuse of government authority to evade agreements with foreign investors and action in bad faith in the course of contractual performance may well lead to a finding that the standard of fair and equitable treatment has been breached”); Dolzer, supra note 26, at 105 (“A related issue concerns the comparison between the effect of a stabilization clause, of an umbrella clause and of the requirements of fair and equitable treatment in the context of an investment contract. Strict insistence on the concept of reliance for a contractual arrangement would come close to having the same effect as a stabilization clause or an umbrella clause. The issue does not become more simple when it is recognized that neither the legal significance of a stabilization nor the meaning of an umbrella clause has been clarified by recent decisions, and the entire issue must be deemed to remain open at this point.”).
subject to reasonable limits. The concern is that “fair and equitable treatment” not be interpreted so as to effectively require host States to freeze their legal system for an investor’s benefit.\textsuperscript{28} In this context, some tribunals and commentators have suggested that it is only when a change in State policy or regulation amounts to “manifestly arbitrary conduct” or “to abuse of State power”\textsuperscript{29} that a violation of fair and equitable treatment would occur. This approach shifts the terms of debate from the investor’s own expectations to an assessment of the legitimate objectives and good faith of the State.

Several cases may be cited as defending the preservation of a State’s regulatory autonomy and/or an express requirement of “manifestly arbitrary” State conduct. For example, the Tribunal in S.D. Myers, para. 261, stated that “a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making.” It then considered that a “breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.” Id. para. 263.\textsuperscript{30}

More recently, in the 2006 decision in Satuka, the Tribunal stated that while the notion of legitimate expectations is “closely tied” to the fair and equitable treatment standard and may even be considered its dominant element, para. 302, it recommended caution with application of that approach, so as not to “impose upon host States’ obligations which would be inappropriate and unrealistic.” Id. para. 304. For the Satuka Tribunal, the scope of protection against unfair and

\textsuperscript{28} See, e.g., Schreuer, supra note 5, at 379 (noting that a general stabilization requirement would go beyond what the investor can legitimately expect, and a reasonable evolution of the host State’s law is part of the environment with which investors must contend); Dolzer, supra note 26, at 102 (“Each state has always had the right to determine its own laws, within the boundaries of the international minimum standard and of its cogens, and this legal position has not been abandoned in the process of economic and legal globalization.”). In a more recent article, however, Dolzer stated that “[a]lthough no single set of guidelines exists to direct each state as it seeks to strike a balance in these matters, the international trend is certainly to place higher emphasis on an investment-friendly climate leading to economic growth rather than on legal and political concepts of national sovereignty.” Rudolf Dolzer, The Impact of International Investment Treaties on Domestic Administrative Law, 37 NYU J. Int’l L. & Pol. 953, 972 (2005).

\textsuperscript{29} See Francisco Orrego Vicuña, Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society, 5 International Law Forum du Droit International 188, 194 (2009) (“Governments and international organizations may undertake changes of policy in their continuing need to search for the best choices in the discharge of their functions. However, to the extent that policies in force earlier might have created legitimate expectations both of a procedural and substantive nature, for citizens, investors, traders or other persons, these may not be abandoned if the result will be so unfair as to amount to an abuse of power.”).

\textsuperscript{30} Notwithstanding, the Tribunal in S.D. Myers determined that Canada breached its obligations under NAFTA Article 1105.
inequitable treatment cannot be determined exclusively by foreign investors' subjective motivations and considerations. Id. Rather, in order to be protected, the investor's expectations "must rise to the level of legitimacy and reasonableness in light of the circumstances." Id. The Tribunal went further to say that "[n]o investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged," and that "a breach of the standard requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interests on the other." 31

Id. paras. 305–306. The Tribunal concluded that an investor may only expect that the State "implements its policies bona fide by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and nondiscrimination." Id. para. 307 (emphasis added). Based on the facts of the case, the Saluka Tribunal found that the treatment accorded to Saluka's investment by the Czech Republic did violate the fair and equitable treatment provision of the Netherlands-Czech Republic BIT. Id. para. 281.

