4 Fair and equitable treatment

4.1 Introduction

The use of the phrase 'fair and equitable' in the field of foreign investment protection seems to originate from the 1948 Havana Charter of the International Trade Organisation (ITO), an institution that never came into existence.[1] Article 11(2) conferred power on the ITO to promote international agreements 'to ensure just and equitable treatment for the enterprise, skills, capital, arts and technology from one member country to another.'[2] Soon afterwards, the obligation to provide 'fair and equitable treatment' to both foreigners and their property began to appear in US treaties on Friendship Commerce and Navigation (FCN), the precursors to modern investment treaties.[3] Specific obligations to provide fair and equitable treatment (FET) to foreign property were then included in the 1959 Abs-Shawcross Draft Convention on Investments Abroad and the 1967 Organization for Economic Cooperation and Development (OECD) Draft Convention on the Protection of Foreign Property.[4] From these draft multilateral instruments, the obligation passed into the model bilateral investment treaties (BITs) of developed states.[5] The obligation to accord

[1] Cf. Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (2013), p. 90, identifying use of the phrase 'fair and equitable' in economic treaties of the mid-1930s, albeit not in the context of investment protection.

[2] Havana Charter (24 March 1948) 62 UNTS 30, para. 143.

[3] Yannaca-Small, 'Fair and Equitable Treatment Standard in International Investment Law' (2004) [online], p. 4.

[4] Abs and Shawcross, 'Draft Convention on Investments Abroad' (1960) 9 *Journal of Public Law*, art. 1; OECD Draft Convention on the Protection of Foreign Property (1967), art. 1(a).

[5] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) 70 *British Yearbook of International Law*, p. 112; Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment*, p. 92.

foreign investment FET is now contained in the majority of investment treaties. Under many of the remaining investment treaties – those that do not contain a FET provision – a foreign investor could rely on an MFN clause to import the standard from another treaty.[6]

The FET standard has risen to prominence remarkably swiftly. Prior to 2000, no publicly available arbitral award applied the FET standard.[7] Since that time, investors have alleged breach of FET in almost every claim brought under an investment treaty.[8] Two of the standard's characteristics are particularly important in explaining its popularity among claimants. The first is that a government may breach the standard even if a foreign investment is treated as well (or better) than local investment.[9] The second is that an exceedingly broad range of government conduct can be challenged for failure to meet the standard.[10] During the past decade, breach of FET is also the claim with which foreign investors have the best record of success in arbitral proceedings.[11] For all these reasons, commentators now suggest that the standard is the most significant substantive protection contained in investment treaties.[12]

The obligation to provide 'fair and equitable treatment' could be read as requiring both fair treatment and equitable treatment. However, arbitral awards are unanimous in reading the two words as a single standard.[13] The legal content of this standard is not immediately obvious. Decisions are replete with observations that the wording of the standard is 'somewhat vague' and 'none too clear and precise.'[14] Indeed, some commentators have gone so far as to argue that FET is

[6] Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009, p. 255; *MTD* v. *Chile*, Award, para. 104; *Bayindir* v. *Pakistan*, Award, para. 157.

[7] Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39 *The International Lawyer*, p. 88.

[8] Salacuse, *The Law of Investment Treaties* (2010), p. 218.

[9] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice', p. 105.

[10] Dolzer, 'Fair and Equitable Treatment', p. 90.

[11] Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn, 2012), p. 130; Reed and Bray, 'Fair and Equitable Treatment: Fairly and Equitably Applied in Lieu of Unlawful Indirect Expropriation?' in Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2007* (2008).

[12] Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 130; Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 255.

[13] Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 133.

[14] *CMS Gas* v. *Argentina*, Final Award, para. 273; *Enron* v. *Argentina*, Award, para. 256.

an intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules necessary to achieve the treaty's object and purpose in particular disputes.[15]

Regardless of whether treaty-makers intended to confer such broad authority on tribunals, it is clear that the text of investment treaties does not provide a great deal of guidance about what distinguishes fair and equitable treatment from unfair and inequitable treatment.

This chapter seeks to understand and elucidate the different ways in which tribunals have interpreted the FET standard of investment treaties. I propose a basic taxonomy of the 'elements' of the FET standard and then employ an inductive methodology to locate arbitral reasoning within that taxonomy. The taxonomy divides decisions between those dealing with the protection of the legitimate expectations of the investor; decisions reviewing governmental conduct on procedural grounds; and decisions reviewing governmental conduct on substantive grounds. Although this taxonomy is original, it should not prove controversial. Almost every commentator has argued that FET comprises a number of elements, which include the protection of the investor's legitimate expectations and other doctrines providing for the procedural and substantive review of governmental conduct.[16] These elements function as quasi-independent components of the FET standard, in that a state can be found liable for breach of one element of the standard without any suggestion that it has breached any of the other elements.

Notwithstanding the use of common terminology – for example, reference to an investor's 'legitimate expectations' – I show that tribunals give markedly different legal content to the various elements of FET. I argue that arbitral decisions can be further divided into distinct interpretations of each element. In this chapter, I do not seek to determine which interpretation of each element of the FET standard is 'correct' (although I do return to this question in Section 7.3). Rather, each interpretation is sketched as a level of protection that might be explicitly incorporated

[15] Brower CH, 'Structure, Legitimacy, and NAFTA's Investment Chapter' (2003) 36 *Vanderbilt Journal of Transnational Law*, p. 63.

[16] E.g., Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 275; Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 145; Choudhury, 'Defining Fair and Equitable Treatment in International Investment Law' (2005) 6 *The Journal of World Investment and Trade*, p. 316; Kläger, *'Fair and Equitable Treatment' in International Investment Law* (2011), pp. 117–8.

in future investment treaties. This analysis and classification is, in itself, a contribution to existing scholarship on the interpretation of the FET standard. The classification also provides the basis for Chapter 6, which applies the framework developed in Chapter 3 to evaluate these different levels of protection.

This chapter comprises seven substantive sections. Section 4.2 examines the differences in the wording of FET provisions between investment treaties and justifies the decision to treat arbitral decisions that interpret differently worded FET provisions as parts of a single body of jurisprudence. Section 4.3 explains and justifies the parameters of this chapter – I do not address decisions in which liability under the FET standard stems from the fact that treatment is discriminatory, or in bad faith, or a denial of justice. Section 4.4 argues that the remaining FET decisions can be divided into those concerned with three distinct elements of the FET standard: protection of an investor's legitimate expectations; procedural review of government conduct; and substantive review of government conduct. Section 4.5 examines tribunals' interpretation of the protection of legitimate expectations under the FET standard; Section 4.6 considers interpretation of the procedural review element; and Section 4.7 considers interpretation of the substantive review element. Each of these three sections argues that arbitral reasoning coalesces around a number of distinct interpretations of the element of FET in question.

4.2 Foundational doctrinal issues in the interpretation of the FET standard

4.2.1 The drafting of FET clauses

Although the obligation of states to treat foreign investment fairly and equitably is common to most investment treaties, there is significant variation in the way in which treaty clauses containing this provision are drafted. Following the classification proposed in the 2008 edition of Dolzer and Schreuer, three basic patterns of drafting can be identified.[17] First, the FET standard can be a freestanding obligation. For example, Article 3(1) of the China-Myanmar BIT provides simply that 'investments of investors of each Contracting Party shall all the time be accorded fair and equitable treatment in the territory of the other Contracting Party.'[18]

[17] Dolzer and Schreuer, *Principles of International Investment Law* (1st edn, 2008), p. 121.
[18] China-Myanmar BIT (12 December 2001).

Second, the FET standard can be included in a clause that contains a number of standards of treatment. For example, Article 10(1) of the ECT reads:

> Each Contracting Party shall, in accordance with the provision of this Treaty, encourage and create stable, equitable favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal.[19]

Third, the FET standard can be identified as a standard that is required by 'international law', where the basic obligation is to comply with an international law standard. For example, Article 1105(1) of the North American Free Trade Agreement (NAFTA) provides that '[e]ach Party shall accord investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.'[20]

These three basic drafting patterns could be further disaggregated to highlight nuances in treaty language. In a 2007 study, UNCTAD proposed dividing FET provisions into seven model types.[21] The UNCTAD taxonomy draws attention to the different standards that are sometimes included alongside FET within a single treaty clause and to different ways in which clauses refer to international law. A particularly important distinction is between provisions that require treatment according to international law including FET, and those that require FET including treatment 'in no case . . . less favourable than that required by international law'.[22] The latter terminology leaves open the possibility that the FET standard may require treatment beyond that required by international law, whereas the former does not.[23] Of course, questions remain as to what standard of treatment is required by international law and whether 'international law' refers only to customary international law.

[19] ECT, art. 10(1). [20] NAFTA, art. 1105(1).
[21] UNCTAD, *Bilateral Investment Treaties 1995–2006, Trends in Investment Rule-Making* (2007), p. 28.
[22] ECT, art. 10(1).
[23] Vandevelde, *Bilateral Investment Treaties: History, Policy and Interpretation* (2010), p. 191; *Lemire* v. *Ukraine (II)*, Decision on Jurisdiction and Liability, para. 253.

4.2.2 FET: customary international law minimum standard or autonomous treaty standard?

Most academic analysis of textual nuance in FET provisions focuses on the significance of treaty text in determining whether a particular provision embodies the customary international law minimum standard for the treatment of aliens (IMS – international minimum standard) or whether it imposes an autonomous, presumably more exacting, treaty standard.[24] This debate is also central to arbitral analysis of textual variation. Often, an investor alleging breach of FET will argue that the FET provision in the applicable investment treaty imposes an autonomous standard, whereas the respondent state will argue that it imposes the IMS.[25] Thus, the issue put to the tribunal is the implication of a specific textual formulation for the determination of whether a given FET provision simply refers back to the IMS.[26] This determination is analytically prior to subsequent questions about the standard of conduct required by the IMS or by FET, to the extent it is construed as an autonomous standard.

The practical significance of the debate is that, historically, the IMS has been understood as a relatively lenient standard. The point of departure for discussion of the IMS is often the *Neer Claim*,[27] which found that

> the 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 recognise its insufficiency.[28]

(However, it is important to note that in *Neer*, the tribunal was reviewing Mexico's investigation of the murder of a foreign national, not the way in which a foreign investment had been treated.)[29]

The debate about the relationship between FET and the IMS has been going on for some time,[30] and a great deal of intellectual energy has been expended on it. The ascendant view is that, unless the text of the

[24] Kinnear, 'The Continuing Development of the Fair and Equitable Treatment Standard' in Bjorklund, Laird and Ripinsky (eds), *Investment Treaty Law: Current Issues III* (2009), p. 215.
[25] Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (2008), pp. 140, 142.
[26] E.g., *Siemens* v. *Argentina*, Award, para. 289.
[27] Yannaca-Small, 'Fair and Equitable Treatment Standard in International Investment Law', fn. 37.
[28] *Neer Claim*, Mexico-US General Claims Commission, RIAA, IV 60.
[29] *Mondev International* v. *United States*, Award, para. 115.
[30] See, Mann FA, 'British Treaties for the Promotion and Protection of Investments' 1981) 52 *British Yearbook of International Law*, p. 244.

investment treaty in question specifically provides otherwise, FET is an autonomous standard.[31] However, a minority view – buttressed by some supporting state practice and the recent scholarly work of Paparinskis – is that FET provisions should always be understood as references to the IMS.[32] This book does not attempt to resolve this doctrinal debate. Instead, this section provides a brief overview of tribunals' discussion of the relationship between treaty text, the FET standard and the IMS. The purpose of this review is to ascertain the extent to which tribunals' interpretation of the legal content of FET provisions is predetermined by their view of whether the FET provision in question embodies the IMS.

4.2.2.1 The IMS versus autonomous standard debate in arbitral awards

When confronted with investment treaties in which the FET provision is not explicitly limited to international law, few tribunals have found that FET refers to the IMS. In *Genin* v. *Estonia*, a case sometimes cited as authority for the proposition that FET does refer to the IMS,[33] the tribunal was confronted with a BIT that provided for FET including treatment not 'less favourable than that required by international law.'[34] The tribunal described the FET standard as 'an "international minimum standard" that is separate from domestic law' but did not make a specific finding that the FET standard referred to *the* customary international law minimum standard.[35] The tribunal in *MCI Power* v. *Ecuador* went further. Interpreting a similarly worded FET provision, it held that FET obliges states to provide the standard of treatment required by international law, and that 'international law' meant 'customary international law'.[36]

Most tribunals have come to the opposite conclusion – that, absent express textual linkage, the FET standard is not limited to the IMS. The

[31] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice', p. 144; Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 137; Salacuse, *The Law of Investment Treaties*, p. 228; Muchlinski, *Multinational Enterprises and the Law* (2nd edn, 2007), p. 635.

[32] Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment,* p. 162; Montt, *State Liability in Investment Treaty Arbitration* (2009), p. 306; Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 268.

[33] Salacuse, *The Law of Investment Treaties*, p. 223.

[34] *Alex Genin* v. *Estonia*, Award, para. 13.

[35] *Alex Genin* v. *Estonia*, Award, para. 367; *Saluka* v. *Czech Republic*, Partial Award, para. 295.

[36] *MCI Power* v. *Ecuador*, Award, para. 369; similarly, *Lauder* v. *Czech Republic*, Final Award, para. 292; *Suez and InterAgua* v. *Argentina*, Separate Opinion of Arbitrator Pedro Nikken, paras. 6–18.

relevant paragraph of the decision in *Bayindir* v. *Pakistan* is representative of these decisions and is worth quoting in full:

> As an initial matter, the Tribunal notes that Article 4 of the Pakistan-Switzerland BIT makes no reference to general international law. However, as already mentioned, customary international law and decisions of other tribunals may assist in the interpretation of this provision. This is particularly apposite here given that Article 4(2) of the Pakistan-Switzerland BIT simply states a general obligation of fair and equitable treatment. The Tribunal must therefore set forth the meaning of such a general obligation.[37]

Other decisions could be cited to similar effect.[38] Moreover, at least one tribunal has interpreted treaty language that might have been read as limiting FET to the IMS as imposing an autonomous standard. The tribunal in *Vivendi* v. *Argentina (II)* found that an obligation to provide 'fair and equitable treatment according to the principles of international law' set a standard that was more demanding than international law.[39]

Of the decisions that find that the applicable FET provision is autonomous, many go on to observe that the autonomous standard's content is 'not materially different from the content of the minimum standard of treatment in customary international law.'[40] The purported equivalence results from the fact that customary international law has evolved over time to a point where the IMS approximates FET,[41] rather than the 'watering down' of the treaty standard to the level of the IMS. According to these decisions, the evolution of the IMS has been driven, in part, by the proliferation of investment treaties. Investment treaty provisions, along with arbitral awards interpreting them, are the primary evidence cited for evolution.[42] Proceeding on the assumption that the two standards are similar, at least three more tribunals have found it

[37] *Bayindir* v. *Pakistan*, Award, para. 176.

[38] Including *Enron* v. *Argentina*, Award, para. 258; *National Grid* v. *Argentina*, Award, para. 167; *MTD* v. *Chile*, Award, paras. 110–12; *Plama* v. *Bulgaria*, Award, para. 163; *PSEG* v. *Turkey*, Award, para. 239; *Sempra Energy* v. *Argentina*, Award, para. 302; *Suez and Vivendi; AWG Group* v. *Argentina*, Decision on Liability, paras. 177–9; *Tecmed* v. *Mexico*, Award, para. 155; *Rompetrol* v. *Romania*, Award, para. 197.

[39] *Compañia de Aguas del Aconquija and Vivendi* v. *Argentina (II)*, Award, paras. 7.4.1, 7.4.6.

[40] *Biwater* v. *Tanzania*, Award, para. 592; similarly, *Azurix* v. *Argentina*, Award, para. 361; *CMS Gas* v. *Argentina*, Final Award, paras. 282–4; *Occidental* v. *Ecuador (I)*, Final Award, para. 190; *Rumeli* v. *Kazakhstan*, Award, para. 610; *Saluka* v. *Czech Republic*, Partial Award, para. 291; *Siemens* v. *Argentina*, Award, para. 299.

[41] *Azurix* v. *Argentina*, Award, paras. 361–2. [42] Ibid., paras. 361–2.

unnecessary to determine whether the FET provisions in question were autonomous or whether they were references to the IMS.[43]

The situation in cases when tribunals have confronted treaty language in which FET is explicitly limited to international law is more complex. Most claims of this sort have arisen under Article 1105(1) of NAFTA, which demands 'treatment in accordance with international law, including fair and equitable treatment'. Early decisions under Article 1105(1) took the view that this provision did not equate FET with *customary* international law.[44] However, in the context of NAFTA, the FET-IMS debate has now been resolved. In June 2001, the tribunal in *Pope & Talbot* v. *Canada* issued a partial award in which it interpreted Article 1105(1) as including obligations of fair treatment – 'fairness elements' – that were 'additive to the requirements of international law.'[45] The tribunal justified its 'additive' interpretation by reference to the NAFTA parties' BITs with other states.[46] In response the three NAFTA parties used the powers conferred on the NAFTA Free Trade Commission (FTC) to issue a binding interpretation of Article 1105(1), which affirms that Article 1105(1) does not go beyond the IMS.[47] The statement reads as follows:

B. Minimum Standard of Treatment in Accordance with International Law

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).[48]

Subsequent tribunals have accepted that they are bound by the FTC interpretation of Article 1105(1).[49] BITs and free trade agreements (FTAs) signed

[43] *Duke Energy* v. *Ecuador*, Award, paras. 333–7; *BG Group* v. *Argentina*, Final Award, para. 291; *Impregilo* v. *Argentina*, Award, para. 289.

[44] *SD Myers* v. *Canada*, Partial Award, para. 264; similarly, *Metalclad* v. *Mexico*, Award, para. 76; although this portion of the *Metalclad* decision was overturned on review, *The United Mexican States* v. *Metalclad Corporation* 2001 BCSC 664, paras. 68–72.

[45] *Pope & Talbot* v. *Canada*, Award on the Merits of Phase 2, para. 110.

[46] Ibid., paras. 110–8. [47] NAFTA, art. 1131(2).

[48] Notes of Interpretation of Certain Chapter 11 Provisions (31 July 2001).

[49] *Mondev International* v. *United States*, Award, para. 120; *ADF Group* v. *United States*, Award, para. 177.

by the United States and Canada since 2002 also contain, within the treaty text, statements based on the FTC interpretation.[50]

Questions remain as to the standard of conduct required under the IMS and how this standard relates to autonomous FET obligations in other investment treaties. In answering the former question, the majority of NAFTA tribunals have begun by observing that the IMS is an evolving standard, concurring with the view of tribunals under other investment treaties. The tribunal in *Mondev* v. *US* noted a development in 'both the substantive and procedural rights of the individual in international law' and the broad spread of investment treaties containing FET provisions.[51] It concluded that 'the content of the minimum standard today cannot be limited to the content of customary international law as recognised in arbitral decisions in the 1920s.'[52] Similar statements have been made by many other NAFTA tribunals.[53] Only the tribunal in *Glamis Gold* v. *US* found that the IMS had not evolved since the 1920s – or, more precisely, that, although conduct that may once have seemed acceptable might now be deemed outrageous, the legal standard itself could still only be breached by conduct that was 'outrageous', egregious' or 'shocking'.[54]

Most NAFTA tribunals have found it unnecessary to determine whether the IMS has evolved to such an extent that it has converged with the standard set by autonomous FET provisions.[55] It seems that only two tribunals have made findings squarely on the point. In *Merrill & Ring* v. *Canada*, the tribunal held that the two standards were equivalent, arguing that to allow any difference in the scope of the IMS and autonomous FET provisions 'would be to countenance an unacceptable double standard.'[56] In contrast, the tribunal in *Glamis Gold*, having adopted a restrictive interpretation of the IMS, found that it was bound to ignore the decisions of tribunals interpreting autonomous FET provisions.[57]

[50] E.g., Dominican Republic-Central America-United States of America Free Trade Agreement (5 August 2004) (CAFTA), art. 10.5; interpreted and applied in *Railroad Development Corporation* v. *Guatemala*, Award, para. 212.

[51] *Mondev International* v. *United States*, Award, paras. 116–17.

[52] *ADF Group* v. *United States*, Award, para. 123.

[53] *ADF Group* v. *United States*, Award, para. 179; *Waste Management* v. *Mexico (II)*, Final Award, para. 92; *GAMI Investments* v. *Mexico*, Final Award, para. 95; *Merrill & Ring Forestry* v. *Canada*, Award, paras. 205–13; *Chemtura* v. *Canada*, Award, para. 121. Similarly, *Railroad Development Corporation* v. *Guatemala*, Award, para. 218.

[54] *Glamis Gold* v. *United States*, Award, para. 616.

[55] E.g., *ADF Group* v. *United States*, Award, para. 183.

[56] *Merrill & Ring Forestry* v. *Canada*, Award, para. 213.

[57] *Glamis Gold* v. *United States*, Award, para. 611.

A further dimension to the FET-IMS debate is the claim that FET is a general principle of law.[58] The argument is that general principles of law are a legitimate source of guidance in interpreting treaty provisions because they are among the 'relevant rules of international law applicable in the relations between the parties' referred to by Article 31 of the Vienna Convention of the Law of Treaties (VCLT).[59] As such, tribunals might be justified in interpreting differently worded treaty provisions according to the common, underlying general principles which they embody.[60]

For the purpose of this book, it is not necessary to resolve the doctrinal question of whether FET is a general principle of law and, if so, what the implications for treaty interpretation would be. It is sufficient to observe that the view that FET is a general principle of law has not yet taken hold among tribunals.[61] Only Professor Wälde's dissent in *Thunderbird* v. *Mexico* endorses this view and, even then, only with respect to protection of the investor's legitimate expectations.[62] Thus, the foundational question for this chapter remains the relationship among treaty text, the IMS and the interpretation of FET provisions.[63]

4.2.3 Is it legitimate to abstract from textual variation in FET provisions in an analysis of FET decisions?

The question of whether it is permissible to analyse decisions interpreting different FET provisions as a group, or as uniquely tied to a particular treaty text, is particularly pressing when it comes to NAFTA and other recent treaties that follow NAFTA in limiting FET to the IMS.[64] Although some academic commentary does treat NAFTA and non-NAFTA investment

[58] Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 103; similarly, Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law' in Schill (ed), *International Investment Law and Comparative Public Law* (2010), p. 175.

