BILATERAL INVESTMENT TREATIES

HISTORY, POLICY, AND INTERPRETATION

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Chapter 5

Reasonableness

5.1 INTRODUCTION

The reasonableness principle requires in essence that host-state treatment of foreign investment be reasonably related to a legitimate host-state regulatory objective. Thus, it prohibits treatment that is arbitrary or motivated by political or discriminatory considerations.

The reasonableness principle emerged as an explicit element in investment treaty practice only in the Cold War Era. The post-war U.S. FCNs prohibited "unreasonable or discriminatory measures" that impaired certain legally acquired rights, including rights in enterprises or in capital or technology. Those FCNs also required that covered property receive fair and equitable treatment, although that standard had as yet no clearly defined meaning.

The 1959 Abs-Shawcross convention similarly guaranteed fair and equitable treatment for foreign investment and prohibited unreasonable or discriminatory measures that impaired in any way the management, use, or enjoyment of covered property. In a comment they published on the convention, the authors explained that the fair and equitable treatment standard was drawn from U.S. treaty practice. They then explained that the prohibition on unreasonable conduct

> merely gives clear expression to a concept inherent in any system of law and which, in the sphere of international law, has been affirmed in general terms by the International Court of Justice in, for example, the advisory opinion on *Conditions of Admission of a State to Membership in the United Nations.*[1] The prohibition of measures of discrimination is in close accord with the principle laid down by the Permanent Court of International Justice in the *Case of Certain German Interests in Polish Upper Silesia.*[2]

1 Advisory Opinion of May 28, 1948, [1948] I.C.J. Rep. 57 [footnote in original].

2 Hermann Abs and Lord Shawcross, "The Proposed Convention to Protect Private Foreign Investment: A Round Table: Comments on the Draft Convention by its Authors," 9 *Journal of Public Law* 116 (1960). The citation for the *Upper Silesia* case is P.C.I.J. Ser. A, No. 7 (1926).

Thus, it was in the prohibition on unreasonable or discriminatory measures that the reasonableness principle explicitly entered investment treaty practice. Yet, as will be seen, investor-state arbitral tribunals have treated the reasonableness principle as an element of the fair and equitable treatment standard as well.

The reasonableness principle has become a widely applicable restriction on host-state treatment of foreign investment. Indeed, at times it has threatened to subsume, at least in part, the longer established principles of nondiscrimination and security.

First, as will be seen in Section 7.1, the nondiscrimination principle generally is violated only by unreasonable discriminations. Because an unreasonable discrimination by definition would violate the reasonableness principle, the nondiscrimination principle might seem to have been subsumed within the reasonableness principle. Yet, the nondiscrimination principle does retain some independent force. As discussed in Section 7.1, the nondiscrimination principle makes clear that discrimination is not a legitimate policy objective. Thus, the nondiscrimination principle establishes a minimum content to the reasonableness principle: certain host state conduct is per se unreasonable.

Second, as will be seen in Section 6.5.3.1, a very few tribunals have held that, in determining whether regulatory activity constitutes an expropriation, a tribunal must determine whether the impact on the investment was proportional to the public interest served. This proportionality analysis suggests that an investment may be destroyed without compensation by the host state provided that a sufficient public interest exists. Under this approach, the security principle behind the expropriation provision would be collapsed into the reasonableness principle. This approach, however, remains a distinctly minority approach that has been implicitly rejected by most tribunals.

5.2 FAIR AND EQUITABLE TREATMENT

5.2.1 Structure and Policy

The fair and equitable treatment standard defines the nature of the relationship between the host state and covered investment.[3] It establishes a set of norms applicable to every instance of host-state treatment of covered investment.[4] It is the most common general absolute standard of treatment in the BITs.

3 As discussed in Section 5.2.2, the Havana Charter, which inspired (at least in part) the inclusion of the fair and equitable treatment standard as a regular element of post-war treaty practice, would have authorized the International Trade Organization to make recommendations for and promote bilateral and multilateral agreements on measures designed "to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another." Art. 11(2)(a). That was the only characterization of the agreements. Thus, "just and equitable treatment" or its equivalent, "fair and equitable treatment," was understood from the beginning as a standard that characterized the entire relationship between the host state and foreign investment.

4 On the fair and equitable treatment standard generally, *see* Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (2007); Rudolf Dolzer,

The most typical formulation requires that the host-state accord covered investment fair and equitable treatment.[5] Sometimes the standard appears alone in a sentence and sometimes it appears in the same sentence as one or both of two other general absolute standards of protection: the full protection and security standard[6] and the prohibition on unreasonable or discriminatory measures.[7] This juxtaposition is more than casual. These other standards explicitly articulate principles of security, reasonableness, and non-discrimination that are among those at the core of the fair and equitable treatment standard.

Some BITs refer to fair and equitable treatment in conjunction with national or MFN treatment. The most common formulation requires fair and equitable treatment which in no case shall be less than national or MFN treatment.[8] That is, national and MFN treatment establish a minimum standard below which fair and equitable treatment may not fall, although fair and equitable treatment may require more than national or MFN treatment. Thus, some BITs explicitly link fair and equitable treatment with the principle of non-discrimination, although in a way that suggests that fair and equitable treatment requires more than non-discrimination.

Alternatively, some BITs refer to fair and equitable treatment in conjunction with customary international law. This formulation requires each party to provide covered investment with fair and equitable treatment that in no case shall be less than that required by customary international law.[9] Thus, in this formulation, international law establishes a minimum standard below which fair and equitable treatment may not fall, although fair and equitable treatment may require more than customary law. As the tribunal observed in *Azurix v. Argentina*, a case arising under the United States-Argentina BIT, which employs this formulation, "[t]he clause, as drafted, permits to interpret fair and equitable treatment and full protection and security as higher standards than required by international law. The purpose of the third sentence is to set a

"Fair and Equitable Treatment: A Key Standard in Investment Treaties," 39 *International Lawyer* 87 (2005); Christoph Schreuer, "Fair and Equitable Treatment in Arbitral Practice," *Journal of World Investment and Trade* 357 (2005); Katia Yannaca-Small, "Fair and Equitable Treatment Standard: Recent Developments," in *Standards of Investment Protection* (August Reinisch, ed. 2008); Barnali Choudhury, "Evolution or Devolution? Defining Fair and Equitable Treatment in International Investment Law," 6 *Journal of World Investment and Trade* 297 (2005).

5 *See, e.g.*, BLEU-Sudan BIT, Art. 3(1); Italy-Nicaragua BIT, Art. (3) ("just and fair"); Australia-India BIT, Art. 3(2); Indonesia-India BIT, Art. 3(2). *But see* Article 4(1) where fair and equitable treatment shall be not less favorable than MFN treatment; Chile-Lebanon BIT, Art. IV(1).

6 *See, e.g.*, United Kingdom-Bosnia-Herzegovina BIT, Art. 2(2); Germany-Timor-Leste BIT, Art. 2(2); Switzerland-Algeria BIT, Art. 4(1); Austria-Armenia BIT, Art. 3(1); Finland-Armenia BIT, Art. 2(2); Chile-Indonesia BIT, Art. III(2); Egypt-Zambia BIT, Art. 2(2); Cambodia-Vietnam BIT, Art. II(2).

7 *See, e.g.*, Netherlands-Ethiopia BIT, Art. 3(1); Sweden-Kazakhstan BIT, Art. 2(3); Chile-Indonesia BIT, Art. IV(1); Cambodia-Vietnam BIT, Art. III(1). *But see* Art. III(2), where MFN treatment is set as a floor.

8 *See, e.g.*, Denmark-Ethiopia BIT, Art. 3(1); Thailand-Argentina BIT, Art. 4.

9 *See, e.g.*, Finland-Armenia BIT, Art. 2(2).

floor, not a ceiling, in order to avoid a possible interpretation of these standards below what is required by international law."[10]

Other BITs link the fair and equitable treatment standard to customary international law, but in a way that suggests a different relationship between the standard and customary law. This language originated with Article 1105 of the NAFTA, which requires each party to accord covered investment "treatment in accordance with international law, including fair and equitable treatment and full protection and security." The United States incorporated similar language into its most recent BITs,[11] as have Canada[12] and Mexico.[13] Thus, the three NAFTA parties have taken the position that the fair and equitable treatment standard is an element of customary international law, although they have not defined the content of the standard. The 2004 U.S. model BIT does provide that "'fair and equitable treatment' includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world."[14] The use of the word "includes" indicates that the obligation not to deny justice does not exhaust the content of the standard.

Finally, some BITs link fair and equitable treatment with customary international law in a way that leaves the relationship ambiguous. The typical formulation of this type guarantees fair and equitable treatment in accordance with international law.[15] This language could be interpreted to mean either that fair and equitable treatment is required by customary international law[16] or that fair and equitable treatment must be consistent with customary international law.

Many of the earliest cases involving the fair and equitable treatment standard happened to arise under the NAFTA, in which the fair and equitable treatment standard is identified as an element of customary international law. Thus, several of the earliest awards discussed the relationship between the fair and equitable treatment standard and the international minimum standard.

The consequences of linking the fair and equitable treatment standard and the international minimum standard depend upon the assumptions one makes about the meaning of the international minimum standard in the absence of a link. Because of the debates in the mid-twentieth century about the existence and content of an international minimum standard, some believed that the international minimum standard might offer weak protection for foreign investment, such as in *Neer v. Mexico*,[17] where the tribunal

10 Award, para. 361. *Accord Duke Energy v. Ecuador* (United States-Ecuador BIT), Award, para. 336.

11 *See, e.g.*, United States-Uruguay BIT, Art. 5(1).

12 *See* 2003 Canadian Model BIT, Art. 5(1).

13 *See, e.g.*, Mexico-Iceland BIT, Art. 3(1).

14 2004 U.S. Model BIT, Art. 5(2)(a).

15 *See, e.g.*, Mexico-France BIT, Art. 4(1); Canada-Uruguay BIT, Art. II(2(a).

16 *See* Palitha Kohona, "Investment Protection Agreements: An Australian Perspective," 21 *Journal of World Trade Law* 79 (1987).

17 U.S.A. (L.F. Neer) v. United Mexican States, (United States-Mexico), October 15, 1926, 3 *International Law Reports* 213.

held that customary law protects aliens against host-state conduct involving outrage or bad faith. Indeed, one reason for the inclusion of the fair and equitable treatment standard in the post-war U.S. FCNs had been to provide a basis for treaty protection not dependent upon the contested international minimum standard. Where one takes that view of the international minimum standard, treaty language providing that fair and equitable treatment is an element of customary international law could be regarded as strengthening customary international law. For example, Article 1105 of the NAFTA could be regarded as a considerable achievement for the United States and Canada because they had persuaded Mexico, long a Calvo Doctrine country and historically a principal antagonist of the United States on the issue of the content of customary international law, to concede that an international minimum standard exists under customary law and that the standard is breached not only by acts of bad faith, but by any conduct that is not fair and equitable. Even the weakest reading of the terms "fair and equitable" would seem to require more than a mere avoidance of outrage and bad faith. In the absence of the reference to fair and equitable treatment, Article 1105 might have been interpreted to prohibit only outrageous conduct.

