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Fair and Equitable Treatment in International Investment Agreements

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Centre on Asia and Globalisation

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Table of Contents

1. Introduction 2
2. Origins of Fair and Equitable Treatment 2
3. Current Usage of Fair and Equitable Treatment 3
4. Interpretation of the Fair and Equitable Treatment Standard................................ 4
   4.1 Different formulations of fair and equitable treatment................................. 4
   4.2 The Debate Over the Scope of Fair and Equitable Treatment 5
   4.3 The Role of the Preamble and Objective of the Treaty 8
   4.4 The Interpretation of Fair and Equitable Treatment in Past Arbitral Awards 9
      4.4.1 Legitimate Expectations..10
      4.4.2 Due Process in Administrative Decisions 13
      4.4.3 Fair and Equitable Treatment in a Host State's Courts 16
5. Concluding Remarks 16

Fair and Equitable Treatment in International Investment Agreements

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1. Introduction

The fair and equitable treatment standard is now a key element of international law on the protection of investors and their investments. Whilst the words themselves seem simple, interpreting their meaning in investment law has proved to be anything but. The scope of fair and equitable treatment has been hotly debated, not least by host States fearing that it might become a "catch all" provision capable of being invoked in respect of virtually any adverse treatment of an investment. This paper seeks to provide some clarity to this controversial standard.

The paper begins with the origins of the fair and equitable treatment standard, its current proliferation in investment treaties and the various formulations of the standard used in the treaties. It discusses the scope of the standard, including the long-running debate as to whether it is a minimum standard under customary international law, a minimum standard under international law generally, or an autonomous treaty standard to be interpreted on its plain meaning alone. It then reviews the principles used by tribunals to interpret the standard to date, with a special focus on the notion of legitimate expectations, due process in administrative decisions and denial of justice by host State courts. It concludes with some suggestions as to how negotiators might construct the standard as to be fair and equitable for all stakeholders, not only the investor.

2. Origins of Fair and Equitable Treatment

The concept of "equitable" treatment first appeared in the 1948 Havana Charter for an International Trade Organization.[1] The Havana Charter empowered the International Trade Organization to recommend and promote bilateral or multilateral agreements to assure just and equitable treatment for investments from one Member country to another.[2]

Also in 1948, the Conference of American States adopted the Economic Agreement of Bogota. It provided for foreign capital to receive equitable treatment and for States not to take unjustified, unreasonable or discriminatory measures that would impair the legally acquired rights or interests of foreign investors.[3]

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[1] This section is drawn from OECD, Fair and Equitable Treatment Standard in International Law, September 2004, p3-4, http://www.oecd.org/dataoecd/22/53/33776498.pdf.
[2] Article 11(2).
[3] Article 22.

Although neither of the above agreements actually entered force, in the following years some of the United States' treaties on Friendship, Commerce and Navigation (FCN), began to incorporate the terms "equitable" and "fair and equitable treatment".[4]

In 1967 the OECD Council adopted the Draft Convention on the Protection of Foreign Property. Although it was never opened for signature, it required each Party to at all times ensure fair and equitable treatment to the property of the nationals of the other Parties.[5]

3. Current Usage of Fair and Equitable Treatment

Today, the majority of bilateral investment treaties (BITs) include the fair and equitable treatment standard, although some treaties of certain Asian countries do not (e.g. Pakistan, Saudi Arabia and Singapore).[6] Traditionally, some countries, including the Latin American countries, preferred to maintain national control over foreign investments. They therefore adopted national treatment provisions in their BITs rather than fair and equitable treatment. However, in recent years, even these countries have begun to incorporate the fair and equitable treatment standard into their BITs.[7]

The fair and equitable treatment standard is also found in many multilateral trade agreements.[8] For example, the Energy Charter Treaty, Lomé IV,[9] the ASEAN Treaty for the Promotion and Protection of Investments, MERCOSUR's Colonia Protocol on Reciprocal Promotion and Protection of Investments, the Treaty establishing the Common Market for Eastern and Southern Africa (COMESA), the North American Free Trade Agreement (NAFTA), the Free Trade Agreements between Australia and Thailand,[10] between Singapore and the European Free Trade Area,[11] and between the United States and Australia,[12] Central America (CAFTA),[13] Chile,[14] Morocco,[15] and Singapore.[16] The standard is also found in the World Bank Guidelines on Treatment of Foreign Direct Investment.

[4] E.g. FCN treaties between the United States and Belgium, Ethiopia, Federal Republic of Germany, France, Greece, Ireland, Israel Luxembourg, Netherlands and Pakistan.
[5] Article 1(a).
[6] See endnote 1 above, p5-7.
[7] E.g Chile and China. See endnote 1 above, p5.
[8] During most of the twentieth century, the existence of a customary norm of an international minimum standard for the treatment of alien–owned property and investments was repeatedly challenged by developing countries. For further detail, see endnote 1 above, p5-7.
[9] Fourth Convention of the African, Caribbean and Pacific Group of States and the European Economic Community.
[10] Australia-Thailand Free Trade Agreement signed on October 19, 2003, see http://www.dfat.gov.au/trade/negotiations/aust-thai/aust-thai_fta.pdf.
[11] Agreement between Singapore and EFTA signed June 2002.
[12] US-Australia Free Trade Agreement signed 1 March 2004.
[13] US-Central America Free Trade Agreement (CAFTA) signed 28 January 2004. The Central American countries are: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua.
[14] US-Chile Free Trade Agreement signed 6 June 2003.
[15] US-Morocco Free Trade Agreement signed 15 June 2004.
[16] US-Singapore Free Trade Agreement signed 6 May 2003.