[59] Montt, *State Liability in Investment Treaty Arbitration*, p. 304; *Golder* v. *the United Kingdom*, Judgment 21 February 1975, para. 35.

[60] Schill, 'Book Reviews' (2009) 20 *European Journal of International Law*, p. 237.

[61] The relationship between customary international law and general principles of law is briefly discussed in *ADF Group* v. *United States*, Award, para. 185; *Enron* v. *Argentina*, Award, para. 257; *Merrill & Ring Forestry* v. *Canada*, Award, para. 187.

[62] *International Thunderbird Gaming* v. *Mexico*, Separate Opinion, paras. 28–30; similarly, Snodgrass, 'Protecting Investors' Legitimate Expectations: Recognizing and Delimiting a General Principle' (2006) 21 *ICSID Review – Foreign Investment Law Journal*, p. 11. There are, however, doubts about whether this view is correct: see Potesta, 'Legitimate Expectations in Investment Treaty Law' (2013) 28 *ICSID Review*, p. 98.

[63] Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 271.

[64] E.g., CAFTA, art. 10.5.

treaty decisions as separate lines of jurisprudence,[65] most text writers treat all investment treaty decisions on FET as a single body of cases.[66] In this chapter, I follow the dominant practice in academic writing – treating all FET decisions as a single body of cases, while explicitly noting the cases that were decided under a treaty, such as NAFTA, that limits FET to the IMS. This section explains why such an abstraction from textual variation is justified.

The primary justification for treating FET decisions as a group is the high degree of consensus among tribunals that FET embodies a common set of legal elements – protection of the investor's legitimate expectations and protection from procedural unfairness, substantive unreasonableness and denial of justice in the courts of a host state.[67] This consensus in the elements of the standard exists, notwithstanding differences in treaty text. Relative agreement as to the common legal elements of FET makes it sensible to talk of *an* FET standard and provides a basis for the comparison of the reasoning of different tribunals interpreting this standard.[68]

In this vein, Vandevelde goes so far as to assert:

> International arbitral awards have been uniform in their interpretation of the standard, regardless of the context in which it appears, whether alone, combined with other general absolute standards of treatment, linked with non-discrimination standards, or linked with customary international law.[69]

His statement is too sweeping. In subsequent sections, this chapter shows that there is considerable variation in the way in which tribunals have understood the meaning of various elements of the FET standard.

[65] Dolzer and von Walter, 'Fair and Equitable Treatment – Lines of Jurisprudence on Customary Law' in Ortino, Sheppard and Warner (eds), *Investment Treaty Law: Current Issues Volume 1* (2006), p. 103; Kinnear, 'The Continuing Development of the Fair and Equitable Treatment Standard', p. 223.

[66] Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 154; Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 275; Grierson-Weiler and Laird, 'Standards of Treatment' in Muchlinski, Ortino and Schreuer (eds), *The Oxford Handbook of International Investment Law* (2008), p. 272; Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 145; Salacuse, *The Law of Investment Treaties*, p. 228; McLachlan, Shore and Weiniger, *International Investment Arbitration* (2007), p. 226; Vandevelde, *Bilateral Investment Treaties*, p. 194.

[67] E.g., Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 145; Kläger, *'Fair and Equitable Treatment' in International Investment Law*, pp. 117–18.

[68] Note the similarity between the analysis of legitimate expectations in the NAFTA case, *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 147, and the US-Argentina BIT case, *Enron* v. *Argentina*, Award, para. 262.

[69] Vandevelde, *Bilateral Investment Treaties*, p. 194.

However, for the purposes of this inquiry, the crucial point is that the pattern of variation in interpretation of FET provisions is not predetermined by nuances in treaty text, nor by tribunals' views about the relationship between FET and the IMS.

A second justification for treating FET decisions as a group is that NAFTA contains a MFN clause. Other tribunals have interpreted similarly worded MFN clauses in a way that permits a claimant to rely on an FET clause contained in a BIT between the respondent state and a third state.[70] Both Mexico and the United States have signed BITs that post-date the entry into force of NAFTA[71] and contain FET provisions that are not explicitly tied to the IMS.[72] It is certainly arguable that a NAFTA claimant could have recourse to one of these autonomous FET clauses via NAFTA's MFN clause, rendering any difference in the FET standard between NAFTA and other investment treaties meaningless. Surprisingly, it seems that the NAFTA MFN clause has only been invoked once in this manner. In that case, the tribunal was able to avoid the issue on the grounds that it would make no difference to the outcome of the case.[73]

A third justification for treating FET decisions as a group is the convergence of the IMS with autonomous understandings of FET. Recall that, among NAFTA decisions, the predominant view is that the IMS is evolving and that this evolution is, to some extent, influenced by the proliferation of investment treaties and arbitral decisions under them.[74] Tribunals outside NAFTA agree with this position, and a significant number of them suggest that the IMS has evolved to the point where it is equivalent with autonomous FET treaty provisions.[75] These observations are not sufficient to definitively resolve debate about the relationship between FET and the IMS, but they do highlight the close relationship between decisions interpreting different FET provisions.

A final justification for treating all FET decisions as a single group is the cross-citation of decisions of tribunals constituted under different treaties. Tudor, for example, suggests that NAFTA and BIT tribunals freely

[70] *MTD* v. *Chile*, Award, para. 104; *Bayindir* v. *Pakistan*, Award, para. 157.

[71] Art. 1108(6) of NAFTA recognises an exception to the MFN provision for more favourable treatment accorded by treaties listed in the Schedule to Annex IV. Each NAFTA party has an exception for more favourable treatment accorded by treaties signed or in force prior to the NAFTA agreement.

[72] US-Estonia BIT (19 April 1994), art. 2(3); Netherlands-Mexico BIT (13 May 1998), art. 3(1). On the other hand, Canada's BITs from the mid-1990s up to the redrafting of the Canadian model BIT in 2004 require 'fair and equitable treatment in accordance with the principles of international law': e.g., Canada-Lebanon BIT (11 April 1997), art. 2(2)a.

[73] *Chemtura* v. *Canada*, Award, para. 235. [74] See Section 4.2.2.1. [75] See Section 4.2.2.1.

cite each other's decisions.[76] This is not strictly true. Many tribunals under other investment treaties do cite NAFTA decisions. However, only three of the seventeen NAFTA decisions that interpret and apply article 1105(1) cite the decisions of investor-state tribunals from beyond NAFTA.[77] Nevertheless, the regular citation of NAFTA decisions in non-NAFTA awards is both a cause and evidence of the co-evolution of FET jurisprudence. This observation buttresses the decision to treat FET decisions as single group.

4.2.4 Other standards equivalent to the FET standard

Although use of the term 'fair and equitable treatment' is remarkably widespread, occasionally investment treaties employ some other synonym for the word 'fair'. Tribunals have not given these variations legal significance. In *Parkerings* v. *Lithuania*, the tribunal confronted a treaty provision that required 'equitable and reasonable treatment'. It found that this provision was identical to the FET standard.[78] In the consolidated claims of *Suez and InterAgua* v. *Argentina* and *Suez and Vivendi*; *AWG Group* v. *Argentina*, the tribunal was required to apply the French-Argentine BIT. The treaty provided – in its French and Spanish language version respectively – for 'un traitement juste et équitable' and 'un tratamiento justo y equitativo'.[79] The decision (rendered in English) translated the treaty provision as an obligation of 'just and equitable treatment'. It went on to hold that there was no difference in meaning between this provision and the FET standard.[80] The analysis in this chapter includes arbitral decisions interpreting treaty terms that tribunals understand to be *identical* to FET.

4.3 Parameters: the scope of the FET standard and the limitations of this chapter

The FET standard allows investors to challenge the treatment of their investments by any arm of the host state's government in a wide range of circumstances. Arbitral tribunals have developed different doctrines to

[76] Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 154.

[77] Author's citation count, noting *Chemtura* v. *Canada*, Award, para. 137; *GAMI Investments* v. *Mexico*, Final Award, para. 88; *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 194.

[78] *Parkerings* v. *Lithuania*, Award, para. 278.

[79] *Suez and InterAgua* v. *Argentina*, Decision on Liability, para. 176; *Suez and Vivendi; AWG Group* v. *Argentina*, Decision on Liability, para. 183.

[80] *Suez and InterAgua* v. *Argentina*, Decision on Liability, para. 176.

deal with different categories of cases under the standard. In this chapter, I do not address the full range of circumstances in which the FET standard has been applied. Three sets of decisions are excluded: those dealing with treatment of foreign investment by a host state's judicial system, those dealing with liability under the FET standard for discriminatory conduct and those dealing with situations in which a state has embarked on a deliberate and coordinated campaign to ruin an investment. These excluded circumstances correspond roughly with those that would be covered by the doctrines of denial of justice, national treatment and bad faith respectively. Each of these limitations excludes only a small minority of FET cases. Setting these parameters allows this chapter to go into greater depth in analysing the remaining cases – those in which claimants have argued that a state's legislative or administrative actions have breached FET, understood as an objective, non-contingent standard. This section provides a brief description of each of these parameters and explains why, in the context of this book, these limitations are justified.

4.3.1 Conduct of a state's judicial institutions that breaches the FET standard

There is no doubt that the treatment of foreign investment by a host state's judicial system can breach the FET standard. In determining whether the improper conduct of judicial proceedings constitutes a breach of FET, tribunals have looked to the customary international law principles governing the treatment of aliens by foreign courts – the principles of denial of justice.[81] Investment treaty tribunals agree that, with respect to the conduct of judicial proceedings, the FET standard does not go beyond what is required by the doctrine of denial of justice.[82] This position is also endorsed in academic commentary.[83]

The principles of denial of justice are highly specific to the treatment of a foreigner by the judicial institutions of a host state. A full exposition of these principles would require a review of customary international law on the subject, going well beyond the decisions of investment treaty

[81] On the principles of denial of justice, see Paulsson, *Denial of Justice in International Law* (2005).

[82] *Mondev International* v. *United States*, Award, para. 126; *Jan de Nul* v. *Egypt*, Award, para. 188; *Víctor Pey Casado* v. *Chile*, Laudo, para. 657.

[83] Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment,* p. 211; Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 160; Salacuse, *The Law of Investment Treaties*, p. 241.

tribunals.[84] Moreover, consideration of the level of protection that investment treaties should provide from losses caused by the judiciary of a host state (such as losses caused by unfavourable court judgments or delays in judicial proceedings) would raise different issues to the examination of the level of protection that investment treaties should provide from losses caused by legislative and administrative action. For both reasons, I exclude analysis and evaluation of the interpretation of the principles of denial of justice, so as to focus in greater detail on state liability for legislative and administrative action.

4.3.2 Conduct that breaches the FET standard because it is discriminatory

A government may breach the FET standard even if a foreign investment is treated as well (or better) than local investment.[85] However, many tribunals have observed that discrimination against a foreign investment may also constitute a breach of the FET standard.[86] Some tribunals even go far as to suggest that nationality-based discrimination against a foreign investment will always breach the FET standard.[87]

The assessment of whether impugned treatment is discriminatory is seldom decisive in the application of the FET standard. Two decisions serve to illustrate this point. In *Eureko* v. *Poland*, the investor challenged the failure of the Polish government to sell it a second tranche of shares in a Polish bank, as had been agreed in a privatisation contract between the investor and the government. In *Eastern Sugar* v. *Czech Republic*, the investor challenged the reallocation of the national sugar production quota that followed the European Union's (EU) reduction of the Czech national quota; the reallocation reduced Eastern Sugar's quota by more than the entire reduction in the national quota.[88] In both cases, the tribunals accepted that it was likely that the governments' actions had been motivated by nationalist or protectionist sentiment.[89] However, the reasoning of these decisions confirms that these inferences of discriminatory

[84] For a full treatment of these issues, see Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment,* pp. 182–217; Paulsson, *Denial of Justice in International Law.*

[85] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice', p. 105.

[86] *Saluka* v. *Czech Republic*, Partial Award, para. 292; *Waste Management* v. *Mexico (II)*, Final Award, para. 98; cf. *Grand River* v. *United States*, Award, para. 208.

[87] *Noble Ventures* v. *Romania*, Award, paras. 180–2; *Parkerings* v. *Lithuania*, Award, para. 287; *CMS Gas* v. *Argentina*, Final Award, para. 290.

[88] *Eastern Sugar* v. *Czech Republic*, Partial Award, para. 291.

[89] *Eureko* v. *Poland*, Partial Award, para. 233; *Eastern Sugar* v. *Czech Republic*, Partial Award, paras. 314, 338.

motive were not decisive. In *Eureko*, liability rested on the fact that the state had repudiated the fundamental terms of the privatisation contract with the investor;[90] in *Eastern Sugar*, liability was based on the fact that the state could not provide *any* rational justification for the way in which it had reallocated the sugar quota.[91]

There are only two cases in which treatment that arguably would have satisfied the FET standard (in the absence of discrimination) was found to breach the standard on account of being discriminatory. One of these cases is *SD Myers*, in which the tribunal simply stated that breach of the NAFTA national treatment provision entailed breach of the FET standard on the facts in question.[92] The subsequent FTC Interpretation of Article 1105(1) makes it unlikely that the case would now be decided in the same way.[93] The other case is *Saluka* v. *Czech Republic*, a case distinguished by the fact that the tribunal subsumed its discussion of breach of the national treatment provision of the BIT into its analysis of FET.[94]

It is easy to understand why discrimination is seldom determinative of FET cases. Most investment treaties contain a specific provision dealing with discriminatory treatment – either a national treatment clause or a provision prohibiting 'arbitrary or discriminatory measures', or sometimes both.[95] An investor that was able to show that it had suffered discrimination would be able to succeed in a claim under one of these provisions. An additional basis of liability under the FET standard would then be of little consequence. This was the situation in *SD Myers*. On the other hand, an investor that was unable to show that it had suffered discrimination, often due to difficulties in identifying a similarly situated comparator, would be left to advance its claim under the non-contingent elements of the FET standard. This was the situation in the *Parkerings* v. *Lithuania*, *Loewen* v. *US*, *BG* v. *Argentina* and *CMS Gas* v. *Argentina* awards, among others.[96]

Because allegations of discrimination are seldom decisive in FET cases, this chapter is justified in omitting analysis of discriminatory treatment, so as to focus on the non-contingent elements of the FET standard.

[90] *Eureko* v. *Poland*, Partial Award, paras. 232–5.
[91] *Eastern Sugar* v. *Czech Republic*, Partial Award, paras. 333–7.
[92] *SD Myers* v. *Canada*, Partial Award, paras. 264, 268.
[93] Notes of Interpretation of Certain Chapter 11 Provisions (31 July 2001).
[94] *Saluka* v. *Czech Republic*, Partial Award, para. 283.
[95] Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 290.
[96] *Parkerings* v. *Lithuania*, Award, para. 290; *Loewen* v. *United States*, Award, para. 140; *BG Group* v. *Argentina*, Final Award, para. 357; *CMS Gas* v. *Argentina*, Final Award, para. 295.

However, state liability for discriminatory treatment under investment treaties remains an important issue, and there is not yet consensus among tribunals about the interpretation of non-discrimination obligations.[97] The framework developed in Chapter 3 could be used to evaluate the varying levels of protection implied by different interpretations of non-discrimination provisions of investment treaties. For example, it could be used to evaluate different understandings of the requirement that the foreign investor and the domestic investor to which it is compared be 'in like circumstances'. The framework could also be used to evaluate whether various justifications for differences in treatment should prevent a finding of liability against the host state.

4.3.3 Conduct that breaches the standard because it is in bad faith

Tribunals and academic commentary agree that bad faith – governmental conduct motivated by the conscious intent to harm an investment – will breach the FET standard.[98] An allegation of bad faith requires a tribunal to examine the subjective intentions that motivate state conduct. For example, in *Tokios Tokelés* v. *Ukraine*, the claimant alleged that the Ukrainian state mounted a coordinated campaign to punish it 'for its impertinence in printing [political] materials opposed to the regime'.[99] The tribunal accepted that such a campaign would breach the FET standard, although, on the facts, it found that the claimant was unable to establish that the state's conduct was motivated by the objective of retaliation.[100]

Tokios Tokelés is broadly representative of cases in which bad faith is alleged. Although tribunals occasionally suggest that the impugned conduct of a state approaches bad faith,[101] outright findings of bad faith are rare.[102] This is due to the difficulty of proving the subjective intention of the host state.[103] To succeed in a claim based on allegations of bad faith, an investor must be able to establish that the ruin of an investment was the specific *intention* of coordinated governmental conduct, rather than

[97] Ortino, 'Non-Discriminatory Treatment in Investment Disputes' in Dupuy, Francioni and Petersmann (eds), *Human Rights in International Investment Law and Arbitration* (2009), p. 351.

[98] *Frontier Petroleum* v. *Czech Republic*, Final Award, para. 300; *Waste Management* v. *Mexico (II)*, Final Award, para. 138.

[99] *Tokios Tokelés* v. *Ukraine*, Award, para. 123.

[100] Ibid., para. 136.

[101] *Azurix* v. *Argentina*, Award, para. 376; *Petrobart* v. *Kyrgyzstan*, Arbitral Award, p. 76; *Compañia de Aguas del Aconquija and Vivendi* v. *Argentina (II)*, Award, paras. 7.4.19, 7.4.45–46.

[102] *Waste Management* v. *Mexico (II)*, Final Award, para. 139; *Bayindir* v. *Pakistan*, Award, para. 258; *Chemtura* v. *Canada*, Award, para. 138.

[103] *Bayindir* v. *Pakistan*, Award, para. 223; *Chemtura* v. *Canada*, Award, para. 137.

simply a result of government conduct.[104] Of the decisions rendered since 2005, only *Anatolie Stati and others* v. *Kazakhstan*, *Cargill* v. *Mexico* and *Vivendi II* could, arguably, be read as relying on a finding of bad faith.[105] Investors invariably find it easier to succeed by framing their claim under some other element of the FET standard. On this basis, this chapter is justified in focusing on the elements of the FET standard that are usually legally determinative.

4.4 The elements of FET

This section presents and justifies a taxonomy of the elements of the FET standard, which provides a useful heuristic device for understanding arbitral decisions applying the FET standard. This section argues that arbitral reasoning is best understood by distinguishing decisions (or, more commonly, parts of decisions) dealing with the protection of the legitimate expectations of the investor, those reviewing governmental conduct on procedural grounds, and those reviewing governmental conduct on substantive grounds. This is a functional taxonomy in that it looks to the structure of arbitral reasoning, rather than whether arbitral decisions adopt common terminology. In arbitral reasoning, these three elements function as conceptually distinct, although potentially overlapping, bases for liability of the FET standard.

Two objections might be raised to dividing FET decisions into those dealing with different elements of the standard. The first is the argument that all FET decisions can be explained by a single, unified jurisprudential theory – that is, the standard should be understood as having only one element. The second is the argument that any apparent inconsistency in legal reasoning between arbitral decisions can be explained by the different factual situations that tribunals were addressing in each case – that is, the standard should be understood as having *no* elements capable of restatement in the abstract. This section discusses and addresses each objection in turn.

4.4.1 The taxonomy of the elements of FET used in this chapter

Since 2006, protection of the investor's legitimate expectations has emerged as the most significant element of the FET standard. The

[104] *Tokios Tokelés* v. *Ukraine*, Award, para. 136.

[105] *Anatoile Stati and others* v. *Kazakhstan*, Award, para. 1095; *Cargill* v. *Mexico*, Award, para. 298; *Compañia de Aguas del Aconquija and Vivendi* v. *Argentina (II)*, Award, paras. 7.4.19, 7.4.45–46.

doctrine of legitimate expectations has been sufficiently widely accepted that arbitral decisions now spend more time examining the contours of the doctrine than determining whether compliance with the doctrine is an element of FET.[106] This shared recognition of legitimate expectations as an element of FET is reflected in academic commentary.[107] Despite differences of opinion about the scope of the doctrine, the common understanding of arbitral decisions and commentators is that a breach of legitimate expectations is *sufficient* to establish liability.[108] This book, like most contemporary commentary, identifies legitimate expectations as an element of the FET standard.[109] This element of the standard, and arbitral tribunals' differing understandings of it, is examined in Section 4.5.

Classifying the remaining FET decisions is more challenging. Tribunals employ a range of terminology to describe situations in which a state's liability for breach of the FET standard does not rest on violation of an investor's legitimate expectations. Such terms include transparency, stability, reasonableness, consistency, (non-)arbitrariness and due process. The use of common terms is not always consistent between decisions. For example, *Maffezini* v. *Spain* held that a Spanish state entity's withdrawal of funds from an investor's bank account breached the FET standard because of the 'lack of transparency'.[110] However, the basis of liability was that the investor had not consented to the withdrawal, not that the state had failed to disclose the withdrawal.[111] The tribunal's reasoning is difficult to reconcile with the way in which the word 'transparency' is used in other

[106] E.g., *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 147; *International Thunderbird Gaming* v. *Mexico*, Separate Opinion, para. 4.

[107] Schreuer and Kriebaum, 'At What Time Must Legitimate Expectations Exist?' in Werner and Ali (eds), *A Liber Amicorum: Thomas Wälde – Law beyond Conventional Thought* (2010); von Walter, 'The Investor's Expectations in International Investment Arbitration' in Reinisch and Knahr (eds), *International Investment Law in Context* (2008), p. 173; Snodgrass, 'Protecting Investors' Legitimate Expectations', p. 1.

[108] Cf. Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment*, p. 227, recognising that most recent FET decisions endorse the view that a breach of legitimate expectations is sufficient to establish liability, but doubting whether this view is correct.

[109] Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 279; Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 145; Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 163; Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 164; Diehl, *The Core Standard in International Investment Law: Fair and Equitable Treatment* (2012), p. 366.

[110] *Maffezini* v. *Spain*, Award, para. 83.