Finally, in the context of NAFTA, 32 the majority of the Tribunal in Thunderbird, para. 194, remarked that "the threshold for finding a violation of the minimum standard of treatment still remains high." The majority indicated further that "acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law [are] those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards." In that case, the Tribunal concluded that it could not find sufficient evidence that the proceedings at issue "were arbitrary or unfair, let alone so manifestly arbitrary or unfair as to violate the minimum standard of treatment." Id. para. 197 (emphasis added). 33

31 This same balance is found in CMS, para. 277 (noting that it is neither a question of whether the legal framework might need to be frozen, nor one of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made) and Euron, para. 261 (noting that the stabilization requirement does not mean the freezing of the legal system or the disappearance of the regulatory power of the State).
32 Mark Kantor points out that although International Thunderbird is a NAFTA case, the Tribunal did not tie its ruling directly to the particular text of NAFTA, but instead relied upon "recent investment case law and the good faith principle of international customary law." Kantor, supra note 5, at 238.
33 Thomas Wildes, in a separate opinion, objected to the majority's application of the fair and equitable treatment standard to the facts of the case. He argued that the legitimate expectations principle has experienced a significant growth over the last years and now constitutes a distinct subcategory and independent basis for a claim under the fair and equitable treatment standard. He contended that the legitimate expectations principle has become a preferred way for tribunals to provide protection to claimants in situations where the tests for a "regulatory taking" appear too difficult, complex and too easily assailable for reliance on a measure of subjective judgment. See separate opinion, at para. 37.
The most recent articulation of the "manifestly arbitrary" approach is in the U.S. Government's Counter-Memorial of September 2006 and Rejoinder of March 2007, in the ongoing NAFTA case of Glamis Gold, Ltd. v. United States of America. The U.S. Government argued that the minimum standard of treatment required by Article 1105 of NAFTA (which sets forth a State's obligation to provide fair and equitable treatment) is that set by rules of customary international law, and that a rule crystallizes into customary international law only over time through the general and consistent practice of States ("State practice") that is adhered to from a sense of legal obligation ("opinio juris"). Counter-Memorial, at 219; see also Rejoinder, at 140, 150-154.\(^\text{34}\) According to the U.S. Government, the investor has the burden of establishing both the existence of a rule of customary international law and that the State has engaged in conduct that has violated that rule. Counter-Memorial, at 222; see also Rejoinder, at 140. In the absence of a customary international law rule governing State conduct in a particular area, the U.S. Government argued, a State remains free to conduct its affairs as it deems appropriate. Counter-Memorial, at 222. Based on this premise, the U.S. Government asserted that the customary international law minimum standard of treatment:

(a) does not impose a duty on States to compensate any party who complains that a particular regulation or legislation is "unfair." The exercise of regulatory or legislative powers in the context of shifting governmental policies and public interests will inevitably result in outcomes that may appear unfair to some. Counter-Memorial, at 220;

(b) does not impose any particular way of acceptable reclamations (the issue in the particular case). Rather, a survey of State practice reveals a wide range of accepted reclamation practices. Counter-Memorial, at 224;

(c) does not address the processes by which States prescribe their laws, rules or regulations and, in particular, does not require a notice and

\(^{34}\) The U.S. Government argued that sufficiently broad State practice and opinio juris have thus far coincided to establish minimum standards of State conduct in only a few areas: (i) Article 1105(1) embodies the requirement to provide a minimum level of internal security and law and order—the customary international law obligation of full protection and security; (ii) Article 1105 recognizes that a State may incur international responsibility for a denial of justice where its judiciary administers justice to aliens in a notoriously unjust or egregious manner which offends a sense of judicial propriety; and (iii) the most widely-recognized substantive standard applicable to legislative and rule-making acts, the bar on expropriation without compensation—which is governed by Article 1110 of NAFTA. See Counter-Memorial, at 221.
comment period for every new regulation. Counter-Memorial at 225–226; see also Rejoinder, at 154, 159, 169;
(d) does not support the notion that States are obligated to provide a transparent and predictable framework for foreign investment. Counter-Memorial, at 226–227; see also Rejoinder, at 154–171;
(e) does not support the contention that States should refrain from “arbitrary” decision-making by an administrative or legislative body. Rather, States are entitled to a significant degree of deference in legislative and regulatory actions. Counter-Memorial, at 227; see also Rejoinder, at 187–193;
(f) does not require States to regulate in such a manner—or refrain from regulating—so as to avoid upsetting foreign investors' settled expectations with respect to their investments, and that an investor’s legitimate expectations may be relevant in the context of a regulatory expropriation claim, but the same does not apply to the minimum standard of treatment. The U.S. Government states that there is no rule under customary international law requiring compensation for actions that fall short of an expropriation but that frustrate an alien’s expectations, and concludes by saying that “[i]f States were prohibited from regulating in any manner that frustrated expectations—or had to compensate everyone who suffered any diminution in profit because of a regulation—States would lose the power to regulate.” Counter-Memorial, at 230–233; see also Rejoinder, at 177–187;53 and
(g) should not work as a fall-back solution to find liability when tribunals find it too difficult to determine that government action constituted expropriation. Rejoinder, at 145–146.