4. Interpretation of the Fair and Equitable Treatment Standard

There are a number of issues that come into play in understanding the interpretation and application of the fair and equitable standard today. A range of these issues is canvassed in this section. This is not meant to be exhaustive or comprehensive, but to indicate the nature of the issues involved, and some general debates they have engendered.

4.1 Different formulations of fair and equitable treatment

There is not just one formulation of the fair and equitable treatment standard in investment treaties. A 2007 study by UNCTAD grouped the various formulations into seven categories:[17]

1. Treaties that grant investments fair and equitable treatment without making any reference to international law or to any other criteria to determine the content of the standard.[18]

2. Treaties that state that investments will receive fair and equitable treatment no less favourable than accorded to its own investors or to investors of any third State.[19]

3. Treaties that couple the fair and equitable treatment standard with an obligation to abstain from impairing the investment through unreasonable or discriminatory measures.[20]

4. Treaties that require investments to be granted "fair and equitable treatment in accordance with the principles of international law".[21]

5. Treaties that similarly require fair and equitable treatment in accordance with the principles of international law, but that in addition expressly

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[17] UNCTAD (2007), Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking, p30-33, http://www.unctad.org/en/docs/iteiia20065_en.pdf

[18] E.g. Article II (2) of the 2001 BIT between Cambodia and Cuba (2001): "Investments of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and security in the territory of the other Contracting Party."

[19] E.g. Article 4 of the 2001 BIT between Bangladesh and the Islamic Republic of Iran: "Investments of natural and legal persons of either Contracting Party effected within the territory of the other Contracting Party, shall receive the host Contracting Party's full legal protection and fair treatment no less favourable than that accorded to its own investors or to investors of any third State, whichever is more favorable."

[20] For example, Article 2(2) of the 2001 BIT between Hungary and Lebanon (2001): "Investments and returns of investors 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. Each Contracting Party shall refrain from impairing by unreasonable or discriminatory measures the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments."

[21] E.g. Article 4(1) of the 1988 BIT between France and Mexico: "Either Contracting Party shall extend and ensure fair and equitable treatment in accordance with the principles of International Law to investments made by investors of the other Contracting Party in its territory or in its maritime area, and ensure that the exercise of the right thus recognized shall not be hindered by law or in practice [...]."

identify some requirements of the standard. These specific inclusions may broaden the scope of the standard.[22]

6. Treaties that make the fair and equitable treatment standard contingent on the domestic legislation of the host country.[23]

7. Finally, some recent BITs and free trade agreements provide a more precisely defined scope of the fair and equitable treatment standard. They oblige the contracting parties to accord covered investments treatment in accordance with the minimum standard of treatment under customary international law. Some also make it express that fair and equitable treatment is part of the minimum standard and does not create additional substantive rights.[24]

The different forms of drafting impact on the interpretation that any Tribunal may be called upon to give to the provision. At the same time, there appears to be a number of issues beyond the precise formulation that have also emerged as relevant. The relationship of treaty standards to customary international law in this field is one such issue.

4.2 *The Debate Over the Scope of Fair and Equitable Treatment*

The varied formulations of the fair and equitable treatment standard have resulted in considerable discussion as to its scope. A significant part of this discussion has centred on whether the standard is:

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[22] For an example of a provision that would seem to broaden the scope of the standard beyond the minimum standard, Article 3 of the 2002 BIT between France and Uganda provides:
"Either Contracting Party shall extend fair and equitable treatment in accordance with the principles of International Law to investments made by nationals and companies of the other Contracting Party on its territory or in its maritime area, and shall ensure that the exercise of the right thus recognized shall not be hindered by law or in practice. In particular, though not exclusively, shall be considered as de jure or de facto impediments to fair and equitable treatment any restriction to free movement, purchase and sale of goods and services, as well as any other measures that have a similar effect […]."

[23] E.g. Article IV of the 1997 BIT between the Caribbean Common Market and Cuba: "Each Party shall ensure fair and equitable treatment of Investments of Investors of the other Party under and subject to national laws and regulations."

[24] E.g. Article 5 of the 2005 BIT between the United States and Uruguay:
"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.
3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.

i) A minimum standard of treatment under customary international law;

ii) A minimum standard of treatment under international law, including all sources; or

iii) A free-standing, autonomous requirement that should be interpreted according to the plain-meaning of "fair and equitable treatment".

These three approaches may potentially impose very different obligations on host States.