Others might take a more robust view of customary international law as an evolving standard that in the late twentieth century prohibited certain conduct even if not outrageous or in bad faith. Where this view is taken, incorporating the fair and equitable treatment standard into customary law might have done little to raise the minimum standard. In this view, the principal effect of the linkage thus might be merely to limit the fair and equitable treatment standard. For example, in *ADF Group v. United States*, a case arising under the NAFTA, the tribunal observed that "any general requirement to accord 'fair and equitable treatment' and 'full protection and security' must be disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary or general international law."[18] In *Mondev v. United States*, another case arising under the NAFTA, the tribunal noted that it "is bound by the minimum standard as established in State practice and in the jurisprudence of arbitral tribunals. It may not simply adopt its own idiosyncratic standard of what is 'fair' or 'equitable' without reference to established sources of law."[19]

Most tribunals, however, have found no need to address the relationship between the two standards. In the great majority of BITs, the fair and equitable treatment standard appears without a reference to customary international law and thus the text of the treaty does not require that the tribunal address the relationship.[20] The U.S. BITs do require both standards. Cases arising under the U.S. BITs nevertheless have often avoided the issue. As the tribunal explained in *Lauder v. Czech Republic*, a case arising under the United States-Czech Republic BIT, tribunals tend to address whether the host state's conduct violates the more specific language of fair and equitable treatment or full protection and security, where such language appears, rather than broader

18 Award, para. 184.

19 Award, para. 119.

20 *See, e.g.*, *MTD Equity v. Chile* (Malaysia-Chile BIT), Award, paras. 109–115.

language referring to the international minimum standard. In some cases, tribunals merely observe that, under the facts before them, they would reach the same decision whether fair and equitable treatment is part of customary international law or a separate, treaty-based standard.[21] In other cases, tribunals have found that the international minimum standard and the fair and equitable treatment standard are substantially the same.[22] In one case, the parties agreed that any violation of the international minimum standard also constitutes a violation of the fair and equitable treatment standard and, because the tribunal found a violation of the international minimum standard, it did not need to decide whether the fair and equitable treatment standard provided greater protection.[23]

Tribunal decisions applying the international minimum standard have made clear that the standard is an evolving one and that it has evolved beyond the language of *Neer*.[24] One might well conclude that the network of more than twenty-six hundred BITs, nearly all requiring fair and equitable treatment, has influenced customary law by suggesting that a standard of outrage or bad faith simply was anachronistic. That is, the fair and equitable treatment standard arguably has been highly successful in raising expectations concerning the level of protection to which investment is entitled under a BIT and, where a BIT refers to customary law, those heightened expectations have informed the interpretation of the international minimum standard under customary law. Thus, the international community appears to have moved past the situation where associating the fair and equitable treatment standard with customary law is necessary to raise the level of protection under customary law. Nor has associating the fair and equitable treatment standard with customary law served in most cases to limit the scope of the fair and equitable treatment standard. In general, tribunals have declined to distinguish carefully between the two standards and both have been interpreted to provide protection well beyond that of the *Neer* standard. The precise scope of protection is addressed in this and subsequent chapters.

Although the context in which the fair and equitable treatment standard appears varies, those differences have had little impact on the interpretation of the standard. 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.[25]

21 *See, e.g., Occidental v. Ecuador* (United States-Ecuador BIT), Award, para. 190; *Azurix v. Argentina* (U.S.-Argentina BIT), Award, para. 361; *CMS v. Argentina* (United States-Argentina BIT), Award, paras. 282–284.

22 *Azurix v. Argentina* (United States-Argentina BIT), Award, para. 364; *Duke Energy v. Ecuador* (United States-Ecuador BIT), Award, para. 337; *Biwater Gauff v. Tanzania* (United Kingdom-Tanzania BIT), Award, para. 592; *Saluka Investments v. Czech Republic* (Netherlands-Czech Republic BIT), Award, para. 291.

23 *See BG Group v. Argentina* (United Kingdom-Argentina BIT), Award, para. 290–291

24 *See, e.g., International Thunderbird v. Mexico* (NAFTA), Award, para. 194; *BG Group v. Argentina* (United Kingdom-Argentina BIT), Award, para. 302.

25 *See* Section 5.2.3.

In occasional instances, BITs require fair and equitable treatment in a specific context. For example, the 1980 Belgium-Luxembourg Economic Union-Cameroon BIT requires at Article 6(3) that the exchange rate used for transfers related to an investment be fair and equitable. Some U.S. BITs provide that each party "should strive to accord fairness and equity" with respect to its tax policies.[26] These special applications have not contributed significantly to the process of elucidating the meaning of the standard.

The fair and equitable treatment standard has been interpreted by tribunals to require adherence to five of the six core BIT principles: those of reasonableness, security, non-discrimination, transparency, and due process.[27] As I have argued elsewhere,[28] these five principles are related in that all are elements of the rule of law. Thus, the fair and equitable treatment standard instantiates the role of the BITs in promoting the rule of law.

5.2.2 Origins

Variations in the context in which the fair and equitable treatment standard appears have been a feature of the standard since the first BITs. The standard occasionally appeared in FCN practice prior to the 1940s, but was not consistently present in FCNs prior to the war.[29]

The 1948 Havana Charter for the establishment of the International Trade Organization, however, contemplated that the new organization would be authorized to make recommendations for international agreements on measures designed "to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another. . . ."[30] The Havana Charter did not further define the standard of just and equitable treatment.

That same year, the Organization of American States adopted the Economic Agreement of Bogota.[31] Article 22 of the agreement provided that "Foreign capital shall receive equitable treatment. The States therefore agree not to take unjustified, unreasonable or discriminatory measures that would impair the legally-acquired rights or interests of nationals of other countries in the enterprises, capital, skills, arts or technology they have supplied." By the use of the word "therefore," the OAS agreement seemed to associate fair and equitable treatment with reasonable and non-discriminatory treatment. The agreement, however, never received a sufficient number of ratifications to enter into force.

26 *See, e.g.,* United States-Egypt BIT, Art. XI.

27 *See, e.g., Biwater v. Tanzania* (United Kingdom-Tanzania BIT), where the tribunal found that fair and equitable treatment includes protection of legitimate expectations, good faith, transparency, consistency and nondiscrimination. Award, para. 602.

28 *See* Kenneth J. Vandevelde, "A Unified Theory of Fair and Equitable Treatment," (forthcoming).

29 *See* Section 2.1.

30 Havana Charter, Article 11(2). For an excellent discussion of the history of the fair and equitable treatment standard, *see* Stephen Vasciannie, "The Fair and Equitable Treatment Standard in International Investment Law and Practice," 70 *British Yearbook of International Law* 99 (1999).

31 Available at http://www.oas.org.

The fair and equitable treatment standard quickly was incorporated into the FCN treaties then being negotiated by the United States. For example, Article V of the U.S. FCN with Ireland, concluded in 1950, provided that "Each Party shall at all times accord equitable treatment to the capital of nationals and companies of the other Party." By the early 1950s, the United States was sometimes using the equivalent formulation "fair and equitable treatment." For example, Article I(1) of the U.S. FCN concluded with Germany in 1954 provided that "Each Party shall at all times accord fair and equitable treatment to the nationals and companies of the other Party, and to their property, enterprises and other interests."

In 1959, Hermann J. Abs and Lord Shawcross, acting at the behest of a group of European attorneys and business leaders, prepared a Draft Convention on Investments Abroad. Article 1 of the convention provided that "Each Party shall at all times ensure fair and equitable treatment to the property of nationals of the other Parties."[32] Article 1 also required that property receive the most constant protection and security and prohibited the impairment of the maintenance, use and enjoyment of property by unreasonable or discriminatory measures. The imposition of these three standards in a common article established a pattern widely followed in future BITs. In a commentary published with the draft convention, the authors explained that these three standards were based on U.S. FCN practice.[33]

That same year, when Germany signed the first BIT, with Pakistan, the fair and equitable treatment standard did not appear, despite the fact that the standard was known to Germany as a result of its FCN with the United States, which was signed in 1954 and entered into force in 1956. In its 1960 BIT with Malaysia, Germany required in its transfers provision, at Article 7(3), that a "fair and equitable" rate of exchange be used. The BIT with Pakistan, at Article 6(3), had read "just and reasonable". By 1961, however, Germany had adopted the fair and equitable treatment standard. Its BIT with Thailand, for example, provides at Article 2(3) that "[e]ach Contracting Party shall in its territory in any case accord such investments by investors of the other Contracting Party and their returns fair and equitable treatment and full protection." Germany's 1962 BIT with Turkey provided at article 1(1) that "In all cases the Contracting Parties shall accord these investments fair and equitable treatment."

When Switzerland inaugurated its BIT program in 1961, it employed the standard as well. Its first BIT, with Tunisia, required at Article 1 that each party accord investment "just and equitable" treatment, not less favorable than that accorded by that party to its own nationals. Thus, the Swiss language seemed to link the standard to national treatment, although national treatment appeared to set a minimum standard below which fair and equitable treatment could not fall. The following year, Switzerland added MFN treatment to the link.[34] Although this linkage continued into the 1970s

32 Hermann Abs and Lord Shawcross, "The Proposed Convention to Protect Private Foreign Investment: A Round Table: Comments on the Draft Convention by its Authors," 9 *Journal of Public Law* 116 (1960).

33 *Id.* at 119.

34 Switzerland-Guinea BIT, Art. 7.

in Swiss commerce, investment, and technical cooperation agreements, Swiss treaties limited solely to investment sometimes omitted the reference to national or MFN treatment and instead guaranteed fair and equitable treatment, conforming to international law.[35] By the early 1970s, that linkage also had disappeared and the Swiss BITs guaranteed fair and equitable treatment without further elaboration.[36] Yet, the fair and equitable treatment standard could sometimes be found in the same paragraph as the MFN and national treatment standards, reflecting Switzerland's continued association of the of fair and equitable treatment standard with the nondiscrimination principle.[37]

The Netherlands launched its BIT program in 1963, also with Tunisia. Article 1 of the Netherlands-Tunisia BIT required that investment receive treatment that was "just and nondiscriminatory" and that was no less favorable than that accorded to the host party's own nationals. By the mid-1980s, however, the Netherlands no longer linked the standard to national treatment, but rather included it with the full protection and security standard or the prohibition on unreasonable or discriminatory measures. For example, Article 4(1) of the 1984 Netherlands-Sri Lanka BIT provided that investments "shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security. . . ." Article 3(1) of the 1985 Netherlands-Yemen Arab Republic BIT provided that "Each Contracting Party shall ensure fair and equitable treatment to the investments of nationals of the other Contracting Party and shall not impair, by unjustified or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof. . . ."

In 1964, the Belgium-Luxembourg Economic Union (BLEU) inaugurated its BIT program, also with Tunisia. Article 1 required "fair and equitable treatment" of investment, a standard that remained in the BLEU BITs more than forty years later.[38] The first BLEU BIT further provided in the next paragraph that, "to that end," investment shall receive the same security and protection as investment of host-state nationals and nationals of any third country, suggesting that nondiscrimination was an element of fair and equitable treatment. The language quickly evolved, however, to suggest that MFN treatment was merely a floor below which fair and equitable treatment could not fall[39] and that international law provided a different such floor.[40]

Kuwait also commenced its BIT program in 1964, concluding a treaty with Iraq. Article 2 guaranteed to investments "just and equitable treatment as well as full protection in accordance with the provisions" of the treaty. Kuwait's BITs continue typically to require fair and equitable treatment.[41] The standard sometimes appears in the

35 *See, e.g.*, Switzerland-Tanzania BIT, Art. 1(1); Switzerland-Chad BIT, Art. 4(1).