V. FAIR AND EQUITABLE TREATMENT AND THE PROPER MEASURE OF DAMAGES

The final question that should be flagged for further consideration concerns damages. When a State’s liability is premised not on its expropriation

53 In connection with this argument, the U.S. Government argued that customary international law does not support the idea that a mere breach of contract by the State gives rise to State responsibility. For a claim against a State to amount to a violation of the minimum standard of treatment, a claimant must demonstrate something more than breach of contract, such as a denial of justice or that the State repudiated the contract in a way that was discriminatory or motivated by non-commercial considerations. Therefore, if customary international law does not protect expectations simply because they are backed up by contractual commitments, it cannot protect expectations where there are lesser or no forms of assurances made. See Rejoinder, at 179–185.
of investor property but on its violation of an obligation to provide fair and equitable treatment, what damages are properly recoverable? Treaties usually offer no guidance on this question, the way they do for measuring damages for expropriation (see CMS v. Argentina, para. 409; Azurix v. Argentina, para. 419). The decision on damages is therefore left to the tribunal’s discretion (see S.D. Myers v. Canada, para. 422).

Fair and equitable treatment cases have not approached the damages calculation in a consistent fashion. The S.D. Myers tribunal, for example, looked to the Chorzów Factory test for its damages standard, para. 311:

The essential principle contained in the actual notion of an illegal act is that reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.

S.D. Myers concluded that Canada’s temporary closure of the Canada-U.S. border to exports from Canada of PCB-contaminated waste materials violated NAFTA’s fair and equitable treatment commitment. The award on damages went through a 12-step procedure to calculate the impact on the investor of the temporary border closure. Those steps included calculating the investor’s net income stream lost to third-party competitors during the temporary closure period, the net income stream lost to third-parties after the closure period but attributable to the adverse impact on the investor’s market position caused by the closure, and the lost net income stream during the closure period for business the investor failed to fulfill by virtue of the closing but not lost to third parties. See S.D. Myers, Second Partial Award (Damages), Oct. 21, 2002, paras. 229–300. In MTD v. Chile, paras. 239–240, in contrast, the claimant investor sought recovery of its investment expenditures (minus the residual value of the property at issue). The panel accepted MTD’s approach, but partially reduced the award for business risks assumed by the investor.

The ICSID arbitral tribunal in PSEG v. Turkey, para. 309, rejected a fair market value (FMV) test both because the applicable treaty proposed the FMV compensation standard only for lawful expropriations, and the underlying facts did not suit the use of the FMV test. Yet another recent case, CMS v. Argentina,
para. 410, concluded that applying the expropriation standard made sense, even if the relevant investment treaty did not require application of that standard to a fair and equitable treatment obligation.

The CMS Tribunal, para. 422, established a difference between two scenarios—one the “no regulatory change context” and the other the “new regulatory context”—and then awarded the claimant compensation calculated by the loss of market value (including actual damages and lost profits) from the position the Claimant would have enjoyed had the State not acted at all. This methodology is based on the same premise adopted by tribunals to calculate damages in cases of expropriation, i.e. damages should seek to compensate the investor in a way that returns it to the status quo ante; in other words, compensation should wipe out the consequences of the government’s unlawful act.37

But if one acknowledges that States are permitted some latitude for regulatory change without payment of compensation, an alternative methodology might be to calculate damages based on the extent to which the State’s conduct exceeded permissible boundaries—i.e. the difference between the lower value of the investment after the unlawful State conduct, and the value that the investment would have had had the government’s conduct been confined within lawful limits. This latter approach would undoubtedly pose difficulties in measurement, but conceptually it may be appealing in certain circumstances, where the tribunal finds that the government could have acted legitimately with respect to certain objectives, but transgressed treaty limits in the specific manner in which it proceeded. It remains to be seen whether this alternate measure of damages gains any traction in the evolving fair and equitable jurisprudence.

CONCLUSION

The obligation of host States to provide foreign investors with fair and equitable treatment is becoming one of the most important topics of debate in investor-State arbitration. This article is intended to provide an introduction to the contours of the debate involving the interpretation of that obligation.

37 Other recent awards in cases involving Argentina may not offer any more consistency than PSEG, CMS and S.D. Myers. The arbitrators in Siemens decided that Argentina had breached both the treaty’s expropriation obligation and the treaty’s fair and equitable treatment obligation. That panel calculated the amount due to the investor on the basis of the Chorzów Factory standard. The award focused on the book value of Siemens’ investment expenditures, and rejected a lost profits claim as ‘very unlikely to have ever materialized.’ In Aecon, paras. 424, 432, the tribunal looked to the fair market value of the investment expenditures by Enron (not their book value), without regard to the future possible earnings of Enron's Argentine water company.