The first approach requires that the assessment of fair and equitable be made in accordance with the minimum standard of treatment owed to alien-owned property and investments under customary international law.[25] This restricts the scope considerably as the only obligations will be those accepted as reaching the status of norms under customary international law.

The binding interpretation issued by the NAFTA Free Trade Commission on 21 July 2001,[26] the 2004 US Model BIT,[27] and the US Free Trade Agreements with Australia, Central America, Chile, Morocco and Singapore[28] all explicitly restrict the scope of the standard to customary international law.[29] However, in a number of awards released since the interpretation of the NAFTA Free Trade Commission was issued in 2001, tribunals have held that customary international law has evolved and the minimum standard of the early 20th century is not the standard to be applied today.[30]

The second approach has a wider scope than the first. Its scope is not restricted to obligations arising under customary international law but also includes those accruing from other established sources of international law. For instance, tribunals have said it

[25] See endnote 1 above, p8, footnote 33.

[26] 1. 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 another Party.
2. 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.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

[27] See http://www.state.gov/e/eb/rls/prsrl/2004/28923.htm

[28] "Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. For greater certainty [the previous paragraph] prescribes the customary international minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments ... ".

[29] The UNCTAD (2007) study noted that an unintended side-effect of such an approach may be that those BITs that allow for an unqualified fair and equitable treatment will be interpreted as providing for the "plain meaning" approach on the basis that if the contracting parties had intended something different, they would have explicitly stated that the fair and equitable treatment standard does not grant investment protection beyond customary international law. See endnote 17 above p32.

[30] *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB (AF)/99/2) (NAFTA), Award 11 October 2002, para 116-117, 125. *Mondev* para 125 cited in *Azurix Corp. v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award 14 July 2006, para 368; *Siemens AG v. Argentina* (ICSID Case No. ARB/02/8) (Germany/Argentina BIT) Award 6 February 2007 para 295.

includes duties imposed on host States in accordance with State practice, judicial or arbitral caselaw and other sources of general law.[31]

The third approach is found where the treaty includes an obligation to provide fair and equitable treatment without referring to international law. This means that an arbitral tribunal must come to its own view of what is fair and equitable in the circumstances. A number of tribunals and commentators have endorsed the view of Dr. F.A. Mann:[32]

> …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. 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 any other words is likely to be material. The terms are to be understood and implied independently and autonomously.

Some governments have expressed concern that this gives a tribunal so much discretion that the process resembles a decision *ex aequo et bono,* i.e. a decision based solely on the arbitrators' subjective view of "fairness" and "equity".[33]

The three approaches have the potential to impose very different obligations on host States. However, it is not clear whether this has happened in awards to date. Although a number of tribunals have cited the words of Dr. F.A. Mann, no published award has so far been decided purely on subjective grounds without any grounding in legal principle. Several tribunals have reconciled this by claiming that customary international law has now been shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce[34] and that the minimum standard has evolved so that its content is substantially similar whether the terms are interpreted in their ordinary meaning or in accordance with customary international law.[35]

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[31] *Mondev v. United States*, para 119; cited in *ADF Group Inc. v. United States of America* (ICSID Case No. ARB (AF)/00/1) (NAFTA), Award 9 January 2003, para 184. Both *ADF* and *Mondev* cited in *Waste Management, Inc. v. Mexico* (Number 2) (ICSID Case No. ARB (AF)/00/3) (NAFTA), Final Award 30 April 2004, para 96.
[32] F.A. Mann, British Treaties for the Promotion and Protection of Investments, 52 BRIT. YB Int'l L. 241, 244 (1981). His view was shared by the tribunals in *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/8) Award 12 May 2005, para 284; *Azurix v. Argentina*, para 361; *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. ("Vivendi") v. Argentina*, (ICSID Case No. ARB/03/19), Award August 2007, para 7.4.8. It was also echoed by UNCTAD, Fair and Equitable Treatment 40 (UNCTAD Series on Issues in Int'l Investment Agreements) (1999) "where the fair and equitable standard is invoked, the central issue remains simply whether the actions in question are in all the circumstances fair and equitable or unfair and inequitable" and Stephen Vascianne, The Fair and Equitable Treatment Standard in International Investment Law and Practice, 70 BRIT. Y.B. Int'l L 99, 144 (1999). ("Following Mann, where the fair and equitable treatment standard is invoked, the central question remains simply whether the actions in question are in all of the circumstances fair and equitable or unfair and inequitable.")
[33] See endnote 1 above, p3.
[34] *Mondev International v. United States*, para 116-117, 125. *Mondev* para 125 cited in *Azurix v. Argentina*, para 368; *Siemens AG v. Argentina*, para 295.
[35] *Azurix Corp v. Argentina*, para 361; *Tecmed v. Mexico* para. 155; *Occidental Exploration and Production Company v. Ecuador (Republic of)* (LCIA Case No. UN3467) (United States/Ecuador BIT) Final Award 1 July 2004, para 190.