36 *See, e.g.*, Switzerland-Egypt BIT, July 25, 1973, Art. 3(1); Switzerland-D.R. Congo BIT, March 10, 1972, Art. 2; Switzerland-Sudan BIT Feb. 17, 1974, Art. 3.

37 *See, e.g.*, Switzerland-Jordan BIT, Nov, 11, 1976, Art. 2(2); Switzerland-Syria BIT, June 22, 1977, Art. 2(2); Switzerland-Mali BIT, March 8, 1978, Art. 2(2).

38 *See, e.g.*, Belgium-Nicaragua BIT, Art. 3(1).

39 *See, e.g.*, Belgium-Indonesia BIT, Art. 1(1).

40 *See, e.g.*, BLEU-Republic of Korea BIT, Art. 2(3).

41 *See, e.g.*, Kuwait-Hungary BIT, Art. 2(3); Kuwait-Jordan BIT, Art. 4(1); Kuwait-Pakistan BIT, Art. 2(2); Kuwait-China BIT, Art. 2(2); Kuwait-Ethiopia BIT, Art. 4(1); Kuwait-Croatia BIT, Art. 4(1); Kuwait-Bulgaria BIT, Art. 3(2).

same paragraph as the prohibition on unreasonable or discriminatory measures[42] and sometimes with national or MFN treatment.[43]

Italy commenced a BIT program in 1964 as well, but did not include the standard in its BITs until 1985. The standard initially appeared alone in a paragraph,[44] but Italy soon included the standard in the same paragraph as the prohibition on unreasonable or discriminatory measures.[45]

Sweden's BIT program, which began in 1965 with a BIT with the Ivory Coast, linked fair and equitable treatment to international law as well as national treatment. Article VI provided that investments shall receive fair and equitable treatment, in accordance with international law and the domestic law of the parties and no less favorable than that accorded by each party to its own nationals or nationals of any third country. After concluding three BITs, Sweden suspended its BIT program. When the program resumed in 1978, the fair and equitable treatment standard no longer was linked with any other standard.[46] As the Swedish BITs added other absolute standards of treatment, these were included in the same paragraph as fair and equitable treatment.[47]

Denmark began its BIT program in 1965 by concluding a BIT with Madagascar. Article 6 of that BIT required fair and equitable treatment, no less favorable than that provided by the host state to its own nationals or to nationals of the most favored nation. The fair and equitable treatment standard disappeared from the Danish BITs in 1968,[48] only to reappear in 1980 in the Denmark-China BIT, where it was included in the same paragraph as the full protection and security provision and the observance of obligations provision.[49] By 1988, the prohibition on unreasonable or discriminatory measures appeared in the same paragraph as well.[50] In some of its more recent BITs, however, Denmark has placed the standard in a separate paragraph that requires fair and equitable treatment that in no case shall be less than national and MFN treatment.[51] In some cases, a second clause requires fair and equitable treatment with respect to the management, maintenance, use, enjoyment or disposal of investment.[52]

42 *See, e.g.*, Kuwait-Hungary BIT, Art. 2(3); Kuwait-China BIT, Art. 2(2).

43 *See, e.g.*, Kuwait-Jordan BIT, Art. 4(1); Kuwait-Ethiopia BIT, Art. 4(1); Kuwait-Croatia BIT, Art. 4(1); Kuwait-Bulgaria BIT, Art. 3(2).

44 *See, e.g.*, Italy-China BIT, Art. 1; Italy-Tunisia BIT, Art. 2(2).

45 *See, e.g.*, Italy-Hungary BIT, Art. 2(2); Italy-USSR BIT, Art. 2(2); Italy-Czechoslovakia BIT, Art. 2(2); Italy-Venezuela BIT, Art. 2(2); Italy-Nicaragua BIT, Art. II(3).

46 *See, e.g.*, France-Serbia and Montenegro BIT, Art. 2(1); Sweden-Egypt BIT, Art. 2(1).

47 *See, e.g.*, Sweden-Bosnia-Herzegovina BIT, Art. 2(1); Sweden-India BIT, Art. 3(1); Sweden-Ecuador BIT, Art. 2(3). Sweden-Kazakhstan BIT, Art. 2(3).

48 *See* Denmark-Indonesia BIT.

49 Denmark-China BIT, Art. 3(1). The standard was phrased as "equitable and reasonable treatment," while the full protection and security standard did not include the word "full".

50 *See, e.g.*, Denmark-Republic of Korea BIT, Art. 3(1).

51 *See, e.g.*, Denmark-Croatia BIT, Art. 3(1); Denmark-Kyrgyz Republic BIT, Art. 3(1); Denmark-Ethiopia BIT, Art. 3(1).

52 *See, e.g.*, Denmark-Croatia BIT, Art. 3(2); Denmark-Croatia BIT, Art. 3(2).

In 1967, the OECD adopted its Draft Convention on the Protection of Foreign Property. All of the OECD countries that were involved actively in BIT negotiations in the mid-1960s had adopted the fair and equitable treatment standard in their BITs and thus, not surprisingly, the draft convention included the standard. Article 1(a) of the convention provided that "Each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties," language that was almost identical to that of the Abs-Shawcross convention. The same article also required the most constant protection and security for investment and prohibited unreasonable or discriminatory measures that would impair foreign property, again the same approach used in the Abs-Shawcross convention.

Note 1 to the OECD draft convention asserted that there is "a well-established general principle of international law that a State is bound to respect and protect the property of nationals of other States" and that "[f]rom this basic principle flow the *three rules* contained" in Article 1(a). That is, all three of the U.S. FCN standards, fair and equitable treatment; most constant protection and security; and the prohibition on unreasonable or discriminatory measures, were part of the international minimum standard. At the same time, however, these three FCN standards did not exhaust the content of customary law. As Note 1(b) to Article 3 made clear, for example, customary law also imposes limitations on the right of a state to expropriate foreign owned property.

The OECD draft convention was not very illuminating with respect to the meaning of the phrase "fair and equitable treatment." Note 4(a) to Article 1 stated that the phrase

> indicates the standard set by international law for the treatment due by each State with regard to the property of foreign nationals. The standard requires that . . . protection afforded under the Convention shall be that generally accorded by the Party concerned to its own nationals, but, being set by international law, the standard may be more exacting where rules of national law or national administrative practices fall short of the requirements of international law. The standard required conforms in effect to the "minimum standard" which forms part of customary international law.

Note 7 observed that "[i]n many cases," a measure that violated the prohibition on unreasonable measures "will also violate the standard of 'fair and equitable treatment.'" Thus, the OECD draft convention indicated explicitly that the fair and equitable treatment standard incorporates principles of nondiscrimination and reasonableness as well as other principles embraced within customary law, which, given other provisions of the convention, such as that on most constant protection and security, would have included at least the security principle as well. The draft convention, in any event, was never opened for signature.

In the 1970s, several more developed counties inaugurated BIT programs. France had commenced a BIT program in 1960, signing BITs with Chad, the Central African Republic, and Congo over a five-day period in August 1960, but none of these ever entered into force. Although France's first BIT in the 1970s, with Tunisia, did not require fair and equitable treatment, its next BIT, with the D.R. Congo, did impose such a requirement at Article 2. Thus, the standard initially appeared in only some French BITs. By the late 1970s, the provision required fair and equitable treatment, conforming with the principles of international law.[53] Although some variations have appeared over the years,[54] that remains the approach used today.[55]

The United Kingdom concluded its first BIT, with Egypt, in 1975. Article 2(2) provided that "Investments of nationals or companies of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security. . . ." This remains essentially the language used in the U.K. BITs today.[56]

Austria's first BIT, concluded with Romania in 1976, employed the fair and equitable treatment standard as part of the MFN obligation.[57] That is, it required that each party provide to covered investment the fair and equitable treatment that it provided to investment of the most favored nation. Austria, however, subsequently adopted fair and equitable treatment as an independent standard.[58] In its more recent BITs, Austria couples the fair and equitable treatment standard with the full protection and security standard, which is phrased as "full and constant protection and security".[59]

Finland concluded its first BIT, with Egypt, in 1980. Article 2(1) of that BIT required fair and equitable treatment, but the obligation was subject to each party's laws and regulations. In the early 1990s, the subordination to local law was removed and the standard began to appear in a variety of contexts, sometimes accompanied by MFN or national treatment as a floor,[60] sometimes linked with a prohibition on unreasonable or discriminatory treatment,[61] and sometimes accompanied by the full protection and security standard.[62] In Finland's more recent BITs, the fair and equitable treatment standard typically appears accompanied by the full protection and security standard.[63]

The United States inaugurated a BIT program in 1977, but did not conclude its first BIT, with Egypt, until 1982. The Egypt BIT did not include a general requirement of fair and equitable treatment, although Article XI provided that each party "should strive to accord fairness and equity" with respect to its tax policies. The second U.S.

53 *See, e.g.*, France-Jordan BIT, Art. 3; France-Sudan BIT, Art. 3; France-Liberia BIT, Art. 3; France-Equatorial Guinea BIT, Art. 3.

54 *See, e.g.*, France-Hungary BIT, Art. 3 (fair and equitable treatment linked with the prohibition on unjustified or discriminatory measures rather than international law); France-Czechoslovakia BIT, Art. 3 (fair and equitable treatment linked to both international law and the prohibition on unjustified or discriminatory measures); France-Uruguay BIT, Art. 3 (fair and equitable treatment standard not linked to any other standard).

55 *See, e.g.*, France-Tajikstan BIT, Art. 4; France-Bahrain BIT, Art. 3; France-Bosnia-Herzegovina BIT, Art. 4.

56 *See, e.g.*, United Kingdom-Vietnam BIT, Art. 2(1); UK-Bosnia and Herzegovina BIT, Art. 2(1).

57 Austria-Romania BIT, Art. 3(1).

58 *See, e.g.*, Austria-Malaysia BIT, Art, 3(2); Austria-Chile BIT, Art. 3(1); Austria-India BIT, Art. 2(1).

59 *See, e.g.*, Austria-Bosnia-Herzegovina BIT, Art. 3(1); Austria-Armenia BIT, Art. 3(1); Austria-Jordan BIT, Art. 3(1); Austria-Libya BIT, Art. 3(1).

60 *See, e.g.*, Finland-Chile BIT, Art. 3(1).

61 *See, e.g.*, Finland-Turkey BIT, Art. 3; Finland-Vietnam BIT, Art. 2(2); Finland-Argentina BIT, Art. 2(2).

62 *See, e.g.*, Finland-Republic of Korea BIT, Art. 2(2).

63 *See, e.g.*, Finland-Algeria BIT, Art. 2(2); Finland-Armenia BIT, Art. 2(2); Finland-Azerbaijan BIT, Art. 2(2); Finland-Belarus BIT, Art. 2(2).