[111] *Maffezini* v. *Spain*, Award, para. 75; Vandevelde, *Bilateral Investment Treaties*, p. 404; Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 293.

decisions.[112] Such difficulties in classifying the remaining FET decisions are reflected in academic writing. Although all commentators propose some division of FET decisions, no two text writers propose an identical system of classification.[113]

In light of the range of terminology used in arbitral awards, I propose a *functional* division of the FET decisions that do not relate to an investor's legitimate expectations. I distinguish between decisions which examine whether the state has followed fair procedures and those which examine the substantive justification for government measures that have affected an investor.[114] The former category encompasses concepts such as transparency, lawfulness and procedural fairness. The latter encompasses concepts such as rationality, reasonableness and proportionality when they refer to the substance of an impugned measure. This is a functional distinction, in that it looks to the structure of reasoning that tribunals use to determine liability, rather than to whether decisions employ common terminology. For example, arbitrariness connotes procedural review when it is used to mean 'a wilful disregard of due process of law'[115] and substantive review when it is used to mean conduct 'not related to legitimate policy objectives'.[116]

Although many FET decisions involve both substantive and procedural review, it appears that both are capable of operating as independent elements of the FET standard. Several tribunals have held that an irrational measure may breach the standard without any criticism of the procedures by which it was adopted and applied,[117] and an investor that is subjected to unfair administrative procedures may succeed in a claim even if the

[112] *LG&E Energy* v. *Argentina*, Decision on Liability, para. 128, arguing that transparency implies that 'all relevant legal requirements . . . should be capable of being readily known'.

[113] Cf. Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 275; Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 145; Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 154; Salacuse, *The Law of Investment Treaties*, p. 218; Vandevelde, *Bilateral Investment Treaties*, pp. 190, 234; McLachlan, Shore and Weiniger, *International Investment Arbitration*, p. 226; Kläger, *'Fair and Equitable Treatment' in International Investment Law*, pp. 117–18.

[114] The recent decision in *Micula* v. *Romania* adopts essentially the same distinction: *Micula* v. *Romania*, Award, para. 520. Vandevelde and Kläger have also drawn similar distinctions: Vandevelde, 'A Unified Theory of Fair and Equitable Treatment' (2010) 43 *International Law and Politics*, p. 49; Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 154.

[115] *Elettronica Sicula SpA (United States of America* v. *Italy)* Judgment of 20 July 1989, para. 128.

[116] Vandevelde, *Bilateral Investment Treaties*, p. 204.

[117] E.g., *Eastern Sugar* v. *Czech Republic*, Partial Award, paras. 33–7.

decisions ultimately taken by the administrative body are reasonable.[118] These two elements of the FET standard, including the degree to which they function as independent grounds of liability, are examined in Sections 4.6 and 4.7, respectively.

4.4.2 A unified jurisprudential theory of FET?

There have been various attempts to offer a unified jurisprudential theory that would explain and justify the full range of FET decisions. Some commentators suggest that the standard embodies the principle of good faith;[119] others that it embodies the rule of law.[120] Writing in dissent in *Thunderbird*, Professor Wälde argued that the standard embodies norms of good governance.[121] Kläger has recently added to this debate with the argument that the FET standard embodies 'justice'.[122] There are difficulties with all four theories.[123]

The suggestion that FET is grounded in the principle of good faith is difficult to reconcile with the observation that 'FET is an objective standard that does not depend on whether the Respondent has proceeded in good faith or not.'[124] Theories based on the rule of law and good governance must address the fact that these concepts are contestable. Even if a common understanding of the meaning of these concepts could be reached, they sit uneasily with awards holding that a change of government policy may breach the FET standard, even though the change was made and applied through lawful procedures and was the 'result of reasoned judgment rather than simple disregard of the rule of law.'[125]

The theory that the FET standard embodies justice is both the most ambitious and the most problematic attempt to provide an overarching rationalisation of arbitral jurisprudence. Drawing on the work of Thomas Franck, Kläger identifies six competing objectives implicated by

[118] *Pope & Talbot* v. *Canada*, Award on the Merits of Phase 2, para. 181.
[119] Grierson-Weiler and Laird, 'Standards of Treatment', p. 272; see also *Tecmed* v. *Mexico*, Award, paras. 154–5; *Siemens* v. *Argentina*, Award, para. 308.
[120] Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law', p. 154; Vandevelde, 'A Unified Theory of Fair and Equitable Treatment', p. 48; Diehl, *The Core Standard in International Investment Protection*, p. 337.
[121] *International Thunderbird Gaming* v. *Mexico*, Separate Opinion, para. 13.
[122] Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 153.
[123] Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 279.
[124] *Occidental* v. *Ecuador (I)*, Final Award, para. 186.
[125] *LG&E Energy* v. *Argentina*, Decision on Liability, para. 162.

cases in which the FET standard has been applied – 'fair procedure, non-discrimination, transparency, the protection of the investor's legitimate expectations . . . sovereignty and sustainable development.'[126] While conceding that this set of objectives is not necessarily complete,[127] his basic claim is that justice requires a balance to be struck between these (and other) competing objectives.[128]

There are problems with this argument at both the theoretical and the practical level. As a matter of normative theory, Kläger does not explain why the six objectives that happen to figure prominently in existing arbitral jurisprudence should be central to a theory of justice. For example, he does not explain why the protection of investors' expectations is an important component of a normatively attractive conception of justice[129] or how the argument that justice requires the protection of *expectations* relates to influential theories of justice that suggest that justice requires the protection of validly acquired property *rights*.[130] Nor does he explain why the objective of maximising economic benefits (or, stated at a higher level of abstraction, net social welfare) does not feature in his theory of justice, even though the vast majority of investment treaties identify 'economic' objectives as among their principal objectives.[131] For present purposes, there is also an important practical objection. No arbitral award of which I am aware has sought to articulate or defend an overarching conception of justice, nor to use such a conception of justice to justify a particular interpretation of the FET standard. When tribunals have referred to an unelaborated concept of 'justice', it is just as often to explain that FET standard only allows a tribunal to intervene in cases of 'manifest' or 'serious' injustice[132] as it is to argue that the FET standard embodies justice.[133] Thus, Kläger's theory does not provide a useful *explanatory* account of existing jurisprudence.

While noting these difficulties with unified jurisprudential theories, I do not go so far as to suggest that the search for such a theory is a

[126] Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 150.
[127] Ibid., p. 150. [128] Ibid., pp. 149, 151–3. [129] Ibid., p. 149.
[130] E.g., Nozick, *Anarchy, State and Utopia* (1974); for more detailed discussion, see Section 3.5.5.
[131] References to the objectives of 'economic development', 'prosperity' or similar appear in the preambles of US, Canadian, French, German, Dutch, Chinese, Australian and UK investment treaties, among others; for more detailed discussion, see Section 2.2.
[132] *Glamis Gold* v. *United States*, Award, paras. 626–627; similarly, *AES Summit Generation* v. *Hungary*, Award, para. 38; *Chemtura* v. *Canada*, Award, para. 148.
[133] *El Paso* v. *Argentina*, Award, para. 373; *PSEG* v. *Turkey*, Award, para. 239.

fruitless exercise. I make only a more modest claim, from which I draw a modest conclusion. My claim is that a generally accepted jurisprudential theory of the FET standard has yet to emerge in either arbitral decisions or academic commentary. My conclusion is that inductive methodology can help understand and elucidate similarities and differences in the interpretation of the FET standard in decided cases. The application of inductive methodology in subsequent sections strongly supports the conclusion that the FET standard comprises a number of relatively autonomous elements. Even if a consensus were to coalesce around a general jurisprudential theory that could explain and justify all the elements of the standard, inductive methodology would still be a useful way to understand the specific legal content that tribunals give to the unifying jurisprudential principles.

4.4.3 Fact-specific reasoning and the FET standard

Rather than attempt to construct a single jurisprudential theory of the FET standard, one might take a radically different approach and begin from the premise that the reasoning of each arbitral decision is specific to the factual matrix before the tribunal.[134] This understanding of the standard receives some support from arbitral awards. For example, in *Mondev*, the tribunal noted that '[a] judgment of what is fair and equitable treatment cannot be reached in the abstract; it must depend on the facts of the particular case.'[135] A doctrinal theory based on this understanding of FET might simply amount to a list of factors that suggest that the standard has been breached, a list of factors that suggest the standard has not been breached and the claim that each case involves an ad hoc exercise of characterisation.[136]

Notwithstanding that characterisation of contested facts is sometimes determinative, I submit that apparent inconsistencies in the reasoning of FET decisions are not solely attributable to factual nuances. Rather, a close examination of existing arbitral decisions reveals very different understandings of the legal content of the FET standard. These differences entail divergent patterns of legal reasoning and would lead to different decisions on an identical set of facts. These divergent patterns of reasoning

[134] Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 129.

[135] *Mondev International* v. *United States*, Award, para. 118.

[136] E.g., *Renée Rose Levy de Levi* v. *Republic of Peru*, Award, para. 320; Malik, 'Fair and Equitable Treatment' (2009) [online].

are best understood by distinguishing the different elements of FET and then comparing decisions applying each element. The sections of this chapter that follow constitute a detailed and sustained argument for these propositions.

4.5 Legitimate expectations

As an element of the FET standard, the doctrine of legitimate expectations is of relatively recent origin. Its foundations are normally traced to comments made in the early arbitral awards of the twenty-first century.[137] In 2000, the tribunal in *Metalclad* v. *Mexico* observed that the investor 'was led to believe, and did believe, that the federal and state permits allowed for the construction and operation of the landfill.'[138] Subsequent actions of the authorities to halt construction of the landfill on the grounds that an additional, municipal permit was required breached the FET standard.[139] The following year, the *CME* v. *Czech Republic* Tribunal held that the FET standard was breached by the 'evisceration of the arrangements in reliance upon which the foreign investor was induced to invest.'[140] In 2003, the *Tecmed* v. *Mexico* Tribunal referred, for the first time, to the protection of an investor's expectations in general terms. It stated that the FET standard requires treatment 'that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.'[141] In 2004, the *Waste Management* v. *Mexico (II)* Tribunal took a more restrained view. It held that in determining whether treatment breached the FET standard it was 'relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.'[142]

By 2005, academic commentators were already arguing that the FET standard protected investors' legitimate expectations.[143] However, it was not until the *Thunderbird* decision of 2006 that an arbitral tribunal first invoked the terms 'legitimate expectations' in resolving an FET claim.[144] Since that time, the majority of FET cases have examined whether the

[137] E.g., Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), pp. 146–7.
[138] *Metalclad* v. *Mexico*, Award, para. 85. [139] Ibid., para. 89.
[140] *CME* v. *Czech Republic*, Partial Award, para. 611. [141] *Tecmed* v. *Mexico,* Award, para. 154.
[142] *Waste Management* v. *Mexico (II)*, Final Award, para. 98.
[143] Dolzer, 'Fair and Equitable Treatment', p. 103; Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 *The Journal of World Investment and Trade*, p. 386.
[144] *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 196; Snodgrass, 'Protecting Investors' Legitimate Expectations', p. 2.

investor's legitimate expectations were violated.[145] For investors, part of the appeal of the doctrine is that it allows a claim to be framed as an interference with a protected interest of the claimant – a legitimate expectation. Under the other elements of the FET standard, liability turns primarily on the characteristics of governmental conduct, not the extent of interference with the investor's interests. For tribunals, the utility of the doctrine seems to be that it provides a basis for resolving claims that involve a wide range of fact-patterns common in FET claims, including claims arising from changes to the general regulatory arrangements governing an investment and breaches of investor-state contracts by the host state.

Identifying the basis for state liability under the doctrine of legitimate expectations requires answers to three consecutive questions:

1. On what basis must an expectation rest to qualify for protection under the FET standard?
2. Of expectations that rest on a recognised basis, by what criteria are *legitimate* expectations identified?
3. To what extent must a claimant rely on a legitimate expectation to recover for its breach?

One might expect that a final question would arise as to whether the frustration of the investor's expectations was justified in the circumstances, with a state only liable to the investor in the event that interference with its legitimate expectations was not justified. In the early *Saluka* v. *Czech Republic* decision, the tribunal hinted that it would, indeed, be necessary to include this final stage of analysis.[146] However, the occasional notable exception aside,[147] other tribunals have not incorporated this final stage of analysis into their inquiry. Instead, the consistent practice of tribunals is to integrate any discussion of the justifications for a state's conduct into the second stage of the inquiry – that is, the determination of whether a given expectation was legitimate in the circumstances.[148]

In the three-stage inquiry utilised by tribunals, the first of these questions is the most significant because it defines the scope of the doctrine.

[145] Author's count of publicly available arbitral awards rendered since January 2006.
[146] *Saluka* v. *Czech Republic*, Partial Award, para. 305.
[147] E.g., *Total* v. *Argentina*, Decision on Liability, para. 123.
[148] E.g., *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 147; *Duke Energy* v. *Ecuador*, Award, para. 340; *Continental Casualty* v. *Argentina*, Award, para. 261; *International Thunderbird Gaming* v. *Mexico*, Separate Opinion, para. 64; *Enron* v. *Argentina*, Award, para. 264; *Sempra Energy* v. *Argentina*, Award, para. 303.

The way tribunals answer this question is central to understanding the different ways in which they have interpreted the doctrine. Although tribunals also disagree on the second and third questions, their views on these questions are shaped by the way they answer the first question.

This section organises arbitral decisions according to the way in which they answer the first question. I submit that distinct interpretations of the doctrine of legitimate expectations have coalesced around four different answers to this question:[149]

i) Expectations can only rest on specific rights that the investor has acquired under domestic law.
ii) In addition to i), expectations may rest on specific representations made to the investor by government officials.
iii) In addition to ii) expectations may rest on the regulatory framework in force in the host state at the time the investor made the investment.
iv) In addition to iii), expectations may rest on the business plans of the investor.

Two final observations will help clarify the analysis that follows. First, the legitimate expectations of investors have been mentioned in the determination of whether given interests qualify as 'investments' for the purpose of establishing jurisdiction under an investment treaty and in the determination of whether an indirect expropriation has occurred.[150] This section is limited to the protection of legitimate expectations as an element of the FET standard. Second, tribunals have occasionally held that an investor may legitimately expect the full range of treatment required by the FET standard.[151] This is incoherent.[152] To say that an investor legitimately expects the treatment that is required by the FET standard is to make a circular argument – an argument that does not shed any light on the treatment that is required by the FET standard. The doctrine of

[149] Potesta proposes a division of fact scenarios that roughly follows the first three elements of this taxonomy: Potesta, 'Legitimate Expectations in Investment Treaty Law', pp. 100–19.

[150] On the definition of investment: *Southern Pacific Properties* v. *Egypt*, Award, paras. 82–3; *EnCana* v. *Ecuador*, Partial Dissenting Opinion, paras. 17–21. On indirect expropriation: *Azurix* v. *Argentina*, Award, para. 316. For discussion of investors' expectations beyond FET claims: von Walter, 'The Investor's Expectations in International Investment Arbitration', p. 177.

[151] *Saluka* v. *Czech Republic*, Partial Award, para. 303; similarly, *Plama* v. *Bulgaria*, Award, para. 176; *Kardassopoulos and Fuchs* v. *Georgia*, Award, paras. 438, 441.

[152] McLachlan, Shore and Weiniger, *International Investment Arbitration*, p. 234.

legitimate expectation is only meaningful to the extent it gives content to the FET standard.[153]

4.5.1 The legal rights approach

The narrowest interpretation of the doctrine of legitimate expectations is that it protects only specific, enforceable legal rights that have vested in the investor under domestic law. Further criteria then determine the circumstances in which an interference with a particular legal right will amount to a breach of legitimate expectations. According to this interpretation, the doctrine functions as an additional, international layer of protection for existing rights, rather than as a source of new rights. As such, this interpretation best conforms to Crawford's opinion that 'the doctrine of legitimate expectations should not be used as a substitute for the actual arrangements agreed between the parties, or as a supervening and overriding source of the applicable law.'[154]

4.5.1.1 *LG&E Energy* v. *Argentina*

The first case to articulate this view of legitimate expectations was *LG&E* v. *Argentina*. The facts of the case relate to the privatisation of the Argentine gas-distribution sector in the early 1990s. The Argentine government created a regulatory framework to make the privatisation attractive to foreign investors. This framework included guarantees that tariffs would be based on the US Producer Price Index, calculated in US dollars and adjusted twice annually.[155] These guarantees were specifically incorporated in the terms of the gas licenses awarded to the privatised entities.[156] '[T]he government could not rescind or modify the licenses without the consent of the licensees.'[157] LG&E became a shareholder in three licensee companies.

In 2001, Argentina entered a period of deep economic and social crisis. One of the government's responses to the crisis was the January 2002 Emergency Law. The Emergency Law unilaterally modified gas licenses, removing licensees' right to the calculation of tariffs in US dollars and to the indexation of tariffs.[158] LG&E argued that the repudiation of key rights conferred by the gas distribution licenses breached its 'basic expectations'

[153] Vandevelde, *Bilateral Investment Treaties*, p. 235.
[154] Crawford, 'Treaty and Contract in Investment Arbitration' (2008) 24 *Arbitration International*, p. 374; similarly, *MTD* v. *Chile*, Decision on Annulment, para. 67.
[155] *LG&E Energy* v. *Argentina*, Decision on Liability, para. 49.
[156] Ibid., para. 42. [157] Ibid., para. 41. [158] Ibid., para. 65.

relating to the investment and, therefore, the FET standard.[159] The claims in *CMS Gas* v. *Argentina*, *Sempra Energy* v. *Argentina*, *Enron* v. *Argentina* and *BG* v. *Argentina* were brought by other gas licensees as a result of these same events.

Addressing LG&E's FET claim, the tribunal quoted the passages from *Tecmed* and *Waste Management II* dealing with investors' expectations.[160] It then stated its own view of the protection provided to an investor's expectations by the FET standard, as if it followed naturally from these early decisions:

> It can be said that the investor's fair expectations have the following characteristics: they are based on the conditions offered by the host State at the time of the investment; they may not be established unilaterally by one of the parties; they must exist and be enforceable by law; in the event of infringement by the host State, a duty to compensate the investor for damages arises except for those caused in the event of state of necessity; however, the investor's fair expectations cannot fail to consider parameters such as business risk or industry's regular patterns.[161]

The tribunal held that tariff regime was 'not merely an economic and monetary policy of the Argentine government' but a set of rights granted and specifically guaranteed by the state. LG&E relied on these 'key guarantees' in making its decision to invest. By abandoning the tariff regime, Argentina breached LG&E's legitimate expectations and, therefore, the FET standard.[162]

The key clause in the *LG&E* Tribunal's statement is the requirement that expectations 'must exist and be enforceable by law'. The requirement that expectations must *exist by law* imposes a condition that an expectation be grounded in the legal entitlements of the investor under the domestic law of the state (or in the proper law of a contract or licence on which the expectation is based). An expectation that is based on a unilateral statement made by the host state would not meet this condition, except in the narrow circumstance in which domestic law itself recognises the unilateral statement as creating a right vested in the investor. The requirement that expectations must be *enforceable by law* further circumscribes the set of legal entitlements that are capable of supporting a legitimate expectation. At any given time, a state will have a number of laws and regulations in force. However, it would be rare for an investor to have an *enforceable* right for its entitlements under general regulations to remain

[159] Ibid., paras. 102–5. [160] See Section 4.5.
[161] *LG&E Energy* v. *Argentina*, Decision on Liability, para. 130. [162] Ibid., paras. 133–4.

unchanged unless the state has specifically agreed to maintain or guarantee the continuation of existing arrangements through a contract or licence agreement with the investor.

Under the criteria laid down by the *LG&E* Tribunal, the requirement that an expectation rest on a specific legal right vested in the investor is necessary, but not sufficient, for the expectation to be protected by the FET standard. The tribunal also held that an expectation must be 'fair', an assessment that required consideration of 'parameters such as business risk or industry's regular patterns.'[163] Moreover, the tribunal held that to recover for breach of a legitimate expectation, an investor must have relied on the expectation in making its initial investment.[164]

4.5.1.2 Other decisions consistent with *LG&E*

The *LG&E* Tribunal's interpretation of the doctrine of legitimate expectations was cited and applied in *BG* v. *Argentina*, a case brought by another gas investor based on the same facts. The *BG* Tribunal emphasised that both the tariff regime itself and provisions relating to the stability of the tariff regime were incorporated in the gas licences and stressed that Argentine law recognised these interests as 'legitimately acquired rights' vested in the investor.[165] The reversal of these commitments breached the claimant's legitimate expectations.

In another case brought against Argentina, the consolidated *Suez* claims, the claimants alleged that a number of measures affecting their investment in a Buenos Aires water concession breached the FET standard. Foremost among these was Argentina's refusal to revise water tariffs according to the legal framework established by the concession contract.[166] The tribunal noted that the claimants' expectations were basic terms of the concession contract. These expectations 'were not established unilaterally but by the agreement between Argentina and the Claimants; and they existed and were enforceable by law.'[167] Accordingly, Argentina was liable under the FET standard.

Other decisions have limited the doctrine of legitimate expectations to the protection of enforceable legal rights without citing the *LG&E* award. The case of *MCI* v. *Ecuador* arose from a dispute under an electricity contract between the investor and INECEL, a governmental entity.

[163] Ibid., para. 130. [164] Ibid., para. 130.
[165] 'derecho legítimamente adquirido', *BG Group* v. *Argentina*, Final Award, para. 308.
[166] *Suez and Vivendi; AWG Group* v. *Argentina*, Decision on Liability, paras. 79–80.
[167] Ibid., para. 231.

The tribunal rejected the notion that the doctrine of legitimate expectations protected 'the basic assumptions on which the investor made the investment.'[168] It held that

> [t]he legitimacy of the expectations for proper treatment entertained by a foreign investor protected by the BIT does not depend solely on the intent of the parties, but on certainty about the contents of the enforceable obligations.[169]

As the claimant could not prove the violation of an 'enforceable obligation' owed by INECEL or an 'acquired right' vested in the claimant, it could not succeed in its claim for breach of legitimate expectations.[170]

Similar issues were raised in *EDF* v. *Romania*. The claim arose from a set of contractual disputes between the investor and state entities relating to its investment in airport duty-free shops. The central claims of the investor were that the state had failed to extend its contract to provide duty free sales beyond its initial term and that the state subsequently abolished duty free sales in airports. The claimant argued that it had a legitimate and reasonable expectation of the continued operation of its business.[171] The tribunal disagreed:

> The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation.[172]

It went on to state that the claim for breach of legitimate expectations 'presupposes that the acts or the conduct in question were in breach of AIBO's and TAROM's [the state entities] contractual obligations.'[173]

The decision is particularly significant for its attempt to clarify the relationship between unilateral governmental statements and the doctrine of legitimate expectations. The tribunal held that

> [t]o validly claim a breach of the FET standard under the BIT, Claimant should have proven not only a breach of the SKY Contract, but also that such other assurances had been given by the Government and had been breached.[174]

In the tribunal's view, the relevance of governmental representations was that they weigh in the determination of which expectations based on legal rights rise to the status of *legitimate* expectations that are protected by the FET standard.