Even within these three approaches, there is no precise definition of exactly what constitutes "fair and equitable treatment". One of the more comprehensive efforts to delineate the standard was made by the tribunal in *Waste Management v Mexico*:[36]

> 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 above excerpt has been cited by a number of subsequent tribunals.[37] However, tribunals have repeatedly stressed that a judgment of what is fair and equitable cannot be reached in the abstract. It will always depend on the specific circumstances of the particular case.[38]

4.3 The Role of the Preamble and Objective of the Treaty

The rules for interpreting treaties, including investment treaties, are set out in article 31 of the 1969 Vienna Convention on the Law of Treaties.[39] Article 31(1) of the Vienna Convention provides:

> 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.

Various tribunals have agreed that the ordinary meaning of "fair" and "equitable" is "just", "even-handed", "unbiased", "legitimate".[40] However, as one tribunal has noted,

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[36] *Waste Management No. 2 v. Mexico*, para 98.

[37] *GAMI Investments, Inc. v. Mexico*, UNCITRAL (NAFTA), Final Award 15 November 2004, para 89; *Methanex v. United States of America*, UNCITRAL (NAFTA), Award 3 August 2005, Part IV Chapter C para 12; *Siemens v. Argentina*, para 297; *Azurix v. Argentina*, para 370.

[38] *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL (The Netherlands/Czech Republic BIT) Partial Award 13 September 2001, para 336; *Mondev v. United States*, para 118; *Petrobart v. Kyrgyz Republic*, Stockholm Chamber Case No. 126/2003 (Energy Charter) Final Award, 29 March 2005, para 26; *Noble Ventures v. Romania* (ICSID Case No. ARB/01/11) Award 12 October 2005, para 181; *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile* (Republic of) (ICSID Case No. ARB/01/7) (Malaysia/Chile BIT), Award 25 May 2004, para 109; *ADC Affiliate Limited and ADC & ADMC Management Limited v. Hungary (The Republic of)* (ICSID Case No. ARB/03/16) (Hungary/Cyprus BIT) Award 2 October 2006, para 44; *Waste Management v. Mexico*, para 99 cited in *GAMI Investments v. Mexico*, para 96.

[39] Article 31 represents customary international law for the interpretation of treaties, see *Eureko B.V. v. Poland*, Ad Hoc Investment Treaty Case (Netherlands/Poland BIT), Partial Award on Liability, para 247; *Siemens AG v. Argentine Republic* (ICSID Case No ARB/02/8) Decision on Jurisdiction 3 August 2004, para 80.

[40] *MTD v. Chile*, para 112; *Siemens v. Argentina, Award,* para 290, *Saluka Investments v. Czech Republic*, UNICTRAL, Partial Award 17 March 2006, para 297; *Azurix v. Argentina,* para 360.

these definitions do not take one very far because they replace "fair" and "equitable" with terms of almost equal vagueness.[41]

Tribunals have, however, found more assistance in looking at the object and purpose of the treaty in question. The object and purpose may be discerned from its title and preamble[42] as well as other relevant provisions of the treaty. This has led many tribunals to hold that the object and purpose of the treaty in question was to promote foreign investment and to create a stable framework for investment and effective use of economic resources.[43] One tribunal took a more nuanced view. It called for a balanced approach to the interpretation of the treaty's provisions, saying that an interpretation that exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments. It said that this would undermine the overall aim of extending and intensifying the parties' mutual economic relations.[44]

However, even under the more nuanced approach, the tribunal still viewed the ultimate aim as investment promotion without regard as to whether the said investment contributed to the sustainable development of the host State. If the preambles and objective provisions of BITs remain silent as to the need to balance the interests of the various stakeholders and to ensure the sustainable development of the host State, tribunals may find it hard to deviate from this view. Negotiators may wish to bear this in mind when drafting the preamble and objective provisions of future investment treaties.[45]

4.4 The Interpretation of Fair and Equitable Treatment in Past Arbitral Awards

There is no doctrine of precedent in international arbitration law. While arbitral tribunals may in general seek to act consistently with each other, in the end each tribunal must exercise its competence in accordance with the applicable law, which will by definition be different for each BIT and respondent State.[46]

Notwithstanding this, certain principles seem to be emerging from the growing body of arbitral awards dealing with fair and equitable treatment. The majority of cases have dealt with administrative decision-making and a few with the investors' treatment in the host States' courts. In respect of administrative decisions, the cases might usefully be

[41] *Saluka v. Czech Republic*, para 297.
[42] *Saluka v. Czech Republic*, para 299.
[43] E.g. *MTD v. Chile*, para 113; *Siemens v. Argentina*, Award, para 289; *Azurix v. Argentina*, para 360.
[44] *Saluka v. Czech Republic*, para 300.
[45] The preamble of the 2005 BIT between the United States and Uruguay may go some way to achieve this by desiring that its objectives be achieved "in a manner consistent with the protection of health, safety, and the environment, and the promotion of consumer protection and internationally recognized labor rights."
The preamble and object of the IISD Model International Agreement on Investment for Sustainable Development go further, see http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf
[46] *SGS Societe Generale de Surveillance S.A. v. Philippines* (ICSID Case No. ARB/02/6) (Switzerland/Philippines BIT), Decision on objection to jurisdiction, 29 January 2004, para. 97.

divided between those addressing the protection of the legitimate expectations of investors and those looking at the due process elements of the decision itself.[47]

4.4.1 Legitimate Expectations

The notion of legitimate expectations, also called basic expectations or reasonable and justifiable expectations,[48] is a key element of the fair and equitable treatment standard.[49]

The tribunal in *Tecmed v Mexico* provided the most far-reaching statement of the notion of legitimate expectations to date:[50]

> ...this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The 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. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting 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, and not to deprive the investor of its investment without the required compensation.