BIT, however, signed one month later with Panama, required at Article II(2) that investment "shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Party." A subsequent sentence required treatment in accordance with national law and international law. That language appeared in the U.S. BITs until the preparation of the 1984 model negotiating text, when the reference to national law was omitted. With the omission of the reference to national law, the United States shortened the text by adding the requirement of compliance with international law to the sentence requiring fair and equitable treatment and full protection and security. The new language thus read, "Investments shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law."[64] The U.S. language remained unchanged until the 1994 model, when some stylistic changes were made.[65]

Thus, by the early 1980s, the fair and equitable treatment standard was widely employed in BITs, although some BITs associated it with nondiscrimination while other BITs associated it with references to the international minimum standard. Typically, though, the language of these BITs tended to use nondiscrimination or the international minimum standard as setting a minimum level of treatment below which fair and equitable treatment could not fall. The OECD draft convention had suggested in 1967 that fair and equitable treatment was an element of the international minimum standard and that in some cases it required more than nondiscriminatory treatment and would be violated by unreasonable treatment. In 1984, the OECD's Committee on International Investment and Multinational Enterprises issued a report that briefly addressed the meaning of "fair and equitable treatment." The precise issue addressed by the report was whether the fair and equitable treatment standard added a substantive obligation or merely affirmed other obligations in the BIT, such as the nondiscrimination obligation. As the United States explained in its counter-memorial in *Loewen v. United States*, all member countries that commented on this point believed that "fair and equitable treatment introduced a substantive legal standard referring to general principles of international law. . . ."[66] The report thus seemed to link the standard not to "international custom" within the meaning of article 38(2) of the Statute of the International Court of Justice, but to "general principles of law recognized by civilized nations" within the meaning of article 38(3) of the statute.[67] The report did not indicate, however, whether the standard incorporated all such general principles or only some and, if so, which. The committee's report also did not indicate how many of the OECD countries commented on this point. The report, however, did answer the question that it had posed and concluded that fair and equitable treatment is an independent substantive obligation and not a mere reference to other treaty obligations.

64 *See, e.g.*, United States-Grenada BIT, Art. II(2).

65 *See, e.g.*, United States-Georgia BIT, Art. 2(3)(a).

66 Counter-Memorial of the United States of America, page 172, note 89.

67 *See* Katia Yannaca-Small, "Fair and Equitable Treatment Standard in International Law," in Organisation for Economic Co-operation and Development, *International Investment Law: A Changing Landscape* 97 (2005).

Meanwhile, in 1992, Canada, Mexico, and the United States concluded the North American Free Trade Agreement (NAFTA), which entered into force in 1994. Article 1105 of that agreement requires that each party accord to covered investment "treatment in accordance with international law, including fair and equitable treatment and full protection and security." The NAFTA thus adopted the position taken in the 1967 OECD draft convention, under which international law requires fair and equitable treatment. The language of the U.S. BITs, however, was not modified at that time to conform to the NAFTA language. Beginning in 1995, the United States asserted in its public explanation of its BITs that customary international law requires fair and equitable treatment. In 2004, the United States modified its model BIT language to conform closely to the NAFTA language.[68] Article 5(1) of the United States-Uruguay BIT, for example, provides that "'fair and equitable treatment' includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world."

The principal ways in which the fair and equitable treatment standard would appear in BITs thus were not established until the early 1990s. The standard appears in the vast majority of BITs. Typically, it appears as a free-standing obligation, although some BITs link it with international law and others with non-discrimination. These linkages may imply that fair and equitable treatment duplicates in some ways, but is not precisely coextensive with, either non-discrimination or the customary international law minimum standard of treatment or they may imply that non-discrimination or the international minimum standard set a floor below which treatment under the fair and equitable treatment standard may not fall. The requirement of fair and equitable treatment is normally considered an absolute standard, which is not dependent on how other investment is treated, and thus non-discrimination could not exhaust the requirements of fair and equitable treatment, although it could be a component of it. Some BITs place the fair and equitable treatment standard in the same paragraph as other general absolute standards, such as the full protection and security standard or the prohibition on unreasonable or discriminatory measures, suggesting a relationship between the fair and equitable treatment and the principles of security, reasonableness and non-discrimination embraced in these other standards. A small number of BITs explicitly provide that fair and equitable treatment is an element of customary international law. The U.S. BITs from 2004 and later are unusual in attempting to define the standard, although even the U.S. definition is not exhaustive, but merely indicates one component of the standard, essentially the principle of due process.

5.2.3 Arbitral Practice

Tribunals applying the fair and equitable treatment standard have held that the standard embraces principles of reasonableness, consistency (in effect, the security of

68 Language virtually identical to that which appeared in the U.S. BITs in 2004 previously had appeared in the investment chapters of the U.S. FTAs beginning in 2002. *See* Kenneth J. Vandevelde, *U.S. International Investment Agreements* 315–320 (2009).

legitimate expectations), non-discrimination, transparency, and due process. This section will discuss arbitral awards in which the fair and equitable treatment standards has been held to incorporate the principle of reasonableness. Arbitral awards holding that the standard incorporates other principles will be discussed in the chapters addressing those principles.

The fair and equitable treatment standard is the standard most often invoked by investors in investor-state arbitrations. This is largely attributable to the ubiquity, generality, and vagueness of the standard. The standard appears in the great majority of BITs and thus is nearly always available as a basis for a claim. Because the language by its terms can apply to virtually any instance of host-state conduct, it is potentially a basis for recovery in any situation. Further, because the meaning of the standard historically was uncertain, few claims could be categorically excluded from its scope. Thus, claimants' counsel, in the exercise of their professional responsibility as zealous advocates, could scarcely avoid alleging a violation of the standard. At the same time, where a tribunal concluded that the host state's conduct was sufficiently unacceptable to merit an award of compensation, such conduct likely could be characterized as unfair or inequitable. Unless the conduct fell within one of the more specific standards, such as in the case of an expropriation or the imposition of exchange controls, the fair and equitable treatment standard offered a malleable basis for an award in favor of the claimants.

One consequence of the broad applicability of the fair and equitable treatment standard is that it may displace some of the other standards in important ways. For example, the national and MFN treatment standards often include exceptions for commitments under regional economic integration agreements or taxation agreements. Yet, such exceptions usually do not apply to the fair and equitable treatment standard, with the result that the fair and equitable treatment standard may provide a basis for compensation for discriminatory treatment where the national or MFN treatment provisions would not have. Of course, the same result could occur under the standard prohibiting unreasonable or discriminatory measures and thus the seeming inconsistency in prohibiting under one standard the very conduct that is permitted under another is not solely attributable to the breadth of the fair and equitable treatment standard in those BITs where the prohibition on unreasonable or discriminatory measures appears.

As noted in Section 5.2.1, tribunals generally have placed little significance on the varied contexts in which the fair and equitable treatment standard appears. That is, they have not given the standard a different meaning depending upon the context in which the standard appears, such as whether it appears in isolation, with other general absolute standards, linked with non-discrimination, or linked with customary international law. For example, in *Bogdanov v. Moldova*, the text of the Russia-Moldova BIT linked the fair and equitable treatment standard with nondiscrimination, which the sole arbitrator found not to exist in that case. The sole arbitrator held, however, that the standard also prohibited conduct that violated principles of reasonableness, transparency, and security.[69]

69 Award, para. 4.2.4.

Nor have differences in the wording of the standard been treated as significant. For example, in *Parkerings-Compagniet v. Lithuania*, a case arising under the Norway-Lithuania BIT, the tribunal held that "equitable and reasonable" has the same meaning as "fair and equitable."[70]

In cases applying the reasonableness principle, tribunals generally consider whether the action of the host state was reasonably related to legitimate policy objectives. As the tribunal explained in *Saluka Investments v. Czech Republic*, a case arising under the Netherlands-Czech Republic BIT, reasonableness requires that the host state's conduct "bear[] a reasonable relationship to some rational policy. . . ."[71] Thus, a purely arbitrary act, that is, one not related to legitimate policy objectives, would violate the standard. Tribunals have been reluctant to conclude that host-state conduct was unreasonable, unless it was motivated by political or discriminatory considerations. Where it appears that host-state action was based on legitimate policy concerns, tribunals have tended to find the conduct to be reasonable, even if the host state acted unwisely or incompetently.

The tribunal in *S.D. Myers v. Canada*, a case arising under the NAFTA, averred that its duty was to interpret the fair and equitable treatment standard "in light of the high measure of deference that international law generally extends to domestic authorities to regulate matters within their own borders."[72] Thus, in determining whether the act of the host state is reasonable, a tribunal does not examine the action of the host state for errors of judgment, but for acts that are arbitrary or that are based on political or discriminatory motives. In many cases, the tribunal has found the host-state conduct to be reasonably related to a legitimate policy objective and thus reasonable.

For example, in *ADF Group Inc. v. United States*, another case arising under the NAFTA, the tribunal found that a domestic content regulation for steel used in highway construction did not violate the fair and equitable treatment standard. First, such a regulation could hardly be considered per se a violation of international law given that all three NAFTA parties as well as many other states impose domestic content requirements. Thus, these requirements could not be considered "idiosyncratic or aberrant and arbitrary."[73] Over time, the U.S. Congress had modified the statutes applicable to the program and thus the failure of the U.S. government to adhere to court decisions applying the predecessor statute was not "grossly unfair or unreasonable."[74]

The claimant complained that the U.S. Federal Highway Administration had acted *ultra vires* in its administration of the highway program, but any such violation of national law did not necessarily violate Article 1105. In an oft-quoted remark, the tribunal noted that "something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent"

70 Award, para. 276.

71 Award, para. 460. *See also* para. 309.

72 Award, para. 263.

73 Award, para. 188.

74 Award, para. 189.

with Article 1105.[75] The tribunal did not explain what the something more was, but found that the claimant had not shown it.

In *Noble Ventures v. Romania*, a case arising under the United States-Romania BIT, the tribunal found the fair and equitable treatment standard "to be a more general standard which finds its specific application in *inter alia* the duty to provide full protection and security, the prohibition of arbitrary and discriminatory measures and the obligation to observe contractual obligations towards the investor."[76] The tribunal noted that it already had found that none of these other provisions had been breached, but then noted that "this in itself cannot lead to the conclusion that the more general fair and equitable treatment standard has not been breached."[77] The tribunal next considered whether Romania violated the standard by seeking judicial reorganization of the claimant's company, which the claimant alleged had been undertaken not for commercial purposes but in order to effect a rescission of Romania's privatization agreement with the claimant and to regain control of the company. The tribunal found that the decision to initiate the proceedings was not arbitrary, but seemingly the only solution to the company's insolvency and its inability to pay its four thousand employees. Further, the proceedings were conducted in accordance with Romanian law. Because the decision was not arbitrary, it did not violate the fair and equitable treatment standard.