In the case of *Metalpar* v. *Argentina*, the investor alleged that the changes made during the Argentine financial crisis to Argentina's regime of

[168] *MCI Power* v. *Ecuador*, Award, para. 237. [169] Ibid., para. 278.
[170] Ibid., paras. 322–5. [171] *EDF* v. *Romania*, Award, para. 243.
[172] Ibid., para. 217. [173] Ibid., para. 240. [174] Ibid., para. 298.

currency convertibility breached its legitimate expectations relating to its investment in a bus manufacturing company.[175] The tribunal gave the claim short shrift. It reviewed a range of decided cases and found that, in every case where a legitimate expectations claim had been successful, 'the government [had] refused to renew or comply with [a] contract, license or permit.'[176] The fact that the claimant had 'no bid, license, permit or contract of any kind' with the state was sufficient to show that it could have no legitimate expectation that the currency regime would not change.[177]

A further set of decisions is consistent with the proposition that the doctrine of legitimate expectations is limited to the protection of vested legal rights, without expressly foreclosing the possibility that expectations could be based on other forms of state conduct in other cases. In the recent decision *Paushok* v. *Mongolia*, the claimant, an investor engaged in the mining of gold, argued that the introduction of windfall profits tax on the sale of gold breached its legitimate expectations. The tax was calculated at the rate of 68 per cent on the portion of the sale price exceeding a base price of USD 500 an ounce.[178] While noting that the tax imposed a significant burden on the operation of the investment, the tribunal held that governments regularly change their tax policies and that, in the absence of a stabilisation agreement with the host state, an investor could not legitimately expect tax arrangements to remain unchanged.[179] In *Eureko* v. *Poland*, the tribunal held that the Polish state 'consciously and overtly' refused to respect the terms of its contract with the investor, thereby breaching 'the basic expectations' of the investor.[180] The NAFTA claim in *GAMI* v. *Mexico* failed because the investor's expectation that the state would enforce sugar quotas was not based on any obligation on the state under Mexican law.[181]

4.5.1.3 Restatement of the legal rights approach

Taken together, these cases constitute a coherent interpretation of the doctrine of legitimate expectations under the FET standard. This interpretation of the doctrine can be restated as follows:

[175] *Metalpar* v. *Argentina*, Award on the Merits, para. 116.
[176] Ibid., para. 185. [177] Ibid., paras. 186–7.
[178] *Sergei Paushok* v. *Mongolia*, Award on Jurisdiction and Liability, para. 104.
[179] Ibid., Award on Jurisdiction and Liability, para. 302.
[180] *Eureko* v. *Poland*, Partial Award, para. 232; similarly, *Alpha Projektholding* v. *Ukraine*, Award, paras. 421–2.
[181] *GAMI Investments* v. *Mexico*, Final Award, para. 76.

1. An expectation can only qualify for protection under the FET standard if it is based on a specific and enforceable legal right vested in the investor.
2. Not all expectations based on specific legal rights qualify for protection under the doctrine. An expectation must also be legitimate and reasonable in the circumstances. This determination must be made in light of normal business risk, the regulatory patterns in the industry and any specific representations made by the state to the investor. The expectation must also be basic to the investment.
3. To recover for the infringement of a legitimate expectation, the investor must have relied on the expectation in making the decision to invest.

The domestic law of the host state plays an important role in this interpretation of the doctrine of legitimate expectations. However, this understanding of legitimate expectations does not reduce to a question of the legality of state conduct under domestic law. For example, what was crucial for the *LG&E* and *BG* Tribunals was that the gas licences granted gas companies specific and enforceable legal rights under Argentine law. It may well have been that, under Argentine constitutional law, it was legal for the state to subsequently repudiate these rights in an emergency situation. This issue was not decisive. Having created specific and enforceable legal rights under domestic law, the doctrine of legitimate expectations was activated; the subsequent treatment of these rights was then assessed according to an international standard.

4.5.2 The representations approach

A broader view of the scope of the doctrine of legitimate expectations is that it protects investors from prior unilateral statements made by the state. Further criteria then determine the circumstances in which an interference with expectations arising from representations will amount to a breach of legitimate expectations. The principle that justifies this view is that representations amount to official 'positions' taken by a host government, even when they are not legally binding. The doctrine of legitimate expectations then functions as a liability rule requiring a state to compensate an investor when it changes a position on which the investor has relied.[182] In keeping with this rationalisation of the doctrine, tribunals

[182] Grierson-Weiler and Laird, 'Standards of Treatment', p. 275, arguing that the doctrine is based on the 'concept of detrimental reliance'; Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 279, arguing that the doctrine is 'closely related to the principle of estoppel and state responsibility under public international law for unilateral acts'; Reisman and Arsanjani, 'The Question of Unilateral governmental

have described the protection of investors' expectations as embodying principles of 'certainty', 'consistency' and 'predictability'.[183] The overwhelming majority of academic commentary accepts that the doctrine of legitimate expectations protects expectations based on specific unilateral representations.[184] I call this the 'representations approach'.

4.5.2.1 The representations approach

The majority in the NAFTA tribunal in *Thunderbird* articulated the view that expectations protected by the FET standard could be derived from the host state's conduct without any requirement that such conduct create legal rights vesting in the investor:

> [T]he concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.[185]

In this paragraph, the majority also indicates that, to be *legitimate*, an expectation based on a state's conduct must be 'reasonable and justifiable'. In applying this standard to the facts, the tribunal gave more precise content to these limitations.

Thunderbird was a gaming company, seeking to install its gaming machines in Mexico. Mexican law banned gambling machines. Thunderbird requested an official opinion concerning the legality of its gaming machines under Mexican law from SEGOB, the relevant regulatory authority.[186] In its request Thunderbird declared that its machines operated according to the users' 'skills and abilities', not 'chance and wagering or betting'.[187] In its official response, SEGOB explained that Mexican law banned machines in which 'the principal factor . . . is luck or gambling'; and stated that if the investor's machines operated in the manner

Statements as Applicable Law in Investment Disputes' (2004) 19 *ICSID Review – FILJ*, p. 342; similarly, *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 147.

183 *Total* v. *Argentina*, Decision on Liability, para. 129; *Saluka* v. *Czech Republic*, Partial Award, para. 307; *CMS Gas* v. *Argentina*, Final Award, para. 276.

184 E.g., Potesta, 'Legitimate Expectations in Investment Treaty Law', p. 121; Diehl, *The Core Standard in International Investment Protection*, p. 411; Snodgrass, 'Protecting Investors' Legitimate Expectations', p. 34; Fietta, 'Expropriation and the "Fair and Equitable Treatment" Standard' in Ortino et al. (eds), *Investment Treaty Law: Current Issues II* (2007), p. 189;

185 *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, paras. 147, 196.

186 Ibid., para. 48. 187 Ibid., para. 50.

in which the investor had described, they would be permissible under Mexican law.[188] One year later, on its own motion, the Mexican authorities held an administrative hearing to determine whether Thunderbird's machines complied with Mexican law. Thunderbird appeared and gave evidence. SEGOB subsequently determined that Thunderbird's machines did not comply with Mexican law.[189] Thunderbird argued that on the basis of SEGOB's official response, it had a legitimate expectation that its machines were compliant with Mexican law.

The majority held that Thunderbird's legitimate expectations had not been breached. It noted that the information provided in Thunderbird's request for an official opinion was both incomplete and inaccurate.[190] SEGOB's response was explicitly conditional on the accuracy of this information. As such, it had not made a clear and specific statement on which Thunderbird could reasonably have relied.[191] In addition, the tribunal noted that Thunderbird had already begun to install its machines in Mexico prior to SEGOB's official response. On this basis, it doubted whether Thunderbird's investment had been made in reliance on SEGOB's response.[192]

In the recent decision in *Total* v. *Argentina* – another case arising out of events in the Argentine gas sector – the tribunal agreed that unilateral representations were capable of creating legitimate expectations. However, it was careful to limit the scope of the doctrine to situations where the representations were clear and specific to the investor:

> Representations made by the host State are enforceable and justify the investor's reliance only when they are specifically addressed to a particular investor.[193]

It argued that the assessment of whether a given expectation was legitimate required consideration of the state's 'right to regulate' and an assessment of whether the state's actions were reasonable and proportionate.[194] On the facts, the tribunal distinguished the findings of the other Argentine gases. It held that Total had invested a decade after other investors and, as such, was not an addressee of the promises made at the time of privatisation.[195]

In *Duke Energy* v. *Ecuador*, the tribunal accepted that expectations could be derived from 'conditions that the State offered the investor' at the time of the investment, without any requirement that the offer be embodied

[188] Ibid., para. 55. [189] Ibid., paras. 70–3. [190] Ibid., para. 151. [191] Ibid., paras. 159–61.
[192] Ibid., para. 167. [193] *Total* v. *Argentina*, Decision on Liability, para. 119.
[194] Ibid., para. 123. [195] Ibid., para. 144.

in a legally effective form.[196] The tribunal also noted that the assessment of whether an expectation is legitimate:

> [M]ust take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State.[197]

The tribunal held that a state's contractual agreement to guarantee payments owed to the investor by the electricity regulator created a legitimate expectation.[198] The tribunal dismissed a further claim arising from an arbitration agreement on the grounds that the doctrine of legitimate expectations did not protect expectations created by the state after an investor has made its investment.[199]

The tribunal in *Bayindir* v. *Pakistan* affirmed the comments made in *Duke Energy*.[200] It held that the claimant could not derive legitimate expectations from the fact that the former prime minister had been a key supporter of its highway construction project.[201] Specifically, the claimant could not expect that, after a change of government, the state would refrain from exercising its right to terminate a construction contract as a result of the claimant's defective performance.[202]

The *Biwater* v. *Tanzania* Tribunal also stressed the importance of weighing 'countervailing factors' in the assessment of whether an expectation is legitimate. These included the following:

> [T]he responsibility of foreign investors, both in terms of prior due diligence as well as subsequent conduct; the limit to legitimate expectations in circumstances where an investor itself takes on risks in entering a particular investment environment; and the relevance of the parties' respective rights and obligations as set out in any relevant investment agreement.[203]

In *National Grid* v. *Argentina*, the investor was a shareholder in a privatised electricity transmission and distribution company. The case raised essentially the same issue as the *LG&E*, *BG* and the other Argentine gas cases – whether the abandonment of a dollar-denominated tariff regime during the Argentine crisis, which had applied to a public utility and to which the utility was contractually entitled, breached the claimant's

[196] *Duke Energy* v. *Ecuador*, Award, para. 340; similarly, *GEA Group* v. *Ukraine*, Award, paras. 287, 291.
[197] *Duke Energy* v. *Ecuador*, Award, para. 340. [198] Ibid., paras. 362–4. [199] Ibid., para. 365.
[200] *Bayindir* v. *Pakistan*, Award, paras. 190–1. [201] Ibid., para. 194. [202] Ibid., para. 197.
[203] *Biwater* v. *Tanzania*, Award, para. 601.

legitimate expectations.[204] The tribunal began by observing that the FET standard 'protects the reasonable expectations of the investor at the time it made the investment and which were based on representations, commitments or specific conditions offered by the State concerned.'[205] The tribunal recognised much the same limitations on the doctrine as *Duke Energy*, including that Argentina's financial crisis must carry some weight in the assessment of legitimate expectations.[206] However, it went on to find that the claimant had a legitimate expectation that the tariff regime would continue in force, because the tariff regime had been specifically advertised to the claimant in the prospectus that the Argentine government used to attract foreign investors to the electricity transmission industry.[207] As such, the tribunal found that the liability of the state stemmed from its departure from a prior unilateral statement (the prospectus), not from the fact that it had repudiated rights created by the concession contract.

4.5.2.2 The significance of general regulatory arrangements in the representations approach

Thunderbird, *Total*, *Duke Energy*, *Bayindir*, *National Grid* and *Biwater* all dealt with factual scenarios in which the purported expectations were based on investor-state contracts or representations made by the host state. Other tribunals have considered the role of representations relating to the maintenance of general regulatory arrangements. Tribunals that adopt the representations approach agree that the general regulatory arrangements in force at the time of the investment are not a sufficient basis for a legitimate expectation that will be protected by the FET standard. This is the main point of contrast between the representations approach and the stability approach, which is introduced in Section 4.5.3. However, tribunals within the representations approach do agree that representations that the general regulatory framework would be maintained may, on occasion, be a sufficient basis for a legitimate expectation.

Tribunals that follow the representations approach have emphasised that general regulatory arrangements in force at the time an investment is made are not a sufficient basis for a legitimate expectation. For example, In *PSEG* v. *Turkey*, the tribunal addressed a claim based on changes of the legal regime governing the award of build, operate and transfer power

[204] *National Grid* v. *Argentina*, Award, paras. 117–25. [205] Ibid., para. 173.
[206] Ibid., para. 175. [207] Ibid., paras. 176–9.

contracts under Turkish law.[208] In rejecting this element of the claim, it held that 'legitimate expectations by definition require a promise of the administration on which the Claimants rely to assert a right that needs to be observed.'[209]

Similarly, in rejecting a legitimate expectations claim, the NAFTA tribunal in *Glamis Gold* held that no 'quasi-contractual inducement' had been offered by the state to the investor.[210] In the absence of such an inducement, a change in the environmental remediation regulations that would apply to the gold mine that the claimant was seeking to construct could not have breached its legitimate expectations. It was irrelevant that the 'imposition of mandatory backfilling requirements surprised the claimant and upset its [subjective] expectations.'[211]

The claim in *CMS* v. *Argentina* raised the same set of facts involving the Argentine gas industry as *LG&E* and *BG*.[212] Although the *CMS Gas* Tribunal observed elsewhere in the decision that the tariff regime was embodied in the terms of licence held by the investor, it did not refer to these facts in its application of the FET standard.[213] Rather, the tribunal found the liability of the state arose from changes to the general regulatory framework governing the investment in light of representations that this framework would not be changed. The tribunal noted that Argentina's changes to the tariff regime 'did in fact entirely transform and alter the legal and business environment under which the investment was decided and made.'[214] These comments seem to endorse the stability approach, which is outlined in the following section. However, the tribunal ultimately decided the case on the narrower grounds that, in light of 'specific commitments' that the regime would not be changed, the claimant was entitled expect that the tariff regime would not be abandoned.[215]

The tribunal in *Continental Casualty* made a more structured attempt to reconcile the principles governing the protection of expectations based on unilateral representations made by the state with the possibility that those representations might refer back to the stability of general regulatory arrangements. It held that in the assessment of whether a

[208] *PSEG* v. *Turkey*, Award, paras. 13–44.
[209] Ibid., para. 241; similarly, *Plama* v. *Bulgaria*, Award, para. 219; *AES Summit Generation* v. *Hungary*, Award, para. 9.3.18.
[210] *Glamis Gold* v. *United States*, Award, para. 767; similarly, *Cargill* v. *Mexico*, Award, para. 293.
[211] *Glamis Gold* v. *United States*, Award, para. 810.
[212] See Section 4.5.1.1.
[213] *CMS Gas* v. *Argentina*, Final Award, para. 133.
[214] Ibid., para. 275.
[215] Ibid., para. 277.

breach of legitimate expectations has occurred, a tribunal should consider:

> i) [T]he specificity of the undertaking allegedly relied upon which is mostly absent here, considering moreover that political statements have the least legal value, regrettably but notoriously so;
> ii) general legislative statements engender reduced expectations, especially with competent major international investors in a context where the political risk is high. Their enactment is by nature subject to subsequent modification, and possibly to withdrawal and cancellation . . . ;
> iii) unilateral modification of contractual undertakings by governments, notably when issued in conformity with a legislative framework and aimed at obtaining financial resources from investors deserve clearly more scrutiny, in the light of the context, reasons, effects, since they generate as a rule legal rights and therefore expectations of compliance;[216]

In these three paragraphs, the tribunal suggests a hierarchy in the sources of expectations in which specific legal rights deserve the most protection, followed by specific undertakings made to the investor. In the tribunal's hierarchy, general representations that the state would maintain the existing legislative framework deserve the least protection. The question of whether any expectation was legitimate would then involve a further balancing exercise in which the centrality of the expectation to the investment was weighed against the public interest of the state.[217] Continental Casualty had asserted an expectation of the continued operation of Argentina's regime of currency convertibility based on a combination of the general legislative position of the state and public pronouncements of the relevant minister that the regime would be maintained.[218] Applying its understanding of the doctrine, the tribunal held that the prior legislative framework did not provide the basis for a legitimate expectation.[219]

4.5.2.3 Restatement of the representations approach

There are certain differences in emphasis among these decisions. However, they coalesce around a set of propositions about the doctrine of legitimate expectations that can be restated with a degree of precision. With respect to the scope of the doctrine:

[216] *Continental Casualty* v. *Argentina*, Award, para. 261. [217] Ibid., para. 261.
[218] Ibid., para. 252. [219] Ibid., paras. 259–60.

1. An expectation need not be based on a legal right vested in the investor. A unilateral statement made by the host state may be the basis for an expectation. For a statement to be the basis for an expectation, it must be made by government officials in their official capacity and be clear, with a degree of specificity to the claimant. An expectation cannot be based on general regulations in force at the time the investment was made unless the state has made specific representations to the investor that the regulations would not be changed.

With respect to the criteria by which *legitimate* expectations are identified:

2. The assessment of whether a given expectation is legtimate is a balancing exercise involving consideration of all the circumstances relating to the investment. This includes consideration of whether the expectation goes beyond what the investor is legally entitled to under domestic law, as well as whether the expectation is reasonable given the 'political, socioeconomic, cultural and historical conditions' in the host state.

With respect to the reliance:

3. To recover for the infringement of a legitimate expectation, the investor must have relied on the expectation in making the decision to invest.

4.5.2.4 Postscript: are contractual rights excluded from the doctrine of legitimate expectations?

The tribunal in *Parkerings* v. *Lithuania* observed that an expectation

> is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment.[220]

This much is consistent with the representations approach to the protection of legitimate expectations under the FET standard. However, the *Parkerings* Tribunal went on to contend that 'contracts involve intrinsic expectations from each party that do not amount to expectations as understood in international law.'[221] This comment suggests an investor's contract with the host state cannot form the basis of an expectation protected by the FET standard. Arbitral decisions are unanimous in agreeing that not all breaches of contract are breaches of legitimate expectations,[222] but there are serious doctrinal difficulties with the position that a breach of

[220] *Parkerings* v. *Lithuania*, Award, para. 331.
[221] Ibid., para. 344. [222] E.g., *Hamester* v. *Ghana*, Award, para. 335.

contract is never a breach of legitimate expectations. The latter proposition entails the result that when an investor enters into a legally binding agreement with a host state about the arrangements to govern a particular investment, it *reduces* the degree of protection which the FET standard provides from change to these arrangements. This result is not doctrinally coherent.

The situation in *Parkerings* was complicated by an exclusive forum selection clause in the investor's contract with the state.[223] However, even this cannot justify the view that breaches of contract are excluded from review under the FET standard.[224] A claim for breach of the FET standard is a claim for breach of a treaty standard, not a claim for breach of a contract.[225] It may be relevant for a tribunal to come to a view about whether a contract has been breached, but only to the extent it goes to the question of whether the treaty standard has been breached. The jurisdictional basis for an FET claim is the parties' consent to arbitration of disputes under the treaty, not the jurisdiction to resolve contractual disputes; it is the latter that is constrained by a contractual choice of forum clause.[226] In any case, the *Parkerings* Tribunal's comments were not confined to rights created by contracts with forum selection clauses.

The decision in *Impregilo* v. *Argentina* shows how the *Parkerings* dicta might be reconciled with other decisions applying the FET standard. The *Impregilo* Tribunal cited *Parkerings* for the proposition that 'legitimate expectations and the existence of contractual rights are two separate issues.'[227] But the tribunal immediately retreated from this claim, arguing instead that a breach of contract could amount to a breach of legitimate expectations when a host state exercises 'sovereign power'.[228] In this way, the tribunal distinguished ordinary breaches of contract that might occur in a relationship between commercial counter-parties from interferences with contractual rights that can amount to a breach of

[223] *Parkerings* v. *Lithuania*, Award, para. 436.

[224] *Franck Charles Arif* v. *Moldova*, Award, para. 536; Spiermann, 'Premature Treaty Claims' in Binder and others (eds), *International Investment Law for the 21st Century* (2009), p. 484; Kriebaum, 'Local Remedies and the Standards for the Protection of Foreign Investment: The Interface between International Investment Protection and Human Rights' (2006) 3 *Transnational Dispute Management*, p. 447.

[225] Crawford, 'Treaty and Contract in Investment Arbitration', p. 358; *Compañia de Aguas del Aconquija and Vivendi* v. *Argentina (II)*, Decision on Annulment, paras. 101, 105.

[226] The situation is more complex when a claim is brought before an international tribunal under an 'umbrella clause' of an investment treaty. The jurisdictional and substantive issues relating to umbrella clauses are beyond the scope of this book.

[227] *Impregilo* v. *Argentina*, Award, para. 292. [228] Ibid., para. 296.

legitimate expectations under the FET standard. On the facts of the case, the tribunal found that Argentina had indeed breached a concession contract with the claimant in a manner that breached the claimant's legitimate expectations.[229]

4.5.3 The stability approach

A third approach to the protection of investors' legitimate expectations holds that the FET standard grants investors a freestanding entitlement to the stability of the legal arrangements under which the investment was made. Decisions within this approach also adopt a more permissive view of the extent to which expectations may be based on unilateral representations made by the host state. This is consistent with the greater emphasis on ensuring stability for the investor. Many academic commentators endorse the view that FET standard does protect expectations based on the general legal framework in force at the time the investment was made.[230] However, there are some dissenting voices that question whether, in the absence of a clear and specific representation made by the host state, a foreign investor can legitimately expect laws of general application to remain unchanged.[231] The justification for protecting expectations based on general regulatory arrangements in force at the time an investment is made seems to be the assumption that stability in the domestic legal system 'facilitate[s] rational planning and decision making' by foreign investors.[232]

Many of the decisions adopting the stability approach are sparsely reasoned. The possibility of liability arising from changes to general regulations in force at the time an investment is made greatly expands the potential scope of the doctrine of legitimate expectations. As such, the second stage of the legitimate expectations inquiry – the issue of how legitimate expectations based on general regulatory arrangements should be distinguished from expectations of stability that are not protected by the FET standard – assumes special importance. However, the criteria by

[229] Ibid., paras. 324, 331.