Despite the heavy burden *Tecmed v Mexico* places on host States, its words have been endorsed by a series of subsequent tribunals.[51] The tribunal in *Saluka v Czech Republic*, however, distanced itself from such an expansive view:[52]

> This Tribunal would observe…that while it subscribes to the general thrust of these and similar statements, it may be that, if their terms were to be taken too literally, they would impose upon host States' obligations which would be

[47] C. McLachlan, L. Shore, M. Weiniger, *International Investment Arbitration: Substantive Principles*, Oxford University Press (2007) para 7.99 p234.
[48] *Enron and Ponderosa Assets v. Argentina* (ICSID Case No. ARB/01/3) (United States/Argentina BIT) Award 22 May 2007, para 262.
[49] *Saluka v Czech Republic*, para 302.
[50] *Tecmed v. Mexico*, para 154.
[51] Excerpts from *Tecmed* para 154 cited in *MTD v. Chile*, para 112; *Occidental v. Ecuador*, para 185; *Azurix v. Argentina*, para 371; *Siemens v. Argentina*, para 297; *GAMI Investments v. Mexico*, para 88; *Eureko v. Poland*, para 235.
[52] *Saluka v. Czech Republic*, para 304.

> inappropriate and unrealistic. Moreover, the scope of the Treaty's protection of foreign investment against unfair and inequitable treatment cannot exclusively be determined by foreign investors' subjective motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness *in light of the circumstances*." [emphasis in original]

More recently, in *Parkerings v Lithuania*, the tribunal held that the conditions in the host State bore on the legitimacy of the investor's expectations:[53]

> In 1998, at the time of the Agreement, the political environment in Lithuania was characteristic of a country in transition from its past being part of the Soviet Union to candidate for the European Union membership. Thus, legislative changes, far from being unpredictable, were in fact to be regarded as likely. As any businessman would, the Claimant was aware of the risk that changes of laws would probably occur after the conclusion of the Agreement…Therefore, in such a situation, no expectation that the laws would remain unchanged was legitimate.

While the above statements show there exists a significant range of views, some principles may be emerging from arbitral awards on the notion of legitimate expectations:

i. The State must ensure a stable business environment

Providing a stable legal and business environment has been identified in several decisions as an essential element of fair and equitable treatment.[54] Though what a State must do to meet this requirement is not fully specified, it appears to include maintaining a transparent and predictable framework for investors' business planning and investment.[55] Indeed, it has been held that "fair and equitable treatment is inseparable from stability and predictability".[56] However, it has also been acknowledged that no investor can reasonably expect that the circumstances prevailing at the time the investment is made to remain totally unchanged.[57]

ii. Representations, or lack thereof, by the host State to the investor are material

It is relevant if the treatment complained of is in breach of representations made by the host State which were reasonably relied on by the investor.[58] Conversely, a lack of representations by the host State may indicate that the standard has not been breached.[59]

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[53] *Parkerings-Compagniet AS v. Lithuania* (ICSID Case No. ARB/05/8) Award 11 September 2007, paras 335.

[54] *Enron v. Argentina*, para 260; *Occidental v. Ecuador*, para 183; *CMS v. Argentina*, paras 274-276; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability 3 October 2006, paras. 124, 125, *PSEG Global v. Turkey*, para 253, *Saluka v. Czech Republic*, para 303.

[55] *Metalclad Corporation v. Mexico* (ICSID Case No. ARB(AF)/97/1) (NAFTA) Award 30 October 2000, para 99. Also *Tecmed v. Mexico*, para 154; cited in *MTD v. Chile*, para 112; *Occidental v. Ecuador*, para 185; *Siemens v. Argentina*, Award, para 297, *GAMI Investments v. Mexico*, para 88.

[56] *CMS v Argentina*, para 276.

[57] *Saluka v. Czech Republic*, para 305; cited in PSEG Global v. Turkey, para 255.

[58] *Waste Management No. 2 v. Mexico*, para 98, see McLachlan, Shore, Weiniger, para 7.108 p237.