In *Continental Casualty v. Argentina*, a case arising under the United States-Argentina BIT, Argentina adopted a policy that converted dollar denominated assets into pesos at a rate of 1.4 pesos to the dollar, as opposed to the prior rate of one to one, resulting in a nominal gain in the peso value of the assets, although the real value of the assets in fact declined. Argentina nevertheless imposed a capital gains tax on the increase in nominal value. The tribunal held that the tax was consistent with common tax accounting principles and thus did not violate the fair and equitable treatment standard.[78]

In *Tokios Tokeles v. Ukraine*, a case arising under the Lithuania-Ukraine BIT, the tribunal held that retaliation against a covered investment for supporting a political candidate would violate the fair and equitable treatment standard, although the evidence of retaliation in that case was insufficient. In *MCI Power v. Ecuador*, a case arising under the United States-Ecuador BIT, the tribunal found that the host state's conduct toward the claimant, which included threatening a tax audit, investigating its legal representative, and instituting litigation against it, constituted legitimate regulatory acts, rather than harassment.

In *Parkerings-Compagniet v. Lithuania*, a case arising under the Norway-Lithuania BIT, the tribunal found no arbitrariness in Lithuania's failure to disclose information available to the public. Lithuania had obtained a legal opinion that the claimant could have obtained from any qualified law firm. The claimant also alleged that the Lithuania had acted arbitrarily when its courts refused to accept *force majeure* as grounds for excusing the investment's obligation to pay a fee due under a parking concession agreement.

75 Award, para. 190.

76 Award, para.182.

77 *Id.*

78 Award, paras. 269–270.

The tribunal held that an erroneous judgment by a court would not violate the treaty in the absence of a denial of justice.

In *Genin v. Estonia*, a case arising under the United States-Estonia BIT, Estonia had revoked a license held by the investor's bank, thus forcing the bank out of business. The tribunal observed that, to violate the fair and equitable treatment standard, state conduct must reflect "a willful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith."[79] The principal ground for revocation was the fact that corporate documents listed "Eurocapital Group Limited" as a major shareholder, when the entity authorized to acquire a qualified shareholding was the "Eurocapital Group Company." The tribunal found this ground to be "exceedingly formalistic" and "extremely technical" because the similarity of the names of the two entities and the fact that they were listed as having identical shareholdings suggested that the two entities were actually the same.[80] The tribunal concluded nevertheless that Estonia was at least arguably justified in concluding that a major shareholder had not received a permit to acquire its holding, which meant that the bank did not meet capitalization requirements. The tribunal found that the decision was a reasonable regulatory decision that reflected the Estonian government's legitimate concerns about the management and financial soundness of the bank. More generally, the decision occurred in the context of a newly independent state seeking to regulate modern financial institutions, a context in which the claimant knowingly chose to invest. Thus, the tribunal found no violation of the fair and equitable treatment standard.

The *Genin* award seemed to suggest that bad faith might be necessary to violate the standard. Yet, Estonia's conduct was found consistent with the standard not simply because Estonia lacked bad faith, but because Estonia acted pursuant to legitimate regulatory concerns. In any event, the clear consensus now is that bad faith is not required to find a violation of the fair and equitable treatment standard.

In *Pope & Talbot v. Canada*, a case arising under the NAFTA, in an effort to address a trade dispute with the United States over Canadian exports of softwood lumber, Canada had allocated quotas of softwood lumber exports from certain provinces. The effect was to limit the amount of lumber that the claimant could export and the amount diminished over time as the quotas were adjusted. Despite the explicit language of the NAFTA, the tribunal concluded that the fair and equitable treatment standard was not encompassed within the international minimum standard under customary law, but was additive to it.[81] In a very lengthy discussion, the tribunal held that the various aspects of the quota system were reasonable responses to Canada's trade dispute with the United States.[82]

79 Award, para. 367.

80 Award, paras. 359–361.

81 Award, para. 113. The NAFTA Free Trade Commission subsequently issued an interpretation of the relevant NAFTA provision, Article 1105, declaring that the fair and equitable treatment standard is not additive to the international minimum standard, with the result that the tribunal was required to reexamine its initial decision. The FTC interpretation and the tribunal's reexamination are discussed in Section 5.4.

82 Award, paras. 121, 123, 125, 128.

Nevertheless, the tribunal did find a violation. After the claimant had notified the Canadian government that it was submitting the dispute concerning the quotas to investor-state arbitration under the NAFTA, Canada responded with a series of actions that the tribunal regarded as retaliation. The Canadian government imposed unnecessary and onerous reporting requirements on the company and refused to cooperate to find less burdensome alternatives. The government also threatened the company with criminal prosecution for noncompliance with these requirements and wrote internal memoranda in which it mischaracterized the situation, thereby injuring the reputation of the company. The tribunal found that this conduct, taken together, violated the requirement of fair and equitable treatment,[83] citing the lack of a reasonable basis for the conduct[84] as well as a lack of forthrightness.[85]

Conduct motivated by political (or discriminatory) considerations also was found to violate the reasonableness principle in several other cases. For example, in *Eureko v. Poland*, a case arising under the Netherlands-Poland BIT, the claimant had acquired a 30 percent interest in a state-owned insurance company in the process of being privatized, relying upon Poland's commitment to sell the remaining stock, which would enable the claimant to acquire a majority interest. The privatization, however, became politically controversial and Poland decided not to complete it. The tribunal found that Poland had violated the fair and equitable treatment standard because it had refused to honor its commitment for "purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character."[86] Initially, it would seem that Poland's misdeed in *Eureko* was inconsistent conduct: it promised to privatize the company, but then failed to do so. The tribunal, however, appeared willing to excuse the inconsistency if there were a sufficient justification. The tribunal never explained what kind of justification would be necessary, but regarded the justification in that case as "arbitrary." Poland's decision was not a reasoned judgment, but based on political opposition to foreign investment.

In *Azurix Corp. v. Argentina*, a case arising under the United States-Argentina BIT, the claimant's investment had obtained a concession to operate a water distribution system in Buenos Aires. Subsequently, however, disputes arose over the tariffs that could be charged. When, partly as a result of the provincial government's misfeasance, an algae bloom affected adversely the appearance and taste of the water, the province refused to accept any responsibility, blamed the foreign investment, and urged consumers not to pay their bills. At that point, the investment made what the tribunal regarded as a reasonable request to terminate the concession by mutual agreement, but the province refused and insisted on terminating the concession on the grounds of abandonment by the foreign investment.[87] Noting the refusal of this reasonable request and the fact that Argentina had allowed the tariff regime to become politicized,[88] the

83 Award, para. 181.

84 Award, paras. 173–174.

85 Award, paras. 177–179.

86 Award, para. 233.

87 Award, para. 374.

88 Award, para. 375.

tribunal found that the fair and equitable treatment standard had been violated. The tribunal also found a violation in the government's urging of customers not to pay their water bill, another politically motivated act.

In *Biwater v. Tanzania*, a case arising under the United Kingdom-Tanzania BIT, the claimant's investment was awarded a contract to operate the water and sewerage service for the city of Dar es Salaam. After disputes arose concerning performance under the contract, the Minister of Water and Livestock Development, who was campaigning for the office of prime minister, called a press conference at which he announced that the contract was terminated and then four days later he held a political rally and confirmed that the contract was terminated. The tribunal found this conduct to be "an unreasonable disruption of the contractual mechanisms . . . and motivated by political considerations."[89] Such conduct inflamed the situation and polarized public opinion so that it was impossible thereafter to follow prescribed procedures under the contract.[90] A week later, Tanzania unilaterally withdrew a value-added tax exemption, an act that the tribunal found to be unreasonable and unjustified.[91] The government then occupied the water company's offices, took control of the operation and deported the senior management. There being no emergency, the tribunal found this action to be "unreasonable and arbitrary, unjustified by any public purpose. . . ."[92] All of these unreasonable acts violated the fair and equitable treatment standard.[93] The tribunal also found that the appointment of the same minister as regulator of the utility, rather than "an independent, impartial regulator insulated from political influence," constituted a further violation of the standard.[94] As it happened, however, the tribunal held that none of these actions caused compensable damage to the claimant because the position of the investment already was such that contract termination was inevitable.

In *Eastern Sugar v. Czech Republic*, a case arising under the Netherlands-Czech Republic BIT, the Czech Republic, as part of the process of joining the European Union, issued two sugar decrees to regulate the sugar market by, in particular, reducing imports and allocating quotas among domestic producers. One of the decrees was later held unconstitutional. Both were ineffectively implemented. Moreover, they allowed new producers to obtain quotas, a decision that the tribunal found to be illogical in light of the decrees' avowed purpose and that the tribunal believed to have been politically motivated. The tribunal nevertheless found no violation, holding that the host state is entitled to some measure of interest balancing, inefficiency, trial and error, and imperfection. After the European Union reduced the Czech Republic's country sugar quota, however, the government reduced the claimant's quota by more than the entire reduction in the country quota, thus forcing one company to bear the entire effect of the country quota reduction. The disproportionate reduction appeared to have been in retaliation for the claimant's politically unpopular decision to close a plant.

89 Award, para. 500.
90 Award, para. 627.
91 Award, para. 502.
92 Award, para. 503.
93 Award, para. 605.
94 Award, para. 615.

The tribunal found the reduction to be unreasonable and discriminatory and, therefore, a violation of the fair and equitable treatment standard.

In *Vivendi v. Argentina*, a case arising under the France-Argentina BIT, the claimants' investment had obtained a concession to operate a water distribution system undergoing privatization. The tribunal found that, after sharp rate increases and a temporary but harmless discoloration of the water had stirred local opposition, local officials had engaged in a campaign to force the investment to accept new terms, such as by encouraging customers not to pay their bills. Further, after the investment sought to terminate the agreement and to institute arbitration under the BIT, Argentina enacted legislation to prevent the investment from pursuing collection lawsuits or enforcing debts, measures that the tribunal found to constitute "a vindictive exercise of sovereign power aimed at punishing" the investment in violation of the fair and equitable treatment standard.[95]

In a few instances, tribunals have discussed the concept of good faith in finding a violation of fair and equitable treatment. Yet, it is rare that the concept adds anything to the principle of reasonableness or the other principles embraced within the fair and equitable treatment standard. Indeed, the tribunal in *ADF Group v. United States*, a case arising under the NAFTA, observed that the concept of good faith was of "negligible assistance" in interpreting the standard of fair and equitable treatment. Indeed, no award in favor of the claimant seems to rest solely on a good faith principle.

In *Tecmed v. Mexico*, a case arising under the Spain-Mexico BIT, Mexico denied to the claimant's investment the renewal of a permit necessary to operate its solid waste disposal facility. The reason for the denial appeared to be pressure from the community to eliminate the facility. The tribunal found that the denial of the permit was either a coercive attempt to force relocation of the facility or a nontransparent attempt to achieve some other undisclosed objective. The tribunal held that the denial violated the obligation of good faith, which, it said, requires reasonableness, consistency, and transparency. That is, "in light of the good faith principle," the fair and equitable treatment standard requires the host state

> [t]o provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plant its investment and comply with such regulations. Any and all State actions conforming to such criterion should relate not only to the guidelines, directives or requirements issued, or the resolutions approved there under, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e., without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial

95 Award, para. 7.4.45. This is the award in what is often referred to as *Vivendi II*. The award of the first *Vivendi* tribunal was annulled.

> and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation.[96]

Thus, in Tecmed the obligation of good faith, as the ADF Group tribunal predicted, seems to add little. Rather, the term was used as an umbrella for other principles that are embraced within the fair and equitable treatment standard, notably reasonableness, transparency, and consistency (security of legitimate expectations).