[230] E.g., Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 169; Dolzer, 'Fair and Equitable Treatment', p. 103; Schreuer, 'Fair and Equitable Treatment in Arbitral Practice', p. 386; Westcott, 'Recent Practice on the Fair and Equitable Treatment' (2007) 8 *The Journal of World Investment and Trade*, p. 425; Kinnear, 'The Continuing Development of the Fair and Equitable Treatment Standard', p. 227; Salacuse, *The Law of Investment Treaties*, p. 232.

[231] Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment*, p. 259; Potesta, 'Legitimate Expectations in Investment Treaty Law', p. 121.

[232] *Frontier Petroleum* v. *Czech Republic*, Final Award, para. 285.

which *legitimate* expectations should be identified are not fully articulated in these decisions.

4.5.3.1 Expectations based on general regulatory arrangements: the stability approach

A key decision developing the stability approach is *Occidental* v. *Ecuador (I)*. The dispute concerned the reimbursement of value-added tax (VAT) paid by the investor under a petroleum contract between the investor and the state. For the first two years of the contract, the Ecuadorian tax authorities refunded VAT on application from Occidental. The tax authorities then issued a resolution denying further refunds and demanding the repayment of refunds previously paid. The authorities justified this change in policy on the basis that the contract itself, through a participation formula that entitled the claimant for reimbursement of its expenses, already provided the investor with the refunds to which it was entitled.[233] The investor argued that the change in policy of the tax authorities breached the legitimate expectations on which the investment was based.[234]

The two issues of domestic law put to the tribunal were whether Occidental was entitled to a refund of VAT under Ecuadorian tax law and, if so, whether this reimbursement was accounted for by the participation formula. The tribunal found in Occidental's favour on both issues.[235] These findings would have been sufficient for the tribunal to hold that the FET standard had been breached by the tax authority's refusal to honour Occidental's acquired right under Ecuadorian law to a refund on tax already paid. However, the tribunal did not structure its reasoning in this way. Instead, it held that 'the stability of the legal and business framework is . . . an essential element of fair and equitable treatment.'[236] While noting that the tax authorities had justified their change of policy by asserting a 'manifestly wrong' interpretation of the contract, the primary basis for liability in the tribunal's decision was that 'the framework under which the investment has been made and operates has been changed in an important manner.'[237]

Both *Sempra* v. *Argentina* and *Enron* v. *Argentina* were based on the events in the Argentine gas industry considered in *LG&E*, *BG* and *CMS Gas*.[238] The same arbitrator presided over both tribunals, and the reasoning of the two follows a similar pattern. In addressing the claimant's FET claim,

[233] *Occidental* v. *Ecuador (I)*, Final Award, paras. 27–32. [234] Ibid., para. 181.
[235] Ibid., para. 143. [236] Ibid., para. 183. [237] Ibid., para. 184. [238] See Section 4.5.1.1.

the *Enron* Tribunal held that the doctrine of legitimate expectations protects 'expectations derived from the conditions that were offered by the State to the investor at the time of the investment'.[239] It understood 'conditions offered' as a category that includes the regulatory framework at the time an investment is made, in addition to those derived from unilateral statements made by the host state.[240] The tribunal found that Argentina breached the FET standard when it 'substantially changed the legal and business framework under which the investment was decided and implemented.'[241]

Although the *Enron* Tribunal also referred to 'the guarantees of the tariff regime' – a comment that could be read as an allusion to the fact that the tariff regime was incorporated into the terms of the licence acquired by the investor – its conclusion that Argentina had breached the FET standard did not turn on an analysis of the legal rights vested in the investor.[242] For the tribunal, the crucial finding was that the '"stable legal framework" that induced the investment is no longer in place and that a definitive framework has not been made available for almost five years.'[243]

In *Frontier Petroleum* v. *Czech Republic*, the tribunal attempted to articulate the stability approach in general terms:

> Stability means that the investor's legitimate expectations based on this legal framework and on any undertakings and representations made explicitly or implicitly by the host state will be protected. The investor may rely on that legal framework as well as on representations and undertakings made by the host state including those in legislation, treaties, decrees, licenses, and contracts.[244]

However, on the facts of the case before it, the tribunal did not need to apply this understanding of the FET standard to resolve the claim.

Tribunals who allow the protection of expectations derived from the general regulatory arrangements in force at the time an investment is made have not provided a complete account of the criteria by which *legitimate* expectations are to be identified. The *Enron* Tribunal observed that the protection of expectations based on the framework 'does not mean the freezing of the legal system or the disappearance of the regulatory

[239] *Enron* v. *Argentina*, Award, para. 262.
[240] Ibid., para. 265; similarly, *Sempra Energy* v. *Argentina*, Award, para. 298.
[241] *Enron* v. *Argentina*, Award, para. 264; similarly, *Sempra Energy* v. *Argentina*, Award, para. 303.
[242] *Enron* v. *Argentina*, Award, paras. 154, 266. [243] Ibid., para. 267.
[244] *Frontier Petroleum* v. *Czech Republic*, Final Award, para. 285.

power of the State.'[245] However, it did not explain the limits to the doctrine in any greater detail. To the extent that tribunals have engaged with this question, they seem to envisage a balancing process similar to that which occurs within the representations approach but with greater weight given to investors' general expectations of stability.[246] Thus, the tribunal in *Lemire* v. *Ukraine (II)* agreed that general laws in force when an investment is made could form the basis for legitimate expectations, but that legitimacy of any expectations based on such laws would have to be assessed in light of 'the State's sovereign right to pass legislation and to adopt decisions for the protection of its public interests.'[247] In *Alpha Projektholding* v. *Ukraine*, the tribunal said that the question was whether the regulatory change was 'arbitrary'.[248] In *El Paso* v. *Argentina*, the tribunal said the issue was whether the expectation was 'reasonable' in all the circumstances.[249] Both these tribunals seemed to have envisaged a similar balancing process to that prescribed by the *Lemire II* decision.

4.5.3.2 The stability approach to unilateral representations

Within the stability approach, legitimate expectations may also be based on unilateral representations but, in contrast to the representations approach, there is no requirement that such representations be clear and specific to the investor.[250] The roots of this approach can be found in *Tecmed* v. *Mexico*. The case concerned a hazardous waste facility. The investor held a licence to operate the facility for one year, which was renewable annually. In response to community opposition to the facility, the authorities and the investor agreed that the facility should be moved to a different location. This agreement was not documented in written form. Within months of this agreement, the authorities declined to renew the annual licence that allowed the facility to operate at its original site.[251] The investor argued that it had a legitimate expectation that the facility would be permitted to continue to operate until it could be relocated.

The tribunal's reasoning is difficult to follow. There is no doubt that it took a dim view of the authorities' conduct, which seems to have been

[245] *Enron* v. *Argentina*, Award, para. 261.
[246] E.g., *Electrabel* v. *Hungary*, Decision on Jurisdiction, Applicable Law and Liability, para. 7.77.
[247] *Lemire* v. *Ukraine (II)*, Decision on Jurisdiction and Liability, para. 285.
[248] *Alpha Projektholding* v. *Ukraine*, Award, para. 420.
[249] *El Paso* v. *Argentina*, Award, para. 364.
[250] *Electrabel* v. *Hungary*, Decision on Jurisdiction, Applicable Law and Liability, para. 7.78.
[251] *Tecmed* v. *Mexico,* Award, para. 160.

coloured by earlier changes to the licensing regime that had occurred before the entry into force of the BIT.[252] What is clear is that the tribunal found that the decision not to renew the licence breached the investor's legitimate expectation that the old facility would be permitted to continue to operate until it could be relocated.[253] What distinguishes the decision from those discussed in the context of the representations approach to legitimate expectations is that the tribunal did not identify a specific assurance that the investor's licence would be renewed. The closest the Mexican authorities had come to such a statement was in issuing a declaration that the original facility 'shall be closed as soon as the new facilities are ready to operate.'[254] The tribunal did not find that this declaration constituted an implicit promise *relating to the licence*. Rather, liability under the FET standard stemmed from the fact that, in a context in which there had been active negotiations between the investor and the authorities, the authorities had not given 'an explicit, transparent and clear warning' that the facility would be closed prior to relocation.[255]

In *Tecmed*, any expectations derived from the statements and negotiations concerning relocation could only have arisen *after* the investor had made its original investment in the facility. Moreover, the tribunal did not make a finding that the relocation exercise itself constituted an investment. As such, on the facts found, it is clear that the investor did not make an investment in reliance on the expectation identified by the tribunal. This did not preclude the investor from succeeding in its claim.

Professor Wälde's dissent in *Thunderbird* provides a way to rationalise the *Tecmed* decision, so far as it concerns legitimate expectations. The facts of *Thunderbird* are described in the previous section.[256] Professor Wälde agreed with the majority that Thunderbird's request for an opinion was 'factually – with the hindsight of this tribunal's expertise – incorrect' and that the regulator's response was phrased as conditional on the accuracy of the investor's information.[257] Professor Wälde also stressed that legitimate expectations could only be created by officials acting in their official capacity and that SEGOB had been acting in its official capacity.[258] (This was not a point of contrast with the majority; it is a condition of the creation of a legitimate expectation accepted, either explicitly or implicitly,

[252] Ibid., paras. 68, 171–2. [253] Ibid., para. 173. [254] Ibid., para. 160.
[255] Ibid., paras. 160, 163. [256] See Section 4.5.2.1.
[257] *International Thunderbird Gaming* v. *Mexico*, Separate Opinion, paras. 63–64.
[258] Ibid., para. 31.

by all arbitral decisions that allow expectations to be based on unilateral statements of the host state.)

The key difference between Professor Wälde and the majority concerned a question of law, not a finding of fact. The difference was the degree of specificity required of a unilateral statement for it to justify a legitimate expectation. The majority had held that because SEGOB's response did not contain any clear or specific assurance that Thunderbird's machines were permitted under Mexican law, Thunderbird could not expect that its machines were permitted. In contrast, Wälde held 'that the risk of ambiguity falls square on the shoulders of the assurance-issuing public authority'.[259] The fact that SEGOB's response could reasonably have been understood by the investor as suggesting approval of the machines was, on his interpretation of the doctrine, sufficient to establish a legitimate expectation.[260]

4.5.3.3 Restatement of the stability approach

Again, there are differences in emphasis among these decisions. However, they are distinguished from decisions with the representations approach in that they accept that legitimate expectations may be based on general regulations in force at the time the investment is made or on unilateral representations made by the host state that lack the clarity and specificity that would be required by the representations approach. With respect to the scope of the doctrine:

1. Legitimate expectations may be based on general regulations in force at the time the investment was made. Legitimate expectations may also be based on unilateral statements made by the host state. Insofar as legitimate expectations are based on unilateral representations, they need not be based on a clear and specific statement of the state's position.

With respect to the criteria by which *legitimate* expectations are identified:

2. The assessment of whether a given expectation is legitimate still involves a balancing exercise but, consistently with the focus of providing stability to the investor, the perspective of the investor weighs more heavily in this balance than it would under the representation approach. The key issue is whether the altered

[259] Ibid., paras. 57, 77. [260] Ibid., para. 64.

regulation was a basic element of the legal regime governing the investment at the time it was made.

With respect to the reliance:

3. To recover for the infringement of a legitimate expectation based on a general regulation, the investor must have relied on the expectation in making the decision to invest. However, there is some suggestion that an investor may recover from the breach of expectations created by unilateral statements that it did not rely on in making an investment.

4.5.4 The business plan approach

A handful of decisions take a still broader view of the doctrine of legitimate expectations. What distinguishes these cases from those reviewed in previous sections is that, in each of them, the investor succeeded in a claim for breach of legitimate expectations when the protected expectation was neither based on a legal right vested in the investor nor on a unilateral statement of the host state, nor on the regulations in force at the time the investment was made. These decisions are best rationalised as protecting expectations based on the business plans of the investor, when the state knew, or should have known, that the impugned conduct would upset the investor's business plans. There are difficulties in finding a jurisprudential justification for these decisions. Most commentators agree that, as a matter of legal doctrine, an investor's subjective expectations are not protected by the FET standard.[261] However, the three decisions reviewed in this section come close to allowing an investor to recover for interference with its subjective expectations.

4.5.4.1 MTD, Bogdanov and Walter Bau

The case of *MTD* v. *Chile* concerned an investor's proposal to redevelop land near Santiago. The investor acquired land that was not zoned for redevelopment. It then applied for permission to import capital into Chile to fund the project, a transfer which required the approval of the Chilean Foreign Investment Commission (FIC).[262] The application to transfer funds into Chile required the investor to specify the location and nature of the investment project to which the funds related. The FIC, a national agency,

[261] Kinnear, 'The Continuing Development of the Fair and Equitable Treatment Standard', p. 230; similarly, *Saluka* v. *Czech Republic*, Partial Award, para. 304.
[262] *MTD* v. *Chile*, Award, para. 162.

approved the transfer of funds into Chile. The relevant local authority subsequently refused MTD's request to rezone the land for redevelopment. MTD claimed that the FIC's decision created an expectation that the proposed redevelopment could proceed in the specified location.[263]

The tribunal accepted Chile's argument that, as a question of Chilean law, approval of the import of capital did not entitle the investor to proceed with the project without complying with local planning regulations.[264] Indeed, the FIC's approval explicitly noted that all investment projects were required to comply with other applicable national laws.[265] Moreover, the tribunal did not identify any unilateral statement made by the host state which suggested that the land would be rezoned; or that the national authorities would override normal local zoning procedures; or that the investment would be exempted from zoning requirements. Nevertheless, the tribunal characterised the approval of capital transfer and rejection of rezoning as an 'inconsistency of action between two arms of the same Government vis-a-vis the same investor'.[266] In its view, the authorisation to import capital gave 'prima facie to an investor the expectation the project is feasible in that location from a regulatory point of view.'[267] The local authority's refusal to rezone the land breached this expectation.[268]

The tribunal's assertion that liability rested on the inconsistency of Chile's conduct is problematic. In many legal systems, an investor must comply with a range of different regulations simultaneously. The fact that a factory owner must comply with both environmental regulations and tax law is not normally regarded as constituting an inconsistency. Rather, the *MTD* decision seems to rest on the findings of fact that the Chilean state was put on notice of MTD's business plans; it acted in a way that allowed MTD to pursue these plans and then subsequently acted in a way that upset these plans. According to the tribunal's interpretation of the doctrine of legitimate expectations, these three facts were *sufficient* to establish Chile's liability.

The case of *Bogdanov* v. *Moldova* also arose from a relatively simple set of facts. The claimant had signed a privatisation contract with the state. The contract provided that the claimant would transfer assets to the state in exchange for shares in other, unspecified state-owned companies. After the contract had been signed, the Moldovan authorities drew up a list of Eligible Compensation Shares in state-owned companies with which

[263] Ibid., para. 116. [264] Ibid., para. 163. [265] Ibid., para. 188.
[266] Ibid., para. 163. [267] Ibid., para. 163. [268] Ibid., para. 189.

the claimant could be compensated. The claimant argued that all the available shares deprived the compensation mechanism of its substance because the market value of the shares was below their face value.[269] The tribunal found that, under the proper law of the contract at the time it was signed (and at all subsequent times), there was no limit on the state's discretion to nominate which shares in state-owned companies would be offered as compensation shares. It also found that the contract entitled the state to offer shares at their face value, rather than their market value.[270]

Notwithstanding these findings of fact and law, the tribunal held that the claimant had a 'legitimate expectation of obtaining compensation (even if not necessarily a fully satisfactory compensation).' It agreed with the claimant that the compensation mechanism had been 'deprived of its value' and, therefore, held that the claimant's legitimate expectation had been breached.[271] To understand the tribunal's reasoning, it is important to note that the principle that a contractual compensation term should not be 'deprived of its value' was not a principle of Moldovan contract law. The expectation of the claimant was a *business* expectation that existed independently of the terms of the agreement the claimant had made with the state.

The business plan approach to legitimate expectations is articulated most clearly in *Walter Bau* v. *Thailand*. Walter Bau was a minority investor in a Thai tollway project. The investment consortium invested under a concession contract, which required it to build the tollway and then allowed it to collect the toll on the road for 25 years.[272] Ten years into the project, the terms of the concession were renegotiated, with the renegotiated agreement (MoA2) providing for an increase in the toll and the removal of an on-ramp. The Thai authorities subsequently refused to increase the toll, citing the consortium's failure to remove the on-ramp.[273] Then, in further negotiations to which the claimant objected, the consortium agreed to a reduction in the toll in exchange for the settlement of other legal disputes with the authorities.[274] The claimant sold its stake in the consortium and claimed that its legitimate expectations had been breached by the failure of the authorities to increase the toll.

The tribunal held that the state's failure to increase the toll had breached the claimant's legitimate expectation of a reasonable rate of

[269] *Bogdanov* v. *Moldova*, Arbitral Award, p. 3. [270] Ibid., p. 13. [271] Ibid., p. 17.
[272] *Walter Bau* v. *Thailand*, Award, para. 2.36.
[273] Ibid., para. 12.14. [274] Ibid., paras. 12.26–30.

return on its investment. It was explicit that these expectations stemmed from the claimant's business plans:

> The Respondent could not reasonably have expected that foreign investors would enter into an arrangement of the nature proposed, over such a long period, without being fairly confident of a reasonable rate of return on investment. . . .
>
> In spite of the fact that there was no guarantee by the Respondent of an explicit rate of return, the Tribunal considers that a reasonable rate of return – reasonable in all the circumstances, including the signing of MoA2 [which had the effect of reducing the expected rate of return] – was part of the Claimant's legitimate expectations and the failure to fulfil such a reasonable expectation was a breach of the Respondent's obligations.[275]

The tribunal acknowledged that, as a question of Thai corporate law, the minority investor was bound by the decision of the consortium to consent to the toll reduction. However, it held that it would be unfair for this fact to preclude the claimant from recovering for breach of the FET standard.[276]

The tribunal did not consider whether, to recover for breach of a legitimate expectation, a claimant had to rely on that expectation in making its investment. It would be difficult to reconcile Walter Bau's expectation of a reasonable rate of return with such a requirement of reliance. The original concession agreement did not confer any entitlement on the consortium to an increase in the toll. In the quantum section of the award, the tribunal stated that the claimant's legitimate expectations that had been breached were those that existed at the time of the signing of MoA2 in 1996.[277] The claimant's original investment in the consortium had been made ten years earlier and there was no evidence that it made any subsequent investment in reliance on MoA2 or the business plans it engendered.

4.5.4.2 Restatement of the business plan approach

These three decisions constitute a coherent, albeit expansive, interpretation of the doctrine of legitimate expectations. This interpretation can be restated in the following propositions. With respect to the scope of the doctrine:

1. An expectation may be based on the business plans of the investor if the host state knew or should have known of those plans.

[275] Ibid., paras. 12.2–3. [276] Ibid., para. 12.31. [277] Ibid., para. 13.10.

With respect to the criteria by which *legitimate* expectations are identified:

2. Business plans must be reasonable to justify a legitimate expectation. However, a business plan is not unreasonable simply because it is premised on assumptions about the way the state will act in the future that are based neither on the legal rights of the investor, nor on the regulatory arrangements in force when the investment was made, nor on any unilateral statement made by the state.

With respect to reliance:

3. A claimant may recover for a breach of an expectation even if did not rely on that expectation in making the investment.

4.5.5 Summary: the four interpretations of the legitimate expectations element of FET

This chapter has argued that the protection of investors' legitimate expectations is a recognised element of the FET standard. The preceding sections have categorised decisions dealing with this element according to their understanding of the scope of the doctrine of legitimate expectations. Decisions embody four different views of the basis for expectations protected by the FET standard. Each of these views can be characterised as a distinct, coherent interpretation of the legitimate expectations element of the FET standard. The four views are as follows:

i) Expectations must rest on specific rights that the investor has acquired under domestic law. This is the legal rights approach.
ii) In addition to i), expectations may rest on specific unilateral representations of government officials. This is the representations approach.
iii) In addition to ii), expectations may rest on the regulatory framework in force in the host state at the time the investor made the investment. This is the stability approach.
iv) In addition to iii), expectations may rest on the business plans of the investor. This is the business plan approach.

4.6 Procedural review of government conduct under the FET standard

This section examines decisions in which state liability under the FET standard turns on failure to meet procedural standards of conduct, excluding cases associated with the conduct of judicial proceedings. (Such cases

are governed by the doctrine of denial of justice.) It is widely recognised in arbitral decisions that a state's failure to meet a minimum standard of procedural fairness in non-judicial conduct may breach its obligation to provide FET.[278] Academic commentators agree that the FET standard imposes procedural obligations on host states, whether these obligations are classified under the label of 'procedural propriety and due process',[279] 'regulatory fairness and transparency'[280] or simply 'transparency'.[281]

Few decisions have attempted to articulate complete accounts of the principles of procedural review. Nevertheless, there seems to be a degree of consensus around some fundamental propositions. These include the proposition that the obligation of due process in administrative conduct is lower than that required in judicial proceedings under the doctrine of denial of justice,[282] and the proposition that, although a failure to follow the procedural requirements of national law may make a breach of FET more likely, the determination ultimately involves the application of an international standard.[283]

There are also significant differences between decisions in their interpretation of the procedural element of the FET standard. To make sense of these differences, I organise arbitral jurisprudence around key decisions. Three interpretative approaches are identified in this way:

i) A narrow approach, based on *Genin*, in which procedural unfairness must be aggravated either by being intentional or by having led to an outcome that cannot be justified on substantive grounds for it to breach the FET standard;
ii) An intermediate approach, based on *Chemtura*, in which procedural unfairness is sufficient to breach the FET standard, but in which the intensity of review is lenient – requiring 'procedurally improper behaviour . . . both serious itself and material to the outcome' of an administrative process; and

[278] E.g., *Waste Management* v. *Mexico (II)*, Final Award, para. 98; *Methanex* v. *United States* Final Award, pt. IV, chp. C, para. 12; *Saluka* v. *Czech Republic*, Partial Award, para. 308.
[279] Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 154; Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment*, p. 162; similarly, Kläger, *'Fair and Equitable Treatment' in International Investment Law*', p. 213.
[280] Grierson-Weiler and Laird, 'Standards of Treatment', p. 277.
[281] Newcombe and Paradell, *Law and Practice of Investment Treaties*, p. 292.
[282] *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 200; Kreindler, 'Fair and Equitable Treatment', p. 14.
[283] *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 194; *Elettronica Sicula SpA (United States of America* v. *Italy)*, Judgment of 20 July 1989, para. 127.

iii) An exacting approach, based on the detailed set of procedural requirements outlined in *Tecmed*.