[59] *International Thunderbird Gaming v. Mexico*, UNCITRAL (NAFTA), Final Award 26 January 2006, paras 163-166, see McLachlan, Shore, Weiniger, para 7.111 p238.

iii. The investor should not recover for loss attributable to its own conduct

It has been said that "bilateral investment treaties are not insurance policies against bad business judgments."[60] An investor is responsible for meeting the requirements of the host State's law, ignorance of the law is no excuse.[61] Where the investor's conduct has been found to have contributed to its loss, some tribunals have held that the standard was not breached,[62] whilst others have found that it was breached but reduced the amount of compensation to be paid by the host State.[63]

iv. A State is not the investor's insurer

A host State's obligation of fair and equitable treatment does not guarantee that no damage will be suffered by an investor. The standard does not impose strict liability on a host State, i.e. it is not expected to accept responsibility for all injuries to investors.[64]

v. The investor must take the host State as it finds it

The Permanent Court of International Justice held many years ago that an investor must take the conditions of the host State as it finds them.[65] This view has since been endorsed in a number of arbitral decisions that have held that an investor cannot make a subsequent complaint if its investment fails merely because of laws or practices that were in place at the time of investment, and which were, or ought to have been, known to it before making the investment.[66]

vi. Legitimate expectations to be balanced against host States' right to regulate

The scope of the fair and equitable treatment standard cannot exclusively be determined by a foreign investor's subjective motivations and considerations. Its expectations, in order to be protected, must be legitimate and reasonable in light of the circumstances.[67] The host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well.[68] International law extends a high measure of deference to the right of States to regulate matters within their own borders.[69] The determination of a breach of fair and equitable treatment therefore requires a weighing of the investor's legitimate and reasonable expectations on the one hand and the State's legitimate regulatory interests on the other.[70]

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[60] *Emilio Augustin Maffezini v. Kingdom of Spain* (ICSID Case No. ARB/97/7 (Argentina/Spain BIT) Award 13 November 2000, para 64, McLachlan, Shore, Weiniger, para 7.140 p246.

[61] *Maffezini v. Spain*, para 70, McLachlan, Shore, Weiniger, para 7.140 p246.

[62] E.g. *International Thunderbird Gaming v. Mexico*.

[63] E.g. *MTD v Chile*.

[64] *AAPL v Sri Lanka*, ICSID Case No. ARB/87/3 para 546, cited in *Wena Hotels Ltd v. Egypt*, ICSID Case No. ARB/98/4 (United Kingdom/Egypt BIT), Final Award 8 December 2000, para 84.

[65] *The Oscar Chinn Case* (1934) PCIJ Rep Series A/B No 63.

[66] *MTD v Chile*, para 205 and *GAMI Investments v. Mexico*, para 91. See also McLachlan, Shore, Weiniger, para 7.105-7.107 p237.

[67] *Saluka v. Czech Republic*, para 304.

[68] *Saluka v. Czech Republic*, para 305.

[69] *S.D. Myers, Inc. v. Canada*, UNCITRAL (NAFTA), First Partial Award 13 November 2000, para 261; cited in *GAMI Investments v Mexico*, para 93. *S.D. Myers v. Canada*, para 263, cited in *Waste Management No. 2 v. Mexico*, para 94 and *International Thunderbird Gaming v. Mexico*, para 194.

[70] *Saluka v. Czech Republic*, para 306.

4.4.2 Due Process in Administrative Decisions

The second group of cases considers the treatment of investors in administrative decision-making processes, i.e. was the decision-making process itself fair and equitable? A number of principles may be discerned from such cases to date. Many of these principles appear drawn from the domestic administrative law concepts of due process and the rule of law.

Some tribunals have attempted to decide these cases by reference to the notion of legitimate expectations, holding that an investor has a legitimate expectation to be treated with due process.[71] However, this approach has been criticized by commentators.[72] Whether or not a host State's decision-making process is fair and equitable is for international law to judge for itself, and it adds nothing to refer to the putative expectations of the investor. [73]

Some of the principles emerging from arbitral awards concerned with the treatment of investors in administrative decision-making include:

i. Outrageous behaviour and bad faith is not required

What is unfair or inequitable need not equate with the outrageous or the egregious. In particular, some tribunals have held that a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.[74] Malicious intent or bad faith may aggravate the situation but are not essential elements of the standard.[75] However, the existence of bad faith is likely to lead to a finding that the standard has been breached.

ii. It is irrelevant that the State might treat its own nationals in the same manner

A government's treatment of a foreign investor may breach the fair and equitable treatment standard even though it treats its own nationals in a similar manner.[76] When the treatment accorded by a State under its domestic law falls below the fair and equitable treatment standard, non-nationals become entitled to better treatment than nationals.[77]

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[71] E.g. *Saluka v. Czech Republic*, para 303: "The expectations of foreign investors certainly include the observation by the host State of such well-established standards as good faith, due process, and nondiscrimination."
[72] McLachlan, Shore, Weiniger, para 7.99 p234.
[73] Ibid.
[74] *Mondev v. United States*, para 116; cited in *ADF Group Inc. v. United States of America* (ICSID Case No. ARB (AF)/00/1) (NAFTA) Award 9 January 2003, para 180; *Tecmed v. Mexico* para 153; *Waste Management No. 2 v. Mexico*, para 93; *Azurix v. Argentina*, para 368; *Siemens v. Argentina,* para 297; *Eureko v. Poland*, para 234; *Occidental v. Ecuador*, para 186; *Enron v. Argentina,* para 263; *CMS v. Argentina*, para 280; *LG&E v. Argentina* para 129. Also see *Loewen v. United States*, para 132; cited in *Waste Management No. 2 v. Mexico*, para 97, *Azurix v. Argentina*, para 369.
c.f. *Genin v. Estonia,* para 367.
[75] *CMS v Argentina* para 280; cited in *Vivendi v Argentina*, para 7.4.12; *Siemens v. Argentina*, para 297; *Azurix v. Argentina*, para 372.
[76] *CME v Czech* para 611; *SD Myers v. Canada*, para 259; *Petrobart v. Kyrgyz Republic*, para 26.
[77] *ADF Group v. United States*, para 178.