The reference to coercion in the *Tecmed* award is potentially misleading. States are by their nature coercive institutions. The law is coercive and the concept of the rule of law means that individuals are forced to abide by the law. Thus, a host state does not violate the fair and equitable treatment standard merely by coercing an investor or an investment. The rule of law, however, while it coerces individuals, also restrains the power of the state. The state must use its power to advance its legitimate regulatory objectives and in accordance with the law. Accordingly, the violation occurs where the coercion is not related to a legitimate state regulatory objective, in effect, where it is an abuse of power. Similarly, in *Pope & Talbot v. Canada*, a NAFTA case discussed above, the tribunal found a violation where Canada had engaged in a campaign of harassment against the claimant. The campaign included burdensome demands for information and threats of criminal prosecution. Host states may legitimately require investors to provide information and they may pose the threat of criminal sanctions. The violation occurred, however, because these actions were taken for retaliatory purposes rather than to further legitimate regulatory objectives.

The tribunal also relied on the principle of good faith in *Siemens v. Argentina*, a case arising under the Germany-Argentina BIT. In that case, the tribunal observed that

> when a government awards a contract, which includes among its critical provisions an undertaking of that government to conclude agreements with its provinces, the same government cannot argue that the structure of the State does not permit it to fulfill such undertaking. This runs counter to the principle of good faith underlying fair and equitable treatment.[97]

While Argentina's conduct in failing to conclude agreements necessary to fulfill its commitment to the investor would seem quite clearly to violate a principle of good faith, other BIT principles could be invoked to justify finding a violation of the fair and equitable treatment standard. Agreeing to do that which cannot be done would also seem to violate the principle of reasonableness. Alternatively, failing to do that which Argentina had promised to do would violate the principle of consistency, or security of legitimate expectations. The concept of good faith provides an appropriate explanation for the award, but is not essential to it.

In a few awards, the tribunal seemed to believe that the fair and equitable treatment standard included a good faith principle, but found no violation of the principle under the facts of those disputes. For example, in *Waste Management v. Mexico*, a case

96 Award, para. 154.
97 Award, para. 308.

arising under the NAFTA, the tribunal observed that a conspiracy by government agencies "without justification to defeat the purposes of an investment agreement" would violate the obligation under Article 1105 of the NAFTA 'to act in good faith.'"[98] The claimant had failed to prove the existence of any such conspiracy, however.[99]

In *MCI Power v. Ecuador*, a case arising under the United States-Ecuador BIT, the tribunal held that Ecuador had not acted in bad faith in refusing to sign an arbitration agreement. Ecuador was under no obligation to agree to arbitrate. Neither did Ecuador's refusal to accept the investor's position in a dispute constitute bad faith. Again, Ecuador was under no obligation to agree with the investor.

Although tribunals occasionally have suggested that bad faith would violate the fair and equitable treatment standard, the overwhelming weight of authority is that a violation of the standard does not require bad faith.[100]

In a number of cases, tribunals have equated the fair and equitable treatment standard with other standards in a BIT, without attempting to articulate any independent content for the fair and equitable treatment standard. For example, in *ADC v. Hungary*, a case arising under the Cyprus-Hungary BIT, the tribunal found with little discussion that under the facts before it the host state's expropriation of claimant's investment in a way that violated the expropriation provision of the treaty also violated the fair and equitable treatment standard. In *Wena Hotels v. Egypt*, a case arising under the United Kingdom-Egypt BIT, the tribunal found that Egypt had known of an attempt by certain government officials to seize possession of the claimant's hotels, but took no action to prevent the takeover, to restore the hotels promptly to the claimant, or to impose a substantial punishment on those responsible for the seizure. Egypt's failure to exercise reasonable care to protect foreign investment would constitute a classic example of a violation of the obligation of full protection and security and, in fact, the tribunal began its discussion by noting that it was addressing claimant's allegation that Egypt had violated exactly that obligation.[101] Following its discussion of the facts, however, the tribunal concluded that Egypt had violated both the obligation to provide full protection and security and the obligation to provide fair and equitable treatment, without discussing the content of either standard or the relationship between the two. The only cases cited by the tribunal were *American Manufacturing & Trading, Inc. v. Zaire* and *AAPL v. Sri Lanka*, both of which involved physical destruction of property and neither of which relied upon the fair and equitable treatment standard.[102]

In *Petrobart v. Kyrgyz Republic*, a case arising under the Energy Charter Treaty, the claimant was a creditor of a state-owned company that produced oil and gas. The host state had stripped assets from the company to the detriment of its creditors and had

98 Award, para. 138.
99 Award, para. 139.
100 *See, e.g., Duke Energy v. Ecuador* (United States-Ecuador BIT), Award, para. 341; *Jan de Nul v. Egypt* (BLEU-Egypt BIT), Award, para. 185; *LG&E v. Argentina* (United States-Argentina BIT), Award, para. 129; *Azurix v. Argentina* (United States-Argentina BIT), Award, para. 372; *CMS Gas Transmission v. Argentina* (United States-Argentina BIT), Award, para. 280; *Siemens v. Argentina* (Germany-Argentina BIT), Award, para. 300.
101 Award, para. 83.
102 Both cases are discussed in Section 6.3.3.

intervened in a judicial proceeding to stay execution of a judgment against the company. The claimant alleged that this conduct violated each sentence of Article 10(1) of the treaty, which provides that

> Each Contracting Party shall, in accordance with the provisions 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. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

The tribunal declined to analyze the Kyrgyz Republic's actions in relation to each individual element of Article 10(1), but noted that "this paragraph in its entirety is intended to ensure a fair and equitable treatment of investments."[103] The tribunal concluded that the actions of the Kyrgyz Republic "failed to accord Petrobart a fair and equitable treatment of its investment to which it was entitled under Article 10(1) of the Treaty."[104] The tribunal thus treated fair and equitable treatment as an umbrella term for a number of more specific obligations and did not specify which, if any, of those more specific obligations had been violated by the actions of the host state.

The tribunal proceeded in a similar manner in *LLC AMTO v. Ukraine*, another case arising under the Energy Charter Treaty. The claimant alleged that the host state violated the treaty by instituting a bankruptcy proceeding in order to collect back taxes from the investment. The tribunal found "no evidence arising from the tax inspection and related bankruptcy proceedings of any unreasonable, disproportionate, arbitrary, or discriminatory conduct, or any breach of [the claimant's] legitimate expectations. There was no unfair or inequitable treatment, or any other breach of Article 10(1) ECT."[105]

5.3 UNREASONABLE OR DISCRIMINATORY MEASURES

5.3.1 Structure and Policy

The first BIT provision to incorporate the reasonableness principle explicitly was the prohibition on unreasonable or discriminatory measures. The typical provision prohibits impairment of the management, maintenance, use, enjoyment or disposal of

103 Award, page 76.
104 Award, page 76.
105 Award, para. 99.

investment by unreasonable or discriminatory measures.[106] As the fair and equitable treatment standard has been interpreted, the prohibition on unreasonable or discriminatory measures may add little or nothing to the fair and equitable treatment standard.

One issue presented by the prohibition on unreasonable or discriminatory measures is whether it prohibits every host-state measure that discriminates among investments and that impairs the operation or disposal of covered investment. Such an interpretation seems almost certainly too broad. Governments enact countless laws that impose duties on some enterprises and not others. Because these laws do not apply to every enterprise within the jurisdiction of the state, all of them are discriminatory. Yet, it cannot be that every law must apply to every enterprise. Companies that manufacture computer hardware, that process food, or that deliver parcels all perform quite different functions and legitimately are subject to quite different regulations. To treat them differently for reasons related to the nature of their function is not inconsistent with any purpose underlying the BIT, but to require uniform treatment would be an unwarranted imposition on the regulatory discretion of the host state. Thus, the prohibition on non-discriminatory measures must be read as a prohibition on measures that discriminate unreasonably. If the discrimination is reasonably related to a legitimate host-state regulatory objective, it should not be regarded as a violation of the BIT standard.

This interpretation accounts for the pairing of unreasonable measures and discriminatory measures in this standard. They are paired because, despite the use of the disjunctive "or," in fact unreasonableness is the unifying feature of measures that violate this standard.[107] Such measures impair covered investment through unreasonable discrimination or other unreasonable treatment. The term "unreasonable" always appears first in this standard because of its centrality to the standard, but the standard also refers to discriminatory measures, which indicates that all discriminatory measures will be scrutinized to ensure that the discrimination is reasonable. Further, as will be seen, the principal ground on which measures thus far have been found to be unreasonable is that they are based on a discriminatory motive rather than a legitimate policy objective. Thus, unreasonable measures often are discriminatory measures.

Another issue that may arise is whether this provision applies to any discrimination or only those discriminations that are based on nationality. Nothing in the language suggests that it is limited to discriminations based on nationality. Further, one of the purposes of the BIT is to ensure that investors are not placed at a competitive disadvantage relative to other investors. Although the most common competitive disadvantages imposed on foreign investments may be nationality-based, a competitive disadvantage imposed on some other basis may be just as detrimental to the investment.

106 *See, e.g.*, United Kingdom-Bosnia-Herzegovina BIT, Art. 2(2); Germany-Timore-Leste BIT, Art. 2(3); Austria-Armenia BIT, Art. 3(2); Sweden-Kazakhstan BIT, Art 2(3); Denmark-Ethiopia BIT, Art.2(2); Chile-Indonesia BIT, Art. IV(1); Egypt-Zambia BIT, Art. 2(2) (*but see* Article 3, where MFN treatment is set as a minimum standard for fair and equitable treatment); Chile-Lebanon BIT, Art. III(2); Cambodia-Vietnam BIT, Art. III(1). On the unreasonable or discriminatory measures provision generally, see Veijo Heiskanen, "Arbitrary and Unreasonable Measures," in *Standards of Investment Protection* (August Reinisch, ed. 2008).

107 Thus, the standard is introduced in this chapter rather than in Chapter 7, on the nondiscrimination principle.

Thus, the language of the provision and the purpose of the BIT both militate in favor of interpreting this provision potentially to apply to any discrimination. As will be seen, the tribunals have not been entirely consistent with respect to this issue.[108]

Some BITs use the conjunction "and" rather than "or." In these BITs, the standard is narrower because it prohibits only those measures that are both discriminatory and unreasonable. That is, an unreasonable measure that did not discriminate would not violate the standard. Measures that are unreasonable but not discriminatory, as has been noted, however, likely would violate the fair and equitable treatment standard.[109] The use of the conjunction reinforces the conclusion above that a discriminatory measure violates the standard only if it is also unreasonable. The alternative is to read the "or" standard as radically different from the "and" standard. In this alternative view, any non-discriminatory measure would violate the "or" standard, while only an unreasonable, nondiscriminatory measure would violate the "and" standard. That is, the two formulations would reflect fundamentally different concepts of the types of discriminatory conduct that violates the standard. The interpretation advanced here, however, suggests that both formulations prohibit exactly the same types of discriminatory measures, although the "or" formulation also prohibits unreasonable non-discriminatory measures while the "and" formulation does not. That is, the use of a different conjunction has consequences, but those consequences do not include changing the nature of the prohibited discrimination. As has been noted already, measures held to be unreasonable typically are also discriminatory. Thus, to date, there has been little practical difference in the application of the "and" and the "or" versions of the standard.