Each set of decisions is characterised as a coherent, if conceptually incomplete, interpretation of the scope of procedural review under the FET standard. Although the majority of cases are broadly consistent with the intermediate approach, decisions that fall within the narrow and exacting approaches deserve to be taken seriously; they are forthright and unambiguous in proposing interpretations strikingly different from the intermediate approach. Moreover, the narrow approach remains relevant to current arbitral practice, having been applied in the *Glamis Gold* decision.

Finally, some mention must be made of the relationship between the procedural element of the FET standard and principles governing compensation for breach of FET. Although investment treaties do not generally specify the formula by which compensation for a breach of FET should be determined, tribunals have calculated damages on the basis of the principle laid down in *Chorzów Factory*:[284]

> [R]eparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.[285]

The application of this principle in cases of procedural review is not straightforward. Consider for example, a situation in which a domestic regulatory authority must determine whether an investor has satisfied the conditions required for the renewal of its licence to operate the investment. A state may be liable for breach of the FET standard if the procedure by which the authority determines whether to renew the licence fails to meet some minimum standard of fairness. However, it will not necessarily be the case that the investor's licence would have been renewed if fair procedures had been followed. Quantification of the extent of loss *caused* by the procedural unfairness would then require the tribunal to consider what would have occurred if the state had followed a fair procedure.

[284] Paradell, 'The BIT Experience of the Fair and Equitable Treatment Standard' in Ortino et al. (eds), *Investment Treaty Law: Current Issues II* (2007), p. 137.

[285] *Case concerning certain German interests in Polish Upper Silesia (Germany* v. *Poland) (Claim for Indemnity)* (hereafter, *Chorzów Factory*) PCIJ Rep Series A No 17, p. 47.

This counter-factual inquiry may raise issues of some complexity.[286] For present purposes, it is sufficient to note that, on a given set of facts, the compensation to which a claimant is entitled may be affected by whether the tribunal finds that the breach of FET resulted from procedural unfairness or some other element of the FET standard.

4.6.1 Genin*: a narrow approach*

The facts in *Genin* v. *Estonia* concerned the revocation of the banking licence of an Estonian bank, EIB, in which the claimant was a major shareholder. The decision to revoke the licence was made on 'extremely technical' grounds. Authorisation to acquire shares in EIB had been granted to Eurocapital Group Company but EIB's share register showed that shares were acquired by Eurocapital Group Limited, which the regulator took to be a different and unauthorised entity.[287] The central question for the tribunal was whether Estonia breached the FET standard by revoking the licence in a manner that was procedurally unfair.[288] In answering this question, the tribunal also took into account the fact that EIB had previously failed to disclose information on the ultimate ownership of its shareholders, as it was required to do under domestic law.[289] The tribunal found that

> [n]o notice was ever transmitted to EIB to warn that its licence was in danger of revocation unless certain corrective measures were taken, and no opportunity was provided to EIB to make representations in that regard.[290]

The decision to revoke the licence 'was made immediately effective, giving EIB no opportunity to challenge it in court before it was publicly announced.'[291]

The tribunal held that, to breach the FET standard, conduct must fall 'far below international standards':[292]

> [A]ny procedural irregularity that may have been present would have to amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action.'[293]

[286] *Chevron* v. *Ecuador (I)* Partial Award on the Merits, paras. 380–4; *Lemire* v. *Ukraine (II)*, Award, para. 171.
[287] *Alex Genin* v. *Estonia*, Award, para. 359. [288] Ibid., Award, para. 357.
[289] Ibid., paras. 351–7. [290] Ibid., para. 358. [291] Ibid., para. 364.
[292] Ibid., para. 367. [293] Ibid., para. 371.

In the tribunal's assessment, the conduct did not fall below this standard. It relied heavily on the finding that, regardless of the procedural failings, the decision to revoke the licence was *substantively* justified – 'ample grounds existed for the action'.[294] Moreover, it found no evidence that departures from 'generally accepted banking and regulatory practice' were intentional or in bad faith.[295]

This approach was reinforced by the *Glamis Gold* Tribunal, which took a similarly restrained view of the procedural element of the FET standard. It accepted the United States' argument that the FET standard does not impose a freestanding requirement of transparency.[296] The tribunal went on to hold that Article 1105(1) of NAFTA imposed 'a floor, an absolute bottom, below which conduct is not accepted by the international community.' Procedural impropriety could only breach this standard if it constituted 'blatant unfairness, [or] a complete lack of due process' – something 'far beyond the measure's mere illegality, an act so manifestly arbitrary, so unjust and surprising as to be unacceptable from the international perspective.'[297]

The facts of the case did not provide the tribunal with the opportunity to explore the threshold set by this adjective-enriched formulation. Among a patchwork of related claims, the claimant alleged that an official administrative re-interpretation of US mining law breached the FET standard because it did not comply with the requirements under US federal law to afford interested parties notice and the opportunity for comment.[298] The tribunal held that this claim did not raise a live issue because, 'if there was a procedural error, it was corrected quickly and effectively through domestic channels' by the adoption of a new interpretation two years later.[299]

4.6.1.1 Restatement of the narrow approach

Genin and *Glamis Gold* are united by the view that procedural unfairness will only breach the FET standard if it exceeds some very high threshold of seriousness. These decisions are defined by their examination of procedural conduct that *does not* breach the FET standard, rather than by detailed exploration of the forms of conduct that might be sufficiently extreme to cross the threshold of liability. Nevertheless, they provide enough guidance to outline a coherent interpretation of the procedural element of FET, one that is embodied in the following propositions:

[294] Ibid., para. 367, similarly, paras. 361, 363.
[295] Ibid., paras. 364, 371. [296] *Glamis Gold* v. *United States*, Award, paras. 578, 605, 627.
[297] Ibid., paras. 627, 626. [298] Ibid., para. 771. [299] Ibid., para. 771.

1. To breach the FET standard, administrative action must amount to 'bad faith, a wilful disregard of due process of law or an extreme insufficiency of action.'
2. This requirement places only minimal procedural obligations on host states. It seems that procedural unfairness will only breach the FET standard if it is aggravated either by being intentional or by having led to an outcome that cannot be justified on substantive grounds.
3. There is no freestanding requirement of transparency under the FET standard. A failure to act transparently could only breach the FET standard to the extent it falls within still uncharted concepts such as 'extreme insufficiency of action'.

4.6.2 Chemtura*: an intermediate approach*

The NAFTA case *Chemtura* concerned a Canadian ban on pesticides containing lindane, the claimant was a producer of such pesticides. The events leading to the ban were triggered by the US government's decision to prohibit the import of lindane-treated canola seed.[300] The Canadian Pest Management Regulatory Agency (PMRA) then launched a 'Special Review' of the use of lindane. The review took two years and reached the conclusion that the health risks to workers handling lindane-containing pesticides justified a Canadian ban of these products.[301] At the claimant's request, a government 'Board of Review' was established to review the decision of the PMRA. Its report recommended that the PMRA reconsider alternatives to mitigate the occupational-health issues relating to the use of lindane.[302] The PMRA then launched a re-evaluation process, to which the claimant made submissions. The re-evaluation confirmed the findings of the original Special Review and concluded with a letter to the claimant addressing the submissions it had made on alternative mitigation measures.[303]

The claimant made two principal allegations: that the Special Review was a sham, motivated by the need to avoid trade complications with the United States rather than legitimate health and environmental concerns and that the process of the Special Review was flawed.[304] The tribunal dismissed the first claim on the facts.[305] However, it accepted that, even if the Special Review of lindane had been conducted in good faith, it could still have breached the claimant's right to procedural fairness under the FET standard.[306] It held that the review process should be assessed 'as a whole' taking into account the subsequent procedures that constituted 'an additional opportunity offered to the claimant to put forward its

[300] *Chemtura* v. *Canada*, Award, para. 13. [301] Ibid., paras. 21–9. [302] Ibid., paras. 35–40.
[303] Ibid., paras. 41–5. [304] Ibid., para. 133. [305] Ibid., para. 143. [306] Ibid., para. 145.

position.'[307] The claimant advanced a range of contentions, including that it had not been given sufficient notice of the Special Review; it had not been given sufficient practical opportunities to make submissions; the Special Review did not incorporate adequate scientific evidence; and that the Special Review was not completed in a timely manner. The tribunal found a degree of factual support for some of the claimant's contentions, particularly the argument that the claimant lacked opportunities to make submissions to the original Special Review. However, it felt that these facts did not reach the threshold of 'procedurally improper behaviour by the PMRA which was both serious in itself and material to the outcome of its inquiry' that would amount to a breach of the FET standard.[308]

Several other decisions are consistent with the threshold that procedural impropriety must be both serious in itself and material to the outcome of the proceedings to breach the FET standard. The tribunal in *AES* v. *Hungary* held that

> not every process failing or imperfection . . . will amount to a failure to provide fair and equitable treatment. The standard is not one of perfection. It is only when a state's acts or procedural omissions are, on the facts and in the context before the adjudicator, manifestly unfair or unreasonable (such as would shock, or at least surprise a sense of juridical propriety) . . . that the standard can be said to be infringed.[309]

The procedural element of the claimant's FET claim turned on an assessment of the procedures by which the government implemented regulated pricing in the electricity industry. Although the tribunal held that there were 'procedural shortcomings', the most serious being the tight deadlines for comment on the draft price decrees, it held that these did not rise to the level of breaches of FET.[310] The tribunal noted that claimants had been given an opportunity to comment on the draft decrees that would be applied to them; that, notwithstanding the tight deadlines, they had been able to make comments; that the Ministry considered the claimant's comments and, at times, had adjusted the decrees accordingly; and that the claimants had the opportunity to seek review of the process in Hungarian courts.[311]

In *Lemire* v. *Ukraine (II)* the claimant alleged that a series of administrative decisions relating to the award of radio licenses under tender were

[307] Ibid., para. 145. [308] Ibid., para. 148.
[309] *AES Summit Generation* v. *Hungary*, Award, para. 9.3.40.
[310] Ibid., para. 9.3.66. [311] Ibid., paras. 9.3.50–69.

unfair.[312] In considering the claims, the tribunal held that the FET standard did not place a general obligation on the licensing authority to provide reasons for its decisions.[313] However, the licensing authority repeatedly awarded licenses to politically well-connected individuals, notwithstanding the claimant's uncontested evidence that it better-satisfied the criteria for award of particular licenses.[314] In this context, the licensing body's failure to state reasons for its decisions was central to the tribunal's decision that the licensing authority's decision-making procedures had breached the FET standard.[315] Similarly, in *Teco* v. *Guatemala*, the tribunal held that, in setting electricity tariffs, the Guatemalan electricity regulator could not ignore the recommendations of the independent Expert Commission that formed part of regulatory framework governing the sector without providing reasons for its decision.[316]

In *Middle East Cement* v. *Egypt* the procedure by which an administrative seizure and sale of a ship owned by the claimant was executed was deemed to have breached the FET standard. The serious procedural shortcoming in the case was that the authorities did not notify the claimant that the ship would be seized, even though claimant's and its lawyer's addresses were known to the authorities.[317] In *Waste Management II*, the tribunal agreed that the FET standard could be breached by 'a complete lack of transparency and candour in an administrative process.'[318] In *Thunderbird*, the facts of which are described above,[319] the tribunal held that the procedure by which SEGOB had determined that Thunderbird's machines did not comply with gaming legislation satisfied the FET standard because the claimant had been given an opportunity to be heard and present evidence.[320] In *PSEG* v. *Turkey*, the tribunal held that 'continuous and endless' changes in the legislation governing an investment and in the interpretation and implementation of that legislation by the Turkish authorities breached the FET standard.[321]

4.6.2.1 Procedural fairness in contractual dealings?

Chemtura, *AES* v. *Hungary*, *Lemire II*, *Middle East Cement* and *Thunderbird* all concerned the degree of procedural fairness to which a claimant was

[312] *Lemire* v. *Ukraine (II)*, Decision on Jurisdiction and Liability, para. 315.
[313] Ibid., para. 394. [314] Ibid., para. 384.
[315] Ibid., paras. 419–20; Hepburn, 'The Duty to Give Reasons for Administrative Decisions in International Law' (2012) 61 *International and Comparative Law Quarterly*, p. 650.
[316] *Teco* v. *Guatemala*, Award, paras. 583-8. [317] *Middle East Cement* v. *Egypt*, Award, para. 143.
[318] *Waste Management* v. *Mexico (II)*, Final Award, para. 98. [319] See Section 4.5.2.1.
[320] *International Thunderbird Gaming* v. *Mexico*, Arbitral Award, para. 198.
[321] *PSEG* v. *Turkey*, Award, paras. 250–4.

entitled in administrative proceedings that directly affected the claimant's interests. Other decisions have considered whether these requirements extend to contractual dealings. The leading case on this point is *Bayindir*. The claimant argued that it had been denied a right to be heard in the Pakistani government's decision to terminate a contract with the claimant, a decision that had been made on the basis of the claimant's non-performance.[322] The tribunal accepted that a lack of procedural fairness in administrative proceedings could breach the FET standard but held that these procedural guarantees were not available in every situation.[323] A claimant was not entitled to be heard in a government's internal decision-making processes relating to the exercise of rights created by a contract.[324] Similarly, in *Biwater* the tribunal held that the FET standard did not place a procedural obligation on the Tanzanian water-regulator to consider a proposal to modify an existing contract to the benefit of the claimant (and the detriment of the host state) because the claimant had no contractual right to renegotiation.[325]

On the other hand, a state's failure to follow the *procedures specified by the contract* in cancelling a contract with the investor was central to finding a breach of FET in *Rumeli* v. *Kazakhstan*.[326] The tribunal held that the conduct of an administrative review of the validity of the contract cancellation procedure constituted a further breach of FET because the claimants were unable to present their position and the review's finding of validity relied on different grounds to those that formed the basis for the original decision.[327]

An exception to the principle that a claimant is not entitled to procedural fairness in contractual dealings was articulated in the decision *Jan de Nul* v. *Egypt*. The tribunal held that the state's failure to disclose key contractually relevant information in pre-contractual negotiations could amount to a breach of FET.[328] On the facts, the tribunal found that this failure of disclosure did not breach the FET standard as the claimant was on notice that it should rely on its own inquiries and was in a position to ascertain the information.[329] Similarly, in *PSEG* v. *Turkey*, the tribunal held that 'evident negligence' on the part of the host state in contractual negotiations with the claimant breached the FET standard.[330] These two

[322] *Bayindir* v. *Pakistan*, Award, para. 338. [323] Ibid., para. 344. [324] Ibid., para. 345.
[325] *Biwater* v. *Tanzania*, Award, para. 673. [326] *Rumeli* v. *Kazakhstan*, Award, para. 615.
[327] Ibid., para. 617. [328] *Jan de Nul* v. *Egypt*, Award, para. 221.
[329] Ibid., para. 229. [330] *PSEG* v. *Turkey*, Award, para. 246.

decisions can be read as imposing a requirement of procedural fairness in contractual negotiations broadly equivalent to the standard of procedural fairness required in administrative proceedings, as understood in *Chemtura*. Both decisions can be distinguished from *Bayindir* and *Biwater* on the basis that they did not impose procedural obligations on a state to enter into contractual negotiations nor additional obligations relating to the performance of existing contracts.

4.6.2.2 A requirement of lawfulness?

A state's compliance with domestic law can be understood as one aspect of procedural fairness, as a requirement of lawfulness constitutes a constraint on the manner in which a state may exercise its powers. Several decisions have examined the extent to which the FET standard requires a host state to act lawfully. In the NAFTA case *ADF* v. *US*, the claimant alleged that an administrative authority's failure to comply with the terms of its empowering statute breached the FET standard.[331] The tribunal held that 'something more than simple illegality or lack of authority under domestic law of a State is necessary' to breach the FET standard.[332] In another NAFTA case, *GAMI*, the claimant argued that the failure of the Mexican sugar industry regulator to fully implement the pricing and quota regulations that governed the industry breached the FET standard. The tribunal held that a 'failure to fulfil the objective of administrative regulations without more does not necessarily rise to a breach of international law.'[333] It found that the claimant had not proved that the regulator had a 'simple and unequivocal' duty to achieve the objectives of the regulatory regime, nor that the regulator had made an '"outright and unjustified repudiation" of the relevant regulations.'[334] These two decisions are consistent with the threshold defined in *Chemtura* – that procedural unfairness, here a failure to comply with domestic law, must be both serious and material to breach the FET standard.

The extent of a requirement of lawfulness was further explored in the decision *Noble* v. *Romania*. The tribunal held that the FET standard precluded a state from treating an investment in an arbitrary manner.[335] It quoted the ICJ's decision in *ELSI* to explain that arbitrariness, in this context, referred to

[331] *ADF Group* v. *United States*, Award, para. 190. [332] Ibid., para. 190.
[333] *GAMI Investments* v. *Mexico*, Final Award, para. 97. [334] Ibid., paras. 110, 103.
[335] *Noble Ventures* v. *Romania*, Award, para. 182.

[n]ot so much something opposed to a rule of law, as something opposed to the rule of law. . . . It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.[336]

The tribunal held that commencement of insolvency proceedings against the claimant was not arbitrary because the proceedings were 'initiated and conducted according to the law and not against it.'[337] The suggestion that unlawfulness must be wilful appears to introduce a requirement of intent.[338] However, the following phrase – which affirms that arbitrariness includes action that surprises juridical propriety – appears to leave the possibility open that serious disregard of national law would breach FET, even if an intention to ignore national law were not established.

4.6.2.3 Transparency

Several tribunals have held that the FET standard imposes an obligation of transparency on host states. Discussion of 'transparency' in the reasoning of FET decisions is complicated by differences in the way the term is used.[339] Transparency is best understood as one aspect of the procedural element of the FET standard. Although both commentators and tribunals have linked the requirement of transparency to the protection of legitimate expectations,[340] this association is not doctrinally sound. A state may change domestic law in a way that an investor did not anticipate and still inform the investor openly, promptly and clearly that the law has so changed. Such a situation could not be said to lack transparency (save, perhaps, in the narrow circumstance in which a state had concealed a prior intention to change the law). Conversely, a state may refuse to make new regulations publicly available – yet, if the content of such secret regulations were entirely consistent with an investor's expectations, such a situation could not be said to breach an investor's legitimate expectations.

The better view is that any requirement of transparency under the FET standard refers to an obligation on the host state that

[336] Ibid., para. 176, citing: *Elettronica Sicula SpA (United States of America* v. *Italy)*, Judgment of 20 July 1989, para. 128.

[337] *Noble Ventures* v. *Romania*, Award, paras. 178.

[338] Similarly, *Teco* v. *Guatemala*, Award, para. 458.

[339] See Section 4.4.1.

[340] E.g., Dolzer and Schreuer, *Principles of International Investment Law* (2nd edn), p. 149; Wälde, 'Energy Charter Treaty-based Investment Arbitration' (2004) 5 *Journal of World Investment and Trade*, p. 387; *Occidental* v. *Ecuador (I)*, Final Award, para. 185.

all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made under an investment treaty should be capable of being readily known to all affected investors.[341]

This is consistent with the threshold articulated in *Chemtura*. A state that did not make it possible for an investor to ascertain the content of the laws that applied to its investment would perpetrate a serious unfairness, material to the investor's ability to operate its investment. The tribunal in *Champion Trading* v. *Egypt* applied this understanding of transparency in a claim brought by a cotton company regarding administrative decrees that determined the sale price of cotton.[342] The tribunal dismissed the claim, finding that the claimants 'were in a position to know beforehand all rules and regulations that would govern their investments for the respective [cotton] season to come.'[343]

4.6.2.4 Restatement of the intermediate approach

Chemtura concerned the degree of procedural fairness to which an investor is entitled in administrative proceedings that directly affected the claimant's interests. The threshold articulated in that decision is capable of explaining and justifying a number of other decisions concerning the procedural element of the FET standard. This set of cases provides the outline of a coherent interpretation of the procedural element of FET, one embodied in the following propositions:

1. Procedural unfairness will breach the FET standard if it is both serious in itself and material to the outcome of proceedings that directly affect the investor.
2. A state may breach this threshold without the procedural unfairness leading to an outcome that is substantively unjustified or irrational.
3. A state may breach this threshold without acting in bad faith.
4. The record as a whole, including the availability of recourse under domestic law, determines whether the threshold has been breached.
5. Whether administrative proceedings breach this threshold will depend on assessment of what is fair in the specific context, which may include review of the following: whether the investor was notified of proceedings and given an opportunity to be heard in them; whether

[341] *LG&E Energy* v. *Argentina*, Decision on Liability, para. 128.

[342] The claimant originally framed this claim as a breach of the FET provision of the treaty but later framed it simply as a breach of 'international law'. The tribunal referred to a decision of the WTO Appellate Body and the *Tecmed* tribunal's discussion of the FET standard in addressing the claim. *Champion Trading* v. *Egypt*, Award, paras. 157–64.

[343] *Champion Trading* v. *Egypt*, Award, para. 164.

proceedings were conducted according to the requirements of domestic law; whether decision-making was based on the consideration of evidence; whether reasons were given for the decision; and whether the decision was reached in a timely manner.