iii. Liability cannot be avoided because compliance is difficult

If a State has legally committed to treat an investor in a certain way, it cannot avoid its obligations simply on the grounds that compliance may be difficult or costly.[78] A lack of an able administration or a deficient culture of compliance does not provide a defence.[79] If a State assumes contractual obligations, it cannot later argue that its structure does not permit it to fulfill those obligations. To do so, would run counter to the principle of good faith underlying fair and equitable treatment.[80]

iv. A State's failure to comply with its own law is not necessarily a breach

A State's failure to comply with its own laws does not *per se* constitute a breach of an international investment agreement. Rather, something more than simple illegality or lack of authority under the State's national law is required.[81] The failure to fulfil the objectives of administrative regulations without more does not necessarily violate international law. A failure to satisfy requirements of national law does not necessarily violate international law. Proof of a good faith effort by the State to achieve the objectives of its laws and regulations may counter-balance instances of disregard of legal and regulatory requirements. The record as a whole – not isolated events – determines whether there has been a breach of international law.[82]

v. Using powers for an improper purpose may indicate a breach

If a State uses its powers for a purpose other than for which they were intended, this may be found to be a breach of the standard.[83] For example, in *Tecmed v Mexico* the tribunal found that the Mexican environmental agency's refusal to renew the investor's permit for a hazardous waste landfill was in response to political problems arising from public opposition to the landfill, rather than a contravention of environmental regulations by the investor.[84]

vi. Coercion or harassment may indicate a breach

The fair and equitable treatment standard requires 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.[85] However, there is a risk that arbitral tribunals, with the benefit of hindsight, may construe mere bureaucratic officiousness – a decision to "play by the book" – as a campaign of harassment.[86]

vii. Inconsistency of the host State may indicate a breach

Inconsistent conduct by a host State towards an investor can breach fair and equitable treatment. For example, in *MTD v Chile*, one government agency encouraged and approved the investors' project to build a new town in Chile whilst another denied the required zoning permits. Chile was held to be in breach of the standard.

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[78] *GAMI Investments, Inc v.United Mexican States*, Final Award, 15 November 2004, para 94.
[79] Ibid.
[80] *Siemens v. Argentina*, para 308.
[81] *ADF Group v. United States*, para 190, *GAMI Investments v. Mexico*, para 98.
[82] *GAMI Investments v. Mexico*, para 97.
[83] McLachlan, Shore, Weiniger, para 7.124 p242.
[84] *Tecmed v. Mexico*, para 164-166.
[85] *Saluka v. Czech Republic*, para 308.
[86] McLachlan, Shore, Weiniger, para 7.127 p243.

viii. A lack of transparency may indicate a breach

Transparency issues were among the first to be considered by tribunals in relation to the fair and equitable standard. In the *Metalclad v. Mexico* case, the tribunal stated:

> The Tribunal understands [the principle of transparency] to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments…should be capable of being readily known to all affected investors…"[87]

The theme was picked up and expanded upon by the tribunal in *Tecmed v Mexico*:[88]

> The 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.

In contrast, the recent award in *Parkerings v Lithuania* held:[89]

> ….the political environment was changing at the time of the negotiation of the Agreement and the Claimant should have known that the legal framework was unpredictable and could evolve…. the Claimant failed to demonstrate that any investor or at least a qualified law firm was unable to get the information about the amendment process…The acts and omissions of the Municipality of Vilnius, in particular any failure to advise or warn the claimant of likely or possible changes to Lithuanian law, may be breaches of the Agreement but that does not mean they are inconsistent with the Treaty.

Thus, the scope for transparency to be a principle in and of itself is unclear. The tribunal's regard in *Parkerings v Lithuania* for the conditions in the host State suggests that there is no "one size fits all" standard to apply here.

ix. Discrimination may sometimes be a breach

Discriminating between nationals and foreign investors is not necessarily a breach of fair and equitable treatment, unless the treaty explicitly prohibits discriminatory measures in the standard.[90] In *Saluka v Czech Republic,* the State was found to have failed to treat the investor's bank and a State-owned bank in an even-handed way because it granted the

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[87] *Metalclad v. Mexico*, para 176. This part of the tribunal's reasoning was annulled by the Supreme Court of British Columbia on the ground that the reference to a principle of transparency contained in another part of the treaty was outside the scope of a NAFTA Chapter 11 tribunal (see 5 ICSID Rep 236, 253-254). However, commentators have said that the Supreme Court's decision may go too far as it is not in keeping with the Vienna Convention on the Law of Treaties, which requires regard to be had to the whole of the treaty text, nor NAFTA Article 1131, which directs a Chapter 11 tribunal to decide a dispute in accordance with this Agreement and applicable rules of international law (McLachlan, Shore, Weiniger, footnote 198, p241).