Some BITs use the word "arbitrary" in lieu of "unreasonable."[110] These words should be regarded as synonymous. Occasionally, the word "unjustified" or "unjust" appears in lieu of "unreasonable."[111] These too should be regarded as synonymous with "unreasonable." Occasionally the word "discriminatory" does not appear.[112]

The list of protected investment activities also varies. Some BITs add the word "operation,"[113] but it is doubtful that the additional word broadens the scope of the provision. Some BITs include "sale" and "liquidation" instead of the more generic term "disposal."[114] This change similarly seems unlikely to have any substantive impact.

One quite significant variation, however, adds "acquisition" and "expansion" to the list of covered investment activities.[115] This language is significant because it grants to investors rights with respect to the establishment of investment. In some BITs, the list

108 *See* Section 7.3.

109 *See* Sections 5.2.1 and 5.2.3.

110 *See, e.g.*, Germany-Timor-Leste BIET, Art. 2(3).

111 *See, e.g.*, Switzerland-Algeria BIT, Art. 4(1); Italy-Nicaragua BIT, Art. II(3); BLEU-Sudan BIT, Art. 3(2).

112 *See, e.g.*, Finland-Armenia BIT, Art. 2(2) (prohibition on "unreasonable or arbitrary" measures).

113 *See, e.g.*, Austria-Armenia BIT, Art. 3(2); Indonesia-Chile BIT, Art. IV(1).

114 *See, e.g.*, Austria-Armenia BIT, Art. 3(2); Chile-Lebanon BIT, Art. III(2).

115 *See, e.g.*, Finland-Armenia BIT, Art. 2(2).

of covered investment activities includes the "extension" of investment, but not its acquisition.[116]

Given that unreasonable or discriminatory measures would seem to violate the fair and equitable treatment standard, the question arises as to whether this standard serves any purpose. The standard, of course, was introduced into BITs at a time when the meaning of the fair and equitable treatment standard had not yet been elucidated by arbitral practice. Its frequent appearance in BITs reflects the consensus that the kind of investment climate that BITs are intended to produce is one in which unreasonable or discriminatory measures are prohibited. This reinforces the view that such measures would violate the fair and equitable treatment standard, which defines the basic relationship between the investment and the host state. As the meaning of the fair and equitable treatment standard is interpreted today, however, the prohibition on unreasonable or discriminatory measures would seem superfluous in any BIT with a fair and equitable treatment standard. An exception might exist in those BITs where (1) the unreasonable or discriminatory measures provision applies to the establishment of investment and (2) the fair and equitable treatment standard protects only investment once established. In such a BIT, the unreasonable or discriminatory measures provision would ensure that the reasonableness and non-discrimination principles apply to the establishment of investment as well as to its treatment after establishment.

As already noted, the standard is violated in most BITs only if the measure impairs the management, maintenance, use, enjoyment, or disposal of the investment. One effect of this limitation is to indicate that measures that have no significant impact on an investment do not violate the standard, even if they are unreasonable or discriminatory. The fair and equitable treatment standard typically has no similar limitation. Similar limitations appear in the national and MFN treatment provisions of some BITs.

Tribunals generally have not addressed the relationship between this provision and customary international law. One reason may be that the unreasonable or discriminatory measures provision, unlike the fair and equitable treatment provision, is not designated by the NAFTA as an element of customary law. Further, this provision, again in contrast to the fair and equitable treatment provision, rarely appears in BITs in the same sentence as a reference to customary law. Yet, authority exists for the proposition that this standard is part of customary international law. The OECD so indicated in the notes to its 1967 Draft Convention on the Protection of Foreign Property.[117] The United States has taken this position as well.[118] Given that this provision seems to be subsumed within the fair and equitable treatment provision, suggestions that the latter provision is an element of customary law would seem to apply to the former provision as well.

5.3.2 Origins

The prohibition on unreasonable or discriminatory measures originated with the 1948 Havana Charter, Article 11(1)(b) of which provided that "No Member shall take

116 *See, e.g.*, Chile-Lebanon BIT, Art. III(2).

117 *See* Section 5.3.2.

118 *See* Kenneth J. Vandevelde, *U.S. International Investment Agreements* 266–267 (2009).

unreasonable or unjustifiable action within its territory injurious to the rights or interests of nationals or other Members in the enterprise, skills, capital, arts or technology which they have supplied." Thus, the language of the Havana Charter prohibited unreasonable conduct, but did not refer to discrimination.

The Economic Agreement of Bogota, which was adopted that same year by the OAS but never entered into force, added a reference to discriminatory measures. Article 22 of the agreement provided that "Foreign capital shall receive equitable treatment. The States therefore agree not to take unjustified, unreasonable or discriminatory measures that would impair the legally-acquired rights or interests of nationals of other countries in the enterprises, capital, skills, arts or technology they have supplied."

The International Law Association (ILA)'s Draft Statute of the Arbitral Tribunal for Foreign Investment and its Draft Statute of the Foreign Investments Court, also produced in 1948, shortened the language by removing the reference to unjustified measures. Both statutes declared one purpose of these respective entities to be the resolution of any dispute "arising out of any unreasonable or discriminatory impairment within the territory of any Contracting Party of the property of nationals of the other Parties."[119]

The United States incorporated a modified version of the OAS language into its post-war FCNs. These treaties typically provided that "Neither Party shall take unreasonable or discriminatory measures that would impair the legally acquired rights or interests within its territories of nationals and companies of the other Party in the enterprises which they have established or in the capital, skills, arts or technology which they have supplied. . . ." [120] Consistent with the ILA draft statute, however, the U.S. FCNs omitted the word "unjustified."

The standard was adopted as well in the 1959 Abs-Shawcross convention, which further modified the language. Article I of the convention provided that "the management, use, and enjoyment [of covered property] shall not in any way be impaired by unreasonable or discriminatory measures." As noted above,[121] the drafters stated explicitly that they regarded this standard as reflecting a principle of reasonableness that is inherent in any system of law. They traced its origin to the U.S. FCNs.[122]

A prohibition on unreasonable or discriminatory measures also appeared in the earliest BITs and the standard language that appears in contemporary BITs emerged in those early BITs. The 1959 BIT between Germany and Pakistan prohibited either party from subjecting to discriminatory treatment any activities "carried on in connection with investments, including the effective management, use or enjoyment of such investments" unless specifically permitted in the "documents of admission" of

119 The quoted language appeared in Article 1 of both instruments. The other purpose was to resolve disputes concerning the observance or interpretation of any undertaking which a party may have given in relation to investments.

120 *See, e.g.*, Luxembourg-United States FCN, *supra* chapter 2, note 178, Art. IV(2); Pakistan-United States FCN, *supra* chapter 2, note 188, Art. VI(3); Japan-United States FCN, *supra* chap. 2, note 194, Art. V(1); Ireland-United States FCN, *supra* chapter 2, note 178, Art. V.

121 *See* Section 5.1.

122 Hermann Abs and Sir Hartley Shawcross, "Comment on the Draft Convention By Its Authors," 9 *Journal of Public Law* 119 (1960).

the investment.[123] Thus, the German BITs adopted the practice, also employed in the Abs-Shawcross convention, of applying the prohibition to measures affecting certain activities. This established the pattern followed by nearly all BITs.

The first Dutch BIT, concluded with Tunisia in 1963, guaranteed to covered investments, at Article 1, "just and non-discriminatory treatment," which shall not be less than national treatment. By 1968, the Dutch BITs prohibited unjustified or discriminatory measures that impair the management, maintenance, use, enjoyment, or disposal of covered investments.[124]

The first Belgium-Luxembourg Economic Union (BLEU) BIT, concluded with Tunisia in 1964, required each party "to take steps to ensure that the exercise of the right so recognized is not impeded by unjust or discriminatory measures."[125] Only in the 1970s would the BLEU BITs adopt the more familiar structure of the provision, like that in the German BITs.

The unreasonable or discriminatory measures provision was introduced into Swiss treaty practice in the mid 1960s. For example, Article 1 of the 1965 Swiss BIT with Costa Rica prohibited unjust or discriminatory measures that impaired the management, maintenance, utilization, enjoyment, expansion, or liquidation of the investment.[126] Having appeared in both the Abs-Shawcross convention and in the earliest BITs, the standard also was incorporated in the 1967 OECD Draft Convention on the Protection of Foreign Property. Article 1 of the convention provided that a party "shall not in any way impair the management, maintenance, use, enjoyment or disposal [of covered property] by unreasonable or discriminatory measures." The OECD language thus was shaped by the Abs-Shawcross Convention and early BIT practice. Note 1(a) to Article 1 of the draft convention stated that this rule was one of three in Article 1 that flowed from the "well-established general principle of international law that a State is bound to respect and protect the property of nationals of other States." The other two were the fair and equitable treatment standard and the full protection and security standard, which, in the OECD draft convention, was phrased as "most constant protection and security." Thus, the notes to the OECD draft convention considered the unreasonable or discriminatory measures provision to reflect customary law. Note 7(c) made clear that unreasonable measures include those that are arbitrary or involve an abuse of right. Note 8(d) explained that the prohibition on discriminatory measures applied to those that were "not justified by legitimate considerations." That is, it applied to unreasonable discriminations.

The first U.K. BIT, that concluded with Egypt in 1975, followed the pattern established in the earlier BITs, but used the term "unreasonable" rather than "unjust" or "unjustified." Article 2(2) of that BIT provided that "[e]ach Contracting Party shall ensure that the management, maintenance, use, enjoyment or disposal of investments in its territory of nationals or companies of the other Contracting Party is not in any way impaired by unreasonable or discriminatory measures." This remains in substance

123 Germany-Pakistan BIT, Art. 2(1).

124 *See, e.g.*, Netherlands-Indonesia BIT, Art. 5(1).

125 BLEU-Tanzania BIT, Art. I.

126 *See also* Switzerland-Ecuador BIT, Art. 1.

the language used by the United Kingdom, although the provision is now phrased as a prohibition on such measures rather than an obligation to prevent such measures. The new language is preferable because it makes clear that the provision applies to state impairments.

By the 1980s, the prohibition on unreasonable or discriminatory measures was becoming much more common in BITs, although variations existed in the language, particularly whether the first word of the dyad was "unreasonable," "unjustified," "unjust," or "arbitrary."