6. Investors are not entitled to procedural fairness in contractual dealings, save that if a state does enter contractual negotiations with an investor, it must conduct itself fairly in those negotiations.
7. A state's serious and material failure to comply with its own law will breach the FET standard.
8. The procedural element of FET includes a transparency requirement that laws that apply to an investment should be readily capable of being known.

4.6.3 Tecmed*: an exacting approach*

The facts of *Tecmed* were described earlier in the chapter.[344] In its decision, the tribunal articulated a comprehensive conception of the FET standard, much of which addressed procedural requirements imposed by the standard. Portions of the relevant paragraph read as follows:

> 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 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.[345]

This tribunal's reasoning has been criticised for failing to apply its statement of the law to the facts of the case.[346] While noting this criticism, there can be no doubt that the paragraph purported to lay down the tribunal's understanding of the FET standard. It is introduced with the sentence '[t]he Arbitral Tribunal considers that this provision of the Agreement [the FET provision] . . . requires the Contracting Parties to . . . '.[347] The paragraph has also been cited as a statement of the content of the FET

[344] See Section 4.5.3.2. [345] *Tecmed* v. *Mexico,* Award, para. 154.
[346] Douglas, 'Nothing If Not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 *Arbitration International*, p. 28.
[347] *Tecmed* v. *Mexico,* Award, para. 154.

standard by other tribunals.[348] It may be that the tribunal felt no need to chart the outer boundary of the legal standard it had articulated because Mexico's conduct fell short of less exacting standards of conduct.

It is clear that the tribunal's interpretation of the procedural element of FET is more exacting than that of the *Chemtura* Tribunal. The *Tecmed* Tribunal's language is unqualified: a state must act 'totally transparently'; '[a]ny and all state actions' should be lawful and consistent with the goals underlying the laws in question. In this way, the *Tecmed* Tribunal suggests that *any* finding of procedural unfairness would breach the FET standard. The obvious contrast with the *Chemtura* approach is the absence of a threshold of seriousness or materiality before the identified classes of unfairness rise to the level of breaches of FET.

4.6.3.1 Transparency

The *Tecmed* dicta focused closely on unfairness that results from a state's failure to act in a way that is 'free from ambiguity and totally transparent'.[349] This entails a more exacting obligation on host states than the requirement that laws be capable of being known.[350] An investor may know the law that applies to its investment yet be faced with ambiguity, either because the terms of the law are not sufficiently precise or because the law confers a degree of discretion on the authorities that administer it. On the facts of the case, the *Tecmed* Tribunal held that the 'ambiguity and uncertainty' relating to the legal situation of the landfill breached the FET standard.[351] This ambiguity did not stem from any lack of clarity about the conditions governing the claimant's licence or the fact that the licence was – formally – only of one year's duration. Rather, the lack of transparency in the case stemmed from uncertainty about the way in which an administrative authority would exercise a discretion conferred by clear and certain general laws; specifically, the question of whether the investor's licence would be renewed.[352]

A similar understanding of the obligation of transparency under the FET standard was developed in *Metalclad* v. *Mexico*.[353] One of the reasons for the tribunal's decision that Mexico breached the FET standard was that it had failed to provide this degree of transparency.[354] Under Mexican

[348] *MTD* v. *Chile*, Award, para. 114; *Roussalis* v. *Romania*, Award, para. 316.
[349] *Tecmed* v. *Mexico,* Award, para. 154.
[350] Cf. *LG&E Energy* v. *Argentina*, Decision on Liability, para. 128; *Champion Trading* v. *Egypt*, Award, para. 164.
[351] *Tecmed* v. *Mexico*, Award, para. 172.
[352] *Tecmed* v. *Mexico*, Award, para. 172.
[353] *Metalclad* v. *Mexico*, Award, para. 76.
[354] Ibid., para. 88.

law, which was readily capable of being known, it was not clear whether the approval of the claimant's landfill by federal authorities exempted the claimant from the normal requirement of obtaining a municipal construction permit.[355] The fact that the municipal construction permit was denied at a meeting 'of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear' constituted further grounds for the finding that Mexico had breached the FET standard.[356]

4.6.3.2 Administrative proceedings

The *Tecmed* Tribunal did not explore the implications of its interpretation for the conduct of administrative proceedings in great detail. The tribunal did find that the environmental agency: failed to give the investor reasonable notice that, in the agency's view, the investor was in breach of its licence conditions; and that it failed to inform the investor that this could constitute grounds for non-renewal of the licence.[357] The tribunal did not consider whether these events would have constituted an independent breach of the FET standard.

Another case that held that procedural unfairness would breach the FET standard, without identifying a minimum threshold of gravity that such unfairness would need to exceed, is the early NAFTA decision *Pope & Talbot*.[358] The relevant facts concerned a Canadian government agency's 'verification review' of the investor's compliance with lumber regulations. The American investor was required to transport truckloads of documents to Canada for the review. Despite a request from the investor, the agency refused to consider holding the review at the claimant's offices in the United States or to provide reasons justifying its refusal. The tribunal characterised this conduct as placing a 'substantial and disruptive burden' on the claimant, a burden caused by agency's 'imperious insistence on having its own way.'[359] The tribunal drew further support for its conclusion from the fact that the agency refused to disclose what legal authority (if any) entitled it to conduct a review.[360] Although the claimant could have sought judicial review of these administrative actions,[361] the tribunal did not consider that this weighed against a finding of liability.[362]

[355] Ibid., paras. 81–6. [356] Ibid., para. 91. [357] *Tecmed* v. *Mexico*, Award, para. 161.
[358] *Pope & Talbot* v. *Canada*, Award on the Merits of Phase 2, paras. 116–18.
[359] Ibid., paras. 172–3. [360] Ibid., para. 174.
[361] Ibid., para. 183. [362] Ibid., paras. 156–81.

4.6.3.3 Procedural fairness in contractual dealings?

Although the *Tecmed* decision did not discuss procedural fairness in contractual dealings, it is consistent with the exacting approach of *Saluka*. The principal finding in *Saluka* was that the claimant's investment (a bank) had not been treated as well as locally owned banks.[363] However, the tribunal made a further finding that the procedural unfairness suffered by the claimant constituted an *independent* breach of FET. The claimant's bank was struggling to meet the capital adequacy requirements necessary to remain solvent and was seeking to negotiate the terms of a bailout with the host state. The claimant had no legal entitlement to be bailed out, nor had it received assurances that it would be bailed out. The host state made it clear from the outset that it would not gift funds to the claimant's bank unless the investor also injected new capital.[364] The bank subsequently failed.

The Tribunal held that the FET standard imposed a procedural obligation:

> [T]hat the host State [take] seriously a proposal that has sufficient potential to solve the problem and deal with it in an objective, transparent, unbiased and even-handed way.[365]

The tribunal found that the Czech Republic breached this obligation by declining to consider plans proposed by the investor in which the state would bailout the bank without the investor having to make any co-contribution.[366] The decision implies a duty on the state actively to consider (and to consider fairly) an investor's contractual proposals, even those that the state views as substantively unacceptable. This principle contrasts with the *Biwater* decision, which expressly rejected arguments that the FET standard imposes an obligation on host states to consider contractual proposals made by investors.[367]

4.6.3.4 Restatement of the exacting approach

The *Tecmed* decision articulated a clear and detailed interpretation of the procedural element of the FET standard. Although the trend in recent jurisprudence has been towards less exacting interpretations of the procedural element of the FET standard, the key paragraph from *Tecmed* award

[363] *Saluka* v. *Czech Republic*, Partial Award, paras. 314–47. [364] Ibid., paras. 385, 396.
[365] Ibid., paras. 363, 407. [366] Ibid., para. 398.
[367] Cf. *Biwater* v. *Tanzania*, Award, para. 673.

remains influential and is still cited by arbitral tribunals with approval.[368] The decisions identified in this section provide a basic outline of an interpretation of the procedural element of FET that differs significantly from *Chemtura*, one embodied in the following propositions:

1. Procedural unfairness will breach the FET standard. A finding of unfairness is sufficient to breach the standard without any additional finding that the unfairness exceeds a threshold of seriousness.
2. The availability of further administrative or judicial recourse does not necessarily weigh against a finding of unfairness.
3. The FET standard imposes an exacting transparency obligation on host states. Not only must laws be capable of being known, but the policies that underpin them and the manner in which they will be applied to particular fact scenarios must also be capable of being known in advance.
4. The FET standard entails a procedural obligation on states to actively and fairly consider contractual proposals made by investors.

4.6.4 Summary: the three interpretations of the procedural element of FET

This chapter has identified three interpretations of the procedural element of the FET standard:

i) A narrow approach, based on the *Genin*, in which procedural unfairness must be aggravated either by being intentional or by having led to an outcome that cannot be justified on substantive grounds for it to breach the FET standard;
ii) An intermediate approach, based on *Chemtura*, in which procedural unfairness is sufficient to breach the FET standard if it is 'both serious itself and material to the outcome' of an administrative process; and
iii) An exacting approach, based on the detailed set of procedural and transparency requirements outlined in *Tecmed*.

4.7 Substantive review of government conduct under the FET standard

Many arbitral awards have held that the FET standard also allows tribunals to review government conduct on substantive grounds. For example, in *Saluka* the tribunal stated that any government conduct affecting an investment must be 'reasonably justifiable by public policies'

[368] E.g., *Roussalis* v. *Romania*, Award, para. 316.

in order to comply with the FET standard.[369] Academic commentators generally agree. In commentary, discussion of this substantive element of the FET standard is organised under the labels of 'unreasonableness',[370] proportionality,[371] or 'arbitrariness' (using arbitrariness to mean absence of substantive justification).[372] However, unlike the legitimate expectations and procedural review elements of the FET standard, there is a small but significant set of arbitral decisions that rejects the possibility of review of government conduct on substantive grounds under the FET standard.

The recent popularity, and potential breadth, of the doctrine of legitimate expectations has meant that fewer decisions have considered the substantive element of the FET standard than would otherwise be the case. The review of government conduct on substantive grounds bears a particularly close similarity to the 'stability approach' to legitimate expectations. This similarity is clearest in the reasoning of *El Paso* v. *Argentina* tribunal, in which the two concepts were largely merged:

> [T]he legitimate expectations of a foreign investor can only be examined by having due regard to the general proposition that the State should not unreasonably modify the legal framework or modify it in contradiction with a specific commitment not to do so.[373]

Nevertheless, there are several good reasons to distinguish substantive review under the FET standard from the protection of legitimate expectations. First, most tribunals agree that a foreign investor must have *relied* on the legal status quo in making its investment in order to claim a legitimate expectation protected by the FET standard.[374] In contrast, substantive review of government conduct under the FET standard would allow a foreign investor to challenge any government conduct that affects its investment without needing to show reliance. Second, and contrary to the extract of the *El Paso* decision quoted earlier, the majority of tribunals have held that the doctrine of legitimate expectations is limited to situations in which a state infringes either a legal right vested in the investor or a specific representation made to the investor. In contrast, substantive review of government conduct under the FET standard would,

[369] *Saluka* v. *Czech Republic*, Partial Award, para. 307.
[370] Vandevelde, *Bilateral Investment Treaties*, p. 202.
[371] Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 236.
[372] Salacuse, *The Law of Investment Treaties*, p. 240. [373] *El Paso* v. *Argentina*, Award, para. 364.
[374] E.g., *Frontier Petroleum* v. *Czech Republic*, Final Award, paras. 287–8.

however conceived, allow a tribunal to examine government conduct that is neither inconsistent with a representation made to the investor nor in breach of the investor's legal rights. In both of these respects, the substantive review element of the FET standard would allow foreign investors to challenge a broader range of government conduct than could be challenged under the doctrine of legitimate expectations. (Although a greater range of government conduct could be challenged under principle of substantive review, the legal principles applied in the course of substantive review under the FET standard may be more lenient, from the perspective of the state, than those applied under the doctrine of legitimate expectations.)

In this section, I identify four different interpretations of the substantive review element of the FET standard. Section 4.7.1 examines decisions that have held that the FET standard does not provide for the review of government conduct on substantive grounds. Section 4.7.2 introduces the concept of reasonableness, which operates as an organising principle for several decisions interpreting the substantive review element of the FET standard. Sections 4.7.3 and 4.7.4 consider two different interpretations that are based on the principle of reasonableness. These two interpretations are distinguished by their different understandings of how a tribunal should determine whether government conduct pursues a 'rational' objective. Section 4.7.5 examines decisions endorsing the view that the substantive review element of the FET standard requires a tribunal to consider whether government conduct is proportionate.

Before examining arbitral reasoning, it is important to note that some investment treaties contain provisions that specifically prohibit the impairment of an investment by 'arbitrary and discriminatory' or 'unreasonable and discriminatory' measures. In applying these provisions, tribunals also engage in substantive review of government conduct. This chapter examines decisions interpreting and applying these provisions only insofar as the tribunal in question held that arbitrariness or unreasonableness in breach of these provisions would *necessarily* constitute a breach of FET. Some of the key decisions examining the substantive element of the FET standard – notably, *AES* v. *Hungary* and *Biwater* – are based on reasoning incorporated into the FET standard in this way.

4.7.1 The 'no substantive review' approach

The view that the FET standard does not allow for the substantive review of government conduct is most clearly articulated in Paparinskis'

scholarship on the history and development of the IMS. Having reviewed a range of legal material, both within and beyond investment treaty arbitration, he concludes that

> international law defers to the legitimacy of the purpose and means chosen to pursue it as such (unless they are entirely indefensible), but scrutinizes the formal and procedural safeguards against abuse in their implementation (the absence of which permits a more critical engagement with the ends and means).[375]

On this view, the FET standard does not grant arbitral tribunals a general jurisdiction to review government conduct on substantive grounds. Questions of whether government conduct is substantively justified arise only if a state has breached an investor's legal rights or treated the investor in a way that lacks procedural fairness. In these situations, any questions of substantive justification are purely internal to the legitimate expectations and procedural review elements outlined earlier.[376]

In the context of investment treaty arbitration, the view that the FET standard does not provide for generalised substantive review can be traced to the NAFTA decision *SD Myers* v. *Canada*. In the course of its brief discussion of the FET standard, the tribunal held that:

> [w]hen interpreting and applying the "minimum standard", a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive.[377]

Two more recent decisions have endorsed the same view. In *Paushok* v. *Mongolia*, the investor, a company engaged in gold mining, argued that a significant increase in the tax on gold sales breached the FET standard.[378] In rejecting the claim, the tribunal explained that

> the fact that a democratically elected legislature has passed legislation that may be considered as ill-conceived, counter-productive and excessively burdensome does not automatically allow to conclude that a breach of an investment treaty has occurred. If such were the case, the number of investment treaty claims would

[375] Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment*, p. 243.
[376] See, e.g., Section 4.5.1.1; Section 4.6.1.1.
[377] *SD Myers* v. *Canada*, Partial Award, para. 261.
[378] *Sergei Paushok* v. *Mongolia*, Award on Jurisdiction and Liability, para. 104.

increase by a very large number. Legislative assemblies around the world spend a good part of their time amending substantive portions of existing laws in order to adjust them to changing times or to correct serious mistakes that were made at the time of their adoption.[379]

The tribunal's view that 'ill-conceived, counter-productive and excessively burdensome' legislation would not breach the FET standard clearly precludes substantive review under the FET standard. The tribunal did not consider whether different principles would apply to the review of non-legislative measures.

Comments made by the NAFTA tribunal in *Mobil and Murphy Oil* v. *Canada* can also be read as rejecting the possibility of substantive review under the FET standard. In the course of rejecting the claimant's argument that the FET standard requires a state to provide stable legal framework, the tribunal explained:

> Article 1105 is not, and was never intended to amount to, a guarantee against regulatory change, or to reflect a requirement that an investor is entitled to expect no material changes to the regulatory framework within which an investment is made. Governments change, policies changes and rules change. These are facts of life with which investors and all legal and natural persons have to live with.[380]

That the tribunal rejected the possibility of substantive review under the FET standard is confirmed by the way it formulated its conclusions. It held that, in order to show that the FET standard had been breached, the claimant would have had to show either that the host state had breached a specific representation made to the investor or that the state's conduct amounted to serious procedural impropriety.[381]

4.7.1.1 Restatement of the 'no substantive review' approach

A small but significant number of tribunals, mostly within NAFTA, have held that the FET standard does not grant foreign investors a freestanding right to challenge government conduct on substantive grounds. This approach can be summarised as follows:

1. There is no freestanding substantive element to the FET standard; investors cannot challenge government conduct under the standard solely on the grounds that it lacks substantive justification.

[379] Ibid., para. 299.
[380] *Mobil and Murphy Oil* v. *Canada*, Decision on Liability and Principles of Quantum, para. 153.
[381] Ibid., paras 170–1.

2. Questions of whether government conduct is substantively justified arise only if a state has breached an investor's legal rights or treated the investor in a way that lacks procedural fairness. In these situations, any substantive review is internal to the scope and application of these doctrines.

4.7.2 Reasonableness review in general

Contrary to the view that the FET standard is not concerned with the strength of substantive justifications for conduct affecting foreign investments, several tribunals have held that the standard imposes a requirement of reasonableness. Among decisions that adopt reasonableness as the organising principle for the substantive review element of the FET standard, there is relative consensus on some issues and disagreement on others. These decisions agree on the following:

1. To comply with the FET standard, state conduct must be justifiable by some *rational objective* and be a *reasonable* attempt to advance that objective.
2. The substantive element of the FET standard is an independent basis for liability. A sufficiently irrational measure will breach the FET standard even if it is introduced and applied through a fair procedure and does not upset an investor's legitimate expectations.
3. The FET standard does not empower a tribunal to review the legal arrangements in place when the investor makes the initial investment (although it may review the subsequent exercise of a power or discretion conferred by a pre-existing law).[382]

Despite consensus on these basic issues, there is disagreement as to the degree of scrutiny to which a tribunal should subject a state's choice of policy objectives. This disagreement is particularly evident in the way in which tribunals deal with the 'politicisation' of government decision-making, which I use as a fault line to identify to distinct strands of reasoning within the set of decisions that endorses reasonableness as the basic organising principle. In one set of decisions, the politicisation of a measure is irrelevant to the assessment of whether it has a rational objective. In these decisions, tribunals allow states a wide discretion to define the objectives of their public policy. This interpretation is the subject of Section 4.5.3. I label it the margin of appreciation approach.[383] In a second

[382] *GAMI Investments* v. *Mexico*, Final Award, para. 91; Dolzer, 'Fair and Equitable Treatment', p. 102.

[383] I adopt the term 'margin of appreciation' from the jurisprudence of the European Court of Human Rights (ECtHR). The ECtHR allows states a margin of appreciation in

set of decisions, 'political reasons' are contrasted to rational objectives.[384] In these decisions tribunals scrutinise the motivations for a government's conduct and, in effect, invoke a presumption that a politically motivated measure does not pursue a rational objective. This interpretation is the subject of Section 4.5.4. I label it the politics-as-irrationality approach.

4.7.3 Reasonableness review: the margin of appreciation approach

AES v. *Hungary* concerned the reintroduction of regulated pricing in the electricity industry. The tribunal held that this change in the regulatory framework would breach the FET standard if it was substantively unreasonable.[385] The tribunal's expression of this legal standard was clear and concise:

> 10.3.7 There are two elements that require to be analyzed to determine whether a state's act was unreasonable: the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy.
>
> 10.3.8 A rational policy is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter.
>
> 10.3.9 Nevertheless, a rational policy is not enough to justify all the measures taken by a state in its name. A challenged measure must also be reasonable. That is, there needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented.[386]

The tribunal then assessed the three reasons Hungary argued had justified the reregulation of pricing. The first was that it was necessary to overcome electricity generators' refusal to reduce the capacity that they produced and sold to the state under existing contracts. The tribunal

its assessment of whether a given interference with property rights pursues a 'legitimate aim "in the public interest"': *James* v. *UK* (1986) 8 EHRR 123, para. 50; Winisdoerffer, 'Margin of Appreciation and Article 1 of Protocol No 1', p. 19. However, I do not intend to suggest that the way these arbitral tribunals approach the question of the existence of a 'rational policy' is identical to the way the ECtHR approaches the question of the existence of a 'legitimate aim "in the public interest"'. Nor do I intend to suggest that arbitral tribunals consciously imported this concept from the jurisprudence of the ECtHR.

[384] Peterson was the first to note this contrast between the *AES* and *Biwater* decisions: Peterson, 'Hungary Prevails in First of Three Energy Charter Treaty (ECT) Arbitrations over Power Pricing Disputes; Arbitrators Affirm That "Politics" Is Not a Dirty Word' (2010) *IA Reporter* [online].

[385] *AES Summit Generation* v. *Hungary*, Award, paras. 9.3.37–38.

[386] Ibid., paras. 10.3.7–9.

held that the *aim* of forcing a private party to give up contractual rights could not, in itself, qualify as a rational public policy. It contrasted this to a situation in which pursuit of some other rational policy affects an investor's contractual rights, a situation that would be consistent with the rational objective requirement.[387] (At this point, it is important to note that the contracts in question did not fix the price at which the state was required to purchase electricity but only the volume of electricity that generators were entitled to sell to the state).[388] The second was that the measure was necessary for Hungary to comply with European law. The tribunal accepted that this could be a rational policy, although, because concerns under European law had not crystallised until after the measure was introduced, they could not provide a rational justification for it on the facts of the case.[389] The third reason for reregulation was that 'in the absence of either competition or regulation' the generators' profits on the fixed-volume electricity sale contracts 'exceeded reasonable rates of return for public utility sales.'[390] The tribunal held that it was

> a perfectly valid and rational policy objective for a government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational.[391]

Perhaps the most significant finding of the tribunal related to the significance of the politicisation of electricity pricing, stemming from public opposition to the higher prices that resulted from unregulated pricing. The tribunal held that

> the level of the generators' returns became a public issue and something of a political lightning rod in the face of upcoming elections.
>
> 10.3.23 However, the fact that an issue becomes a political matter, such as the excessive profits of the generators and the reintroduction of the Price Decrees, does not mean that the existence of a rational policy is erased.
>
> 10.3.24 In fact, it is normal and common that a public policy matter becomes a political issue; that is the arena where such matters are discussed and made public.[392]

Having accepted that redressing excessive profitability in one sector of the economy was a rational public policy objective, the tribunal held that reregulating pricing was a reasonable way to achieve that objective.[393]

[387] Ibid., para. 10.3.13. [388] Ibid., para. 4.4–11. [389] Ibid., para. 10.3.16.
[390] Ibid., para. 10.3.20. [391] Ibid., para. 10.3.34. [392] Ibid., para. 10.3.22.
[393] Ibid., para. 10.3.35.