[88] *Tecmed v. Mexico*, para 154.

[89] *Parkerings v. Lithuania*, paras 342, 345.

[90] Although it will very likely breach the national treatment standard in the treaty if that standard is included.

latter preferential treatment.[91] In that case, the BIT's provision on fair and equitable treatment expressly forbad discriminatory measures. In *Methanex v United States*, the tribunal held that as there was no reference to discrimination in the NAFTA article on fair and equitable treatment, the burden was on the investor to establish a rule of customary international law prohibiting discrimination of the type complained of.[92]

4.4.3 Fair and Equitable Treatment in a Host State's Courts

Where the treatment of an investor by a host State's courts is at issue, manifest injustice will be enough to constitute a breach of fair and equitable treatment.[93] Manifest injustice has been described as a lack of due process leading to an outcome which offends a sense judicial propriety,[94] bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that treaties for the protection of investments are intended to provide a real measure of protection.[95] An investor cannot bring arbitration proceedings for denial of justice in order to seek international review of national court decisions as though the arbitral tribunal were an appellate body.[96] The due process requirement is higher for a judicial decision than for an administrative decision. [97] A denial of justice may be found if the courts refuse to entertain a suit, if they subject it to undue delay, if they administer justice in a seriously inadequate way, or if they clearly and maliciously misapply the law.[98] However, what matters is the *system* of justice and not any individual decision in the course of proceedings - the system must have been tried and have failed. This means that, in a case where the conduct of the court system is at issue, the notion of exhaustion of local remedies becomes a substantive requirement and not only a procedural prerequisite to an international claim.[99]

5. Concluding Remarks

This paper demonstrates that the fair and equitable treatment standard has become a powerful and far-reaching tool in an investor's BIT armory. Indeed, the above examination shows that it is currently a very one-sided concept, for the most part concerned with what is fair and equitable from the perspective of the investor only. [100]

To date, very few tribunals have considered the context of the investment and in particular the multiple relationships an investment creates to local governments, communities and environment. Moreover, only a small number of tribunals have paid

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[91] *Saluka v. Czech Republic*, paras 408-416.
[92] *Methanex v. United States*, Part IV Chapter C paras 14 –19.
[93] *Loewen v. United States*, para 132; cited in *Waste Management No. 2 v. Mexico*, para 97 and *Methanex v. United States*, Part IV Chapter C para 11.
[94] Ibid.
[95] *Mondev v. United States*, para 127; cited in *Waste Management No. 2 v. Mexico*, para 95.
[96] *Azinian, Davitian & Baca v. Mexico* (ICSID Case No. ARB(AF)/97/2) (NAFTA) Award 1 November 1999, para 99; cited in *Mondev v. United States*, para 126.
[97] *International Thunderbird Gaming v. Mexico*, Final award, para 200.
[98] *Mondev v. United States*, para 126.
[99] *Waste Management No. 2 v. Mexico*, para 97.
[100] Dr. Howard Mann, "Is *fair and equitable* fair, equitable, just or under law?" Speech to 100th anniversary of the American Society for International Law.

regard to the conduct of the investor itself.[101] For "fair and equitable" to be fair and equitable, it should be developed and applied in a manner that is fair and equitable for all stakeholders, not just one. To ignore the full context is thus to truncate its meaning and distort its application.[102]

This paper has pointed towards two ways that negotiators can bring more balance to the current one-sided nature of the standard.

First, in light of the rules of treaty interpretation set out in the Vienna Convention on the Law of Treaties, the preambles and objectives of BITs might be drafted so that the need to balance the interests of the various stakeholders and to provide for the host State's sustainable development is made explicit.[103]

Second, the provision on fair and equitable treatment might be drafted so as to clearly delineate and narrow its scope e.g. defining the standard as the minimum standard of treatment under customary international law.[104] This is to avoid a future tribunal deciding a dispute solely on the basis of what it subjectively considers to be fair and equitable.[105]

Such drafting may improve the balance somewhat. However, it will not stop future tribunals from ruling that customary international law is evolving rapidly, and using this as a basis to expand the content of the standard still further.

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[101] Notable exceptions include *Parkerings-Compagniet AS v. Lithuania*, *MTD v Chile*, *Maffezini v Spain* and *International Thunderbird Gaming v. Mexico*. For an in-depth examination of the issue of investor conduct, see Peter Muchlinski, "Caveat Investor"? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard, 55 ICLQ 527.

[102] A contextual standard such as this is different from a comparative standard such as national treatment.

[103] See IISD's Model International Agreement on Investment for Sustainable Development, http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf.

[104] See option 7 on page 3 of this paper. A similar formulation is used in article 2 of IISD's Model Agreement, see http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf

[105] This is particularly important given that the majority of arbitrators have a business law rather than public law background.