The regulated price was set to allow investors an annual profit of 7.1% of the value of the investment.

A line of earlier decisions are consistent with the principles of substantive review under the FET standard articulated in *AES* v. *Hungary*. In these cases, the analysis of whether conduct is justified by a rational policy and the assessment of whether it is a reasonable attempt to achieve this policy are often closely intertwined. For example, in *Pope & Talbot*, the tribunal held that adjustment of lumber quotas to the claimant's detriment did not breach the FET standard because it was a 'reasonable response to the difficulty with which it [the host state] had to deal'.[394]

In a more recent NAFTA decision, *Glamis Gold*, the tribunal observed that 'it is not for an international tribunal to delve into the details of and justifications for domestic law.'[395] In isolation, this statement could be read as implying that the FET contains no substantive element. However, the tribunal went on to confirm that conduct with a 'manifest lack of reasons' would breach the standard.[396] By lack of reasons, the tribunal meant lack of rational justification, not a failure to state reasons. It found that the host state had met this requirement because a new measure requiring backfilling of goldmines was 'rationally related to its stated [environmental] purpose and reasonably drafted to address its objectives.'[397] The tribunal also addressed the fact that the new backfilling regulation appeared to be partially motivated by public opposition to the mine on environmental grounds. Indeed, one member of Californian legislature had stated as much.[398] The tribunal held that the fact that the mine was politically contentious and the new measure had been designed to apply to it did not foreclose the question of whether the measure had a rational policy objective:

> [E]ven if an individual [legislator] did single out the Imperial Project, it could be in the nature of describing a symbol that has come to represent the harm that the legislature is striving to remedy. Symbols often can serve as a rallying call for expedited action; if, however, this symbolic project is merely a very visible member of a larger class of projects that are viewed as harmful by the legislature, and which also are addressed by the subsequent litigation [sic], it cannot be said that this project alone was 'targeted.'[399]

The decision in *Merrill Ring* was unusual in that the members of the tribunal were unable to agree on the interpretation of Article 1105(1) of

[394] *Pope & Talbot* v. *Canada*, Award on the Merits of Phase 2, para. 125.
[395] *Glamis Gold* v. *United States*, Award, para. 762. [396] Ibid., para. 779.
[397] Ibid., para. 803. [398] Ibid., paras. 703–10. [399] Ibid., para. 792.

NAFTA.[400] To sidestep this disagreement, the tribunal applied both the interpretation of the FET standard asserted by the claimant and that asserted by the respondent to the facts.[401] It found that the host state had not breached either threshold. Nevertheless, the split reasoning of the tribunal neatly encapsulates the difference between the two interpretations of reasonableness identified in this chapter. The interpretation advanced by the host state echoed the *AES* v. *Hungary* decision. Applying this interpretation, the tribunal held that encouraging local processing of timber was a rational policy objective, notwithstanding that it benefited the Canadian timber processing industry at the expense of the Canadian logging industry.[402] The lumber export quota system, of which the claimant (a US investor in the Canadian logging industry) complained, was a reasonable attempt to encourage local processing.[403]

Two further decisions focus more closely on the second-stage of substantive review – the requirement that a measure be reasonable in relation to its objective. Discussing Argentina's response to its financial crisis, without specific reference to the FET standard, the *Metalpar* Tribunal held that

> [e]xcept in very obvious situations, it is extremely difficult to determine at the time such decisions are made, and even some time afterwards, whether said decisions were the best they could have been. . . . Resolving whether the actions taken by the Argentine Republic . . . were correct and taken in a timely manner . . . are discussions that go beyond this Tribunal's sphere of action.[404]

This decision suggests that reasonableness under the FET standard requires only a rational connection between the measure and the achievement of the policy objective pursued by the measure – an interpretation that is consistent with the *AES* v. *Hungary* Tribunal's requirement of an 'appropriate correlation' between means and ends.[405]

The same understanding of reasonableness – rational connection between means and ends – was applied in *Eastern Sugar*. The majority of the tribunal held that two reorganisations of the Czech sugar production quota, both of which disadvantaged the claimant relative to other producers, did not breach the FET standard.[406] In making these findings, the tribunal implicitly accepted that reduction of the sugar quota in line

[400] *Merrill & Ring Forestry* v. *Canada*, Award, para. 246. [401] Ibid., para. 219.
[402] Ibid., para. 236. [403] Ibid., para. 237.
[404] *Metalpar* v. *Argentina*, Award on the Merits, paras. 198–9.
[405] *AES Summit Generation* v. *Hungary*, Award, para. 10.3.9.
[406] *Eastern Sugar* v. *Czech Republic*, Partial Award, paras. 277, 284–5.

with European Community rules was a rational policy objective and that, although poorly designed and implemented, these two measures had a reasoned connection to the realisation of this objective.[407] It was only a third reorganisation of the quota, in which the claimant's quota was cut by more than the entire national quota reduction, that the tribunal found could not be justified by this objective. The state offered no rational justification for the fact the burden was concentrated on the claimant.[408] A measure that *increased* other producers' quotas at the expense of the claimant had no rational connection with the objective of reducing the industry's total sugar production.

4.7.3.1 Restatement of the margin of appreciation approach

This set of decisions is best explained and justified by the doctrinal principles carefully articulated in *AES* v. *Hungary*. To comply with the substantive element of the FET standard:

1. Conduct must be capable of justification by a rational policy and be a reasonable attempt to achieve that policy.
2. A tribunal should show a high degree of deference to a state's choice of policies. The fact that a policy objective is highly politicised does not bear on the question of whether the objective is rational.
3. The assessment of reasonableness requires a rational connection between means and ends; it does not impose a requirement of proportionality or 'least restrictive means'.

4.7.4 Reasonableness review: the politics-as-irrationality approach

In *Biwater* v. *Tanzania*, the tribunal was required to apply an investment treaty provision prohibiting unreasonable or discriminatory measures. It cited the *Saluka* decision as authority for the proposition that 'the standard of "reasonableness" has no different meaning than the "fair and equitable treatment" standard'.[409] The tribunal held that the standard of reasonableness requires that government conduct 'bears a reasonable relationship to some rational policy'.[410] Stated at this level of generality, this interpretation of the substantive element of the FET standard is no different to that articulated in *AES* v. *Hungary*. However, when it came to apply the law to the facts, the tribunal showed less deference to the host state's choice of policy objectives.

[407] Ibid., paras. 261, 290–1. [408] Ibid., para. 336.
[409] *Biwater* v. *Tanzania*, Award, para. 692. [410] Ibid., para. 693.

The case arose out of events relating to the termination of a Tanzanian water concession held by the claimant. The privatisation of the water supply and the poor performance of the concessionaire had become contentious political issues. Although the host state was entitled to terminate the concession on account of the claimant's defective contractual performance, the tribunal held that the state's conduct up to the termination could not be justified by rational policies. The tribunal identified a number of occasions on which the state's conduct lacked substantive justification, of which two are particularly relevant. On 13 May 2005, the water minister held a press conference at which he criticised the claimant's performance of the contract and announced that the contract had been terminated. On 17 May 2005, the minister addressed the concession's staff and also claimed that concession had been terminated. Although the tribunal agreed that, by early May, the government had initiated the process necessary to terminate and that termination was 'inevitable', it found that the concession was not legally terminated until the end of the contractual cure period on 24 June 2005.[411]

In this context, Tanzania argued that the premature claims of termination could be justified by the 'rational policy of keeping citizens apprised of matters that affect their lives.'[412] The tribunal rejected this argument as an attempt to provide an 'ex post facto' justification for statements that were, in fact, politically motivated:

> The press conference exceeded the bounds of normal information, included severe criticisms of BGT [the claimant] which were at least in part clearly motivated by political considerations.[413]

In other cases, tribunals have reviewed the justifications for government conduct, without explicitly identifying the standard as one of rationality. Nevertheless, these cases are consistent with rationality review in which politically motivated conduct is presumptively unreasonable. In *Merrill Ring*, the tribunal applied the two distinct interpretations of the substantive element of FET to the facts. In the application of the broader interpretation, the tribunal held that the investor was entitled to be free from 'interference from government regulations which are not underpinned by appropriate policy objectives.'[414] The tribunal suggested that the objective of supporting an industry, when such support was to the detriment of another industry, would not be a rational policy objective.[415]

[411] Ibid., paras. 625–6. [412] Ibid., paras. 683, 686. [413] Ibid., paras. 696, 698.
[414] *Merrill & Ring Forestry* v. *Canada*, Award, para. 233. [415] Ibid., para. 233.

Applying this interpretation, the tribunal noted that the lumber regulations of which the claimant complained 'appear to be geared towards some sort of benefit to the local [timber processing] industry.'[416] It also noted that the regulations were designed by an industry co-regulatory institution of which representatives of the timber processing industry were members. This politicised institution was contrasted with a 'truly independent body'.[417] Despite these criticisms, the tribunal concluded that the FET standard had not been breached, a conclusion that is difficult to reconcile with the reasoning that precedes it.[418]

Azurix v. *Argentina*, like *Biwater*, concerned the termination of a water concession operated by the claimant. The dispute arose out of a long-running disagreement between the parties about tariffs and costs under the contract. The claimant sought to terminate the concession on the basis of non-compliance by the provincial government. The government denied that it was in breach and insisted that the claimant had abandoned the concession.[419] In its assessment of the facts, the tribunal accepted some of the claimant's contentions relating to the contract and rejected others; it did not make an ultimate finding of whether, under Argentine law, the claimant was entitled to terminate on the basis of the province's non-compliance.[420] Instead, the tribunal resolved the FET claim by examining whether the province's conduct was justified. It held that Argentina had breached the FET standard because the positions taken by the water regulator in the dispute with the concessionaire were motivated by popular opposition to tariff increases: 'the tariff regime was politicized because of concerns with forthcoming elections'.[421]

The tribunal in *Tecmed*, the facts of which were described earlier in the chapter, displayed a similar understanding of the substantive element of FET.[422] Although the primary basis for the state's liability in the case was breach of the investor's legitimate expectations, the tribunal also held that conduct 'arbitrarily revoking any pre-existing decisions or permits issued by the State' would breach the FET standard.[423] When it came to apply this element, the tribunal noted that the environmental agency's decision not to renew Tecmed's operating permit was motivated by the fact the waste facility had become 'a nuisance due to political reasons relating to the community's opposition'.[424] Because the decision

[416] Ibid., para. 226. [417] Ibid., para. 228. [418] Ibid., paras. 226–30.
[419] *Azurix* v. *Argentina*, Award, para. 374. [420] Ibid., paras. 225–61.
[421] Ibid., paras. 375, 92, 378. [422] See Section 4.5.3.2.
[423] *Tecmed* v. *Mexico*, Award, para. 154. [424] Ibid., para. 164.

was motivated by political concerns it was not, in the tribunal's view, justified by environmental or public health objectives.[425]

The *Biwater*, *Azurix* and *Tecmed* decisions all concluded with findings that the measure impugned in the case was not related to a rational policy. These awards had no need to continue to the second stage of analysis – whether the measure in question was reasonable in relation to a rational policy.[426] It is impossible to know whether they would have required a rational connection between means and ends or whether they would have adopted some other, perhaps stricter, understanding of reasonableness. As such, the legal content of this interpretation of the substantive element of FET is not yet fully defined.

4.7.4.1 Restatement of the politics-as-irrationality approach

Of these four decisions, only *Biwater* employs the language of reasonableness and rationality. Nevertheless, it is clear that the *Merrill Ring*, *Azurix* and *Tecmed* Tribunals determined states' liability under the FET standard by reviewing the conduct of the host state on substantive grounds. In all these decisions, the tribunals sought to determine whether the host state's conduct was justified by a rational policy objective. These tribunals (including *Biwater*) engaged in a more detailed examination of the objectives that did, in fact, motivate the conduct of the state in question than tribunals adopting the margin of appreciation approach. This distinction is clearly illustrated by the former's approach to politically motivated conduct. None of these decisions explored the legal contours of the second-stage of substantive review: the requirement that a measure must bear a reasonable relationship to the rational policy that provides its justification. However, it is important to note that they did not purport to introduce requirements of proportionality or a 'least restrictive measure' test. According to these decisions, to comply with the substantive element of the FET standard:

1. Conduct must be capable of justification by a rational policy and be a reasonable attempt to achieve that policy.
2. A tribunal should not defer to a state's choice of objectives. The fact that a policy objective is politicised creates a presumption that it is not rational.

[425] Ibid., paras. 129–30. This aspect of the *Tecmed* Tribunal's reasoning has been criticised in detail in Schneiderman, 'Investing in Democracy? Political Process and International Investment Law' (2010) 60 *University of Toronto Law Journal* 909.

[426] *Biwater* v. *Tanzania*, Award, para. 693.

4.7.5 *The proportionality approach to substantive review*

A final interpretation of the substantive element of the FET standard is based on the principle of proportionality. In recent years, several academic commentators have argued that the principle of proportionality should be applied in the review of government conduct under the FET standard.[427] However, arbitral tribunals have been less enthusiastic.[428] Reasonableness is still more commonly cited and applied as the basis for substantive review under the FET standard. Nevertheless, in light of the *Occidental* v. *Ecuador* (*II*) decision, there is now a line of cases endorsing an approach to substantive review under the FET standard based on the principle of proportionality.

In some early arbitral awards, the concept of proportionality is mentioned alongside other principles of substantive review. For example, in *Vivendi II*, the tribunal concluded that the respondent's 'irresponsible, unreasonable and disproportionate' actions breached the FET standard.[429] Similarly, in *El Paso*, the tribunal opined that 'fair and equitable treatment is a standard entailing reasonableness and proportionality.'[430] However, despite these general statements, neither tribunal conducted a proportionality analysis when it came to apply the FET standard to the facts of the case.

The suggestion – implicit in both the *Vivendi II* and *El Paso* awards – that the principles of 'reasonableness' and 'proportionality' are equivalent is at odds with the academic literature and with the way that other tribunals have understood these concepts.[431] Review of whether government conduct is reasonable involves an examination of whether government conduct pursues a rational policy and is a reasonable attempt to achieve that policy, in the sense of their being a rational connection between the means adopted and the end pursued.[432] Proportionality review is significantly more intrusive. In addition to the examination required by

[427] Kingsbury and Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality' in Schill (ed), *International Investment Law and Comparative Public Law* (2010), p. 97; Diehl, The Core Standard in *International Investment Protection*, p. 337; Montt, *State Liability in Investment Treaty Arbitration*, p. 357.

[428] Kläger, *'Fair and Equitable Treatment' in International Investment Law*, p. 245.

[429] *Compañia de Aguas del Aconquija and Vivendi* v. *Argentina (II)*, Award, para. 7.4.26; similarly, *MTD* v. *Chile*, Award, para. 109.

[430] *El Paso* v. *Argentina*, Award, para. 373.

[431] E.g., Henckels, 'Indirect Expropriation and the Right to Regulate', p. 229.

[432] E.g., *AES Summit Generation* v. *Hungary*, Award, paras. 10.3.7–9.

reasonableness review, proportionality review in most legal systems requires two further stages of scrutiny.[433] For government conduct to be proportionate, it must be the least restrictive means of achieving the objective in question, and the burden on the claimant must be proportionate in light of the objective pursued.[434] Tribunals that suggest 'reasonableness' and 'proportionality' are equivalent misunderstand both concepts and should not be taken as persuasive authority for the application of either principle.

The tribunal in *EDF* v. *Romania* was the first decision to apply the principle of proportionality in the course of substantive review of government conduct under the FET standard. The facts of the case are described earlier in the chapter. In the course of reviewing Romania's decision to abolish airport duty-free sales on substantive grounds, the tribunal held that

> in addition to a legitimate aim in the public interest there must be 'a reasonable relationship of proportionality between the means employed and the aim sought to be realized'; that proportionality would be lacking if the person involved 'bears an individual and excessive burden.'[435]

As Kläger has noted, the *EDF* v. *Romania* Tribunal proceeded directly from the question of whether a measure pursued a legitimate aim to the question of whether the burden on the claimant was proportionate in light of the objective pursued.[436] In doing so, the tribunal skipped over the question of whether the measure was the least means available to achieve Romania's chosen objective. As Section 2.5 explained, this step would normally be included in proportionality analysis in other legal systems.

The decision in *Occidental II* is the first, and so far the only, arbitral decision to apply a full proportionality analysis in the course of substantive review under the FET standard. The claim arose out of an oil participation contract between the claimant and the host state. The claimant had assigned its interest in the concession to a third party, conduct which the tribunal found was in breach of both the terms of the contract and the Ecuadorian Hydrocarbon Law.[437] Both the contract and Hydrocarbon Law (which had been in force at the time the contract was signed) were

[433] See Section 2.5.

[434] Kingsbury and Schill, 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions', pp. 85–7; Stone Sweet and Mathews, 'Proportionality Balancing and Global Constitutionalism' (2008) 47 *Columbia Journal of Transnational Law*, p. 75.

[435] *EDF* v. *Romania*, Award, para. 293.

[436] Kläger, *'Fair and Equitable Treatment' in International Investment Law*, pp. 244–5.

[437] *Occidental* v. *Ecuador (II)*, Award, para. 337.

explicit that any attempt by the claimant to assign its rights to a third party would give the state the right to terminate the contract.[438] Ecuador invoked its powers under the Hydrocarbon Law to terminate the contract, purportedly on the grounds of the claimant's breach of the Hydrocarbon Law. Although the tribunal recognised Ecuador's right to terminate the contract under the applicable law, the tribunal held that both Ecuador's constitution and the FET standard required Ecuador to exercise this right to terminate proportionately.[439] In a crucial passage, the tribunal argued that the requirement of substantive proportionality under the FET was binding, even if its analysis of Ecuadorian constitutional law proved to be incorrect.[440]

The tribunal then conducted a full proportionality review of Ecuador's decision to exercise its right to terminate the contract. It began by considering whether Ecuador's decision to cancel the contract advanced a public interest objective. The tribunal characterised Ecuador's objective as deterring future violations of contracts and accepted that this could be a legitimate objective.[441] The tribunal then conducted a detailed examination of whether this objective could have been achieved by other means. It identified a range of different courses of action the government might have adopted – for example, requiring the claimant to pay a fee – which would have achieved the objective of deterring contractual violations without having such a harsh impact on the claimant.[442] The tribunal did not conclude that the existence of equally effective alternatives involving lesser interference with the claimant's investment *automatically* meant that the government's conduct was in breach of the FET standard. However, the fact that such alternatives were available played an important role in justifying the tribunal's conclusion that termination of the contract was not proportionate on an overall assessment. On this basis, the tribunal found that Ecuador had breached the FET standard.[443]

4.7.5.1 Restatement of the proportionality approach to substantive review under the FET standard

A handful of arbitral tribunals have suggested that government conduct that affects foreign investment must be proportionate to be consistent with the FET standard. Many of these statements are incoherent in that they imply that the principles of 'proportionality' and 'reasonableness' are interchangeable. However, following the decision in *Occidental II*, a

[438] Ibid., paras. 119–21. [439] Ibid., paras. 396–409. [440] Ibid., para. 427.
[441] Ibid., paras. 416–18. [442] Ibid., para. 434. [443] Ibid., para. 452.

new interpretation of the substantive review element of the FET standard has emerged. This proportionality approach can be summarised in the following propositions:

1. To comply with the substantive element of the FET standard government conduct must advance a legitimate public interest objective.
2. In addition to advancing a legitimate objective, the interference with the claimant's investment must be proportionate in light of the objective pursued.
3. In examining whether the conduct is proportionate it is relevant, but not conclusive, that there are other means of achieving the public interest objective that involve lesser interference with the investment.

4.7.6 Summary: the four interpretations of the substantive element of FET

This chapter has identified four interpretations of the substantive element of the FET standard or, more precisely, three different interpretations of the substantive element of the FET standard along with a line of cases holding that the FET standard does not provide for substantive review of government conduct. The four approaches are as follows:

i) The FET standard does not provide for review of government conduct on substantive grounds.
ii) Government conduct must be reasonable to comply with the FET standard. This means that conduct must be capable of justification by a rational policy and be a reasonable attempt to achieve that policy. A state is entitled to a margin of appreciation in its choice of policy objectives.
iii) Government conduct must be reasonable to comply with the FET standard. This means that conduct must be capable of justification by a rational policy and be a reasonable attempt to achieve that policy. However, politically motivated conduct is presumptively irrational.
iv) Government conduct must be proportionate to comply with the FET standard.

4.8 Conclusion

Section 4.2 of this chapter argued that decisions interpreting differently worded FET provisions should be understood as one body of decisions interpreting the FET standard. The FET standard, as understood in these decisions, comprises several distinct elements, each of which is capable of operating as a quasi-independent liability rule. Having explained and justified the parameters of this chapter in Section 4.3, Section 4.4 argued that

decisions interpreting the FET standard are best understood by dividing them into decisions concerning the legitimate expectations, procedural and substantive elements of the standard.

Section 4.5 showed that tribunals have interpreted the legitimate expectations element in four different ways: the legal rights approach; the representations approach; the stability approach; and the business plan approach. Section 4.6 showed that tribunals have interpreted the procedural element of FET in three different ways: the narrow approach; the intermediate approach; and the exacting approach. Section 4.7 showed that tribunals have interpreted the substantive element of FET in four different ways: the 'no substantive review' approach; the margin of appreciation approach; the politics-as-irrationality approach; and the proportionality approach. This doctrinal analysis is, in itself, a contribution to scholarship on the FET standard. In the context of this book, the analysis in this chapter also performs a more specific function. Each interpretation identified in this chapter constitutes a different level of protection that might be explicitly adopted in future investment treaties or by the amendment of existing investment treaties. Chapter 6 applies the framework developed in Chapter 3 to evaluate these different levels of protection. This evaluation leads to a set of conclusions about the level of protection that investment treaties should provide to foreign investors.