For example, although Kuwait inaugurated its BIT program in 1964, a prohibition on unreasonable or discriminatory measures seems to have appeared for the first time in its 1985 BIT with China.[127] Thereafter, the provision commonly appeared in Kuwaiti BITs.[128] Denmark, which began its BIT program in 1965, added a prohibition on "unreasonable or discriminatory" measures that impair the management, maintenance, use, enjoyment, or disposal of investments to its BITs in the late 1980s[129] and the provision remains in its BITs.[130] Austria, which began its BIT program in 1976, included a prohibition on "unjustified or discriminatory measures" in its 1985 BIT with Malaysia BIT,[131] although it was omitted from many later BITs.[132] The provision, phrased as a prohibition on "unreasonable or discriminatory measures," became increasingly common in the BITs concluded by Austria in 2000 and later.[133] Italy, which began its BIT program in 1964, began to include a prohibition on unjustified or discriminatory measures in 1987.[134] The German BITs also had adopted the more typical language by the mid-1980s.[135] Although Sweden began its BIT program in 1965, it did not include a prohibition on impairment of investment by "unreasonable" measures until 1983.[136] In 1991, Sweden modified the language to refer to unreasonable "or discriminatory" measures.[137] That is the formulation still in use.[138] Finland, which began its BIT program in 1980, introduced the provision in its BITs in the early 1990s, paired with the fair and equitable treatment standard[139] or the full protection and security standard.[140]

127 Kuwait-China BIT, Art. 2(2).

128 *See, e.g.*, Kuwait-Hungary BIT, Art. 2(3); Kuwait-Ethiopia BIT, Art. 3(1); Kuwait-Czech Republic BIT, Art. 3(1); Kuwait-Croatia BIT, Art. 3(1); Kuwait-Netherlands BIT, Art. 3(1); Kuwait-Denmark BIT, Art. 3(6).

129 *See, e.g.*, Denmark-Republic of Korea BIT, Art. 3(1).

130 *See, e.g.*, Denmark-Kuwait BIT, Art. 3(6); Denmark-Kyrgyz Republic BIT, Art. 2(2); Denmark-Ethiopia BIT, Art. 2(2); Denmark-Croatia BIT, Art. 2(2).

131 *See, e.g.*, Austria-Malaysia BIT, Art. 3(1).

132 *See, e.g.*, Austria-Cape Verde BIT; Austria-Croatia BIT; Austria-India BIT.

133 *See, e.g.*, Austria-Bosnia-Herzegovina BIT, Art. 32); Austria-Armenia BIT, Art. 3(2); Austria-Jordan BIT, Art. 3(2); Austria-Lebanon BIT, Art. 2(2); Austria-Libya BIT, Art. 3(2).

134 *See* Italy-Hungary BIT, Art. 2(2).

135 *See, e.g.*, Germany-Bolivia BIT, Art. 2(2) (prohibition on arbitrary or discriminatory measures that impair the management, maintenance, use, or enjoyment of covered investment).

136 *See, e.g.*, Sweden-Yemen BIT, Art. 2(2); Sweden-Hungary BIT; Sweden-Poland BIT, Art. 2(1); Sweden-Bolivia BIT, Art. 2(1). The provision does not appear in Sweden's BIT with Tunisia, but otherwise appeared regularly in Sweden's BITs concluded in 1983 and thereafter.

137 *See, e.g.*, Sweden-Argentina BIT, Art. 2(2) (unjustified or discriminatory measures); Sweden-Latvia BIT, Art. 2(2) (unreasonable or discriminatory measures); Sweden-Lithuania BIT, Art. 2(2) (unreasonable or discriminatory measures); Sweden-Estonia BIT, March 31, 1992, Art. 2(2) (unreasonable or discriminatory measures).

138 *See, e.g.*, Sweden-Bosnia-Herzegovina BIT, Art.2(2); Sweden-Kazakhstan BIT, Art. 2(3).

The United States concluded its first BITs in 1982, at which time it introduced the last innovations to appear in the unreasonable or discriminatory measures provision: application of the provision to the establishment or acquisition of investment.[141] The U.S. approach has been followed by a few other countries.[142] The United States also used the conjunction "and" rather than "or" in the standard.

In summary, the prohibition on unreasonable or discriminatory measures can be traced to the very first BIT, where it applied only to discriminatory treatment of activities in connection with an investment. In the early 1960s, the provision was broadened to apply to unjust or discriminatory measures and the familiar formulation of activities to which the provision applies—the management, maintenance, use, enjoyment, or disposal of investment—emerged. By the late 1960s, the term "unjustified" sometimes appeared rather than "unjust." Many BITs, however, did not yet include the provision. In the 1970s, the term "unreasonable" began to displace "unjust" or "unjustified," a trend that continued in the 1980s. By the 1980s, the use of the dyad "unreasonable or discriminatory" had become the dominant practice and the provision itself had become common in BITs. During the 1980s as well, the United States introduced the practice of applying the provision to the establishment of investment and of using the conjunction "and" rather than "or." The provision continues to be common in BITs, but is by no means present in all BITs, and in most cases it takes the form that had begun to appear in the BITs in the 1970s.

5.3.3 Arbitral Practice

Tribunals generally have treated "unreasonable" and "discriminatory" as distinct terms to be defined individually. This contrasts with the standards of "fair and equitable treatment" and "full protection and security," where the conjoined terms usually are treated as if they create a single standard. As the tribunal noted in *Lauder v. Czech Republic*, a case arising under the United States-Czech Republic BIT, the plain wording of the provision (in the case before it) requires that the measure be both arbitrary (the word appearing in the United States-Czech Republic BIT) and discriminatory.[143] At the same time, in *Azurix v. Argentina*, a case arising under the United States-Argentina BIT, one of the few U.S. BITs using the conjunction "or" in the standard,

139 *See, e.g.*, Finland-Turkey BIT, Art. 3; Finland-Vietnam BIT, Art. 2(2); Finland-Argentina BIT, Art. 2(2).

140 *See, e.g.*, Finland-Chile BIT, Art. 2(2); Finland-Brazil BIT, Art. 2(2).

141 *See* United States-Panama BIT, Art. 2(2).

142 *See, e.g.*, Finland-Armenia BIT, Art. 2(3); Finland-Belarus BIT, Art. 2(3); Finland-Algeria BIT, Art. 3(2) (prohibiting "unreasonable or arbitrary" measures).

143 Award, para. 219.

the tribunal held that an arbitrary measure would violate the standard even if it were not discriminatory. Both awards assume, however, that the concepts are distinct.

Tribunals in most cases have found host-state conduct not to be arbitrary within the meaning of this provision. In most cases where conduct has been found arbitrary, typically the conduct was directed at the investor because of its foreign nationality or was politically motivated. In a few cases, however, the tribunal has found host-state conduct to violate the standard simply because it lacked a rational basis in policy.

Because both unreasonableness and discrimination generally are held to violate the fair and equitable treatment standard, tribunals do not always discuss the unreasonable or discriminatory treatment standard separately. In some cases, they address claims under this standard as part of a broader discussion of fair and equitable treatment.[144] As noted above, tribunals applying the unreasonable or discriminatory measures standard sometimes attempt to develop separate definitions of the concepts of reasonableness and nondiscrimination, while tribunals applying these concepts as part of a broader fair and equitable treatment standard may not. Yet, the substance of the concepts appears to be the same under both standards. That is, conduct held to be unreasonable or discriminatory under one standard generally will be found unreasonable or discriminatory under the other standard. As the tribunal said concerning the unreasonable or discriminatory measures provision in *Saluka Investments v. Czech Republic*, a case arising under the Netherlands-Czech Republic BIT,

> The standard of "reasonableness" has no different meaning in this context than in the context of the "fair and equitable treatment" standard with which it is associated; and the same is true with regard to the standard of "non-discrimination".[145]

The tribunal explained that

> a violation of the non-impairment requirement does not therefore differ substantially from a violation of the "fair and equitable treatment" standard. The non-impairment requirement merely identifies more specific effects of any such violation, namely with regard to the operation, management, maintenance, use, enjoyment or disposal of the investment by the investor.[146]

Tribunals tend to define the term "arbitrary" by reference to legal dictionaries. In *CMS Gas Transmission v. Argentina*, a case arising under the United States-Argentina BIT, the tribunal referred to the definition of that term found in *Black's Law Dictionary*. Based on that source, the tribunal found that the term means "depending on individual discretion founded on prejudice or preference rather than on reason or fact."[147] As this suggests, the prohibition on "arbitrary" measures duplicates the protection afforded by

144 *See, e.g., PSEG v. Turkey* (United States-Turkey BIT); *MCI Power v. Ecuador* (United States-Ecuador BIT). The tribunal in *Plama Consortium v. Bulgaria*, a case arising under the Energy Charter Treaty, did not discuss the unreasonableness element of the standard, but may have regarded its discussion of the fair and equitable treatment standard as subsuming that element, having noted the overlap between the two standards. Award, para. 184.

145 Award, para. 460.

146 Award, para. 461.

147 Award, para. 291.

the reasonableness principle of the fair and equitable treatment standard. Indeed, the tribunal declined to analyze whether the emergency measures taken by Argentina in response to its financial crisis of 2001–2002 violated the arbitrary and discriminatory treatment standard, commenting that to the extent that any arbitrariness or discrimination could be found, it should be treated as a factor in assessing whether Argentina had violated the fair and equitable treatment standard. The tribunal went on to observe that arbitrary and discriminatory conduct necessarily violates the fair and equitable treatment standard.

The tribunal in *National Grid v. Argentina*, a case arising under the United Kingdom-Argentina BIT, cited *Black's Law Dictionary* for the definitions of both "arbitrary" and "unreasonable" and found the two terms to be substantially the same in meaning.[148] It found that the emergency measures taken by Argentina to address its economic crisis of 2001–2002 were reasonable. Each measure was taken pursuant to an articulated policy.

The same definition was employed in *LG&E v. Argentina*, another case arising under the United States-Argentina BIT and involving Argentina's response to the 2001–2002 crisis. The tribunal observed that the parties to the BIT sought to prohibit measures affecting investment that were implemented without "a rational decision-making process."[149] Such a process would include a balance of the interests of the state with the burden of the measure on investment. The tribunal found that the measures were the result of reasoned judgment rather than disregard of the rule of law. Accordingly, they were not arbitrary. The tribunal did hold that Argentina had violated the fair and equitable treatment standard through its inconsistent conduct, which contravened the security principle.[150] This case thus illustrates the broader scope of the fair and equitable treatment standard relative to the prohibition on unreasonable or discriminatory measures.

The Black's definition was adopted as well by the tribunal in *Lauder v. Czech Republic*, a case arising under the United States-Czech Republic BIT. In that case, the claimant had entered into a joint venture with a Czech company to operate a television station. The Czech government approved the structure of the venture, but later required a restructuring on the ground that the existing structure allowed the claimant to broadcast without a license. The restructuring allowed the Czech company to force the claimant out of the venture. The tribunal found that the conduct of the Czech government in requiring the restructuring of the joint venture did not violate the standard because it was based on legitimate regulatory concerns. The tribunal also found, however, that a decision of the Czech government prohibiting the claimant from participating in the business except as part of a joint venture, despite having previously announced that the claimant would be permitted to participate as an equity shareholder in the Czech company, violated the standard because it was founded not on reason or fact, but on mere fear reflecting a preference for national ownership of broadcast licenses.

148 Award, para. 197.

149 Award, para.158.

150 *See* Section 6.2.

The tribunal nevertheless held that the claimant was not entitled to compensation because the conduct of the Czech company was a superseding cause of harm.

The same facts were before a different tribunal in *CME v. Czech Republic*, where the tribunal was charged with applying the Netherlands-Czech Republic BIT. The tribunal found that the actions of the Czech government were unreasonable in that they were motivated by an intent to collude with the local company in order to deprive a foreign investor of its investment, although it did not seek to define further the word "unreasonable." The tribunal noted that the conduct of the Czech government "smacks of discrimination" as well.[151]

The definition from *Black's Law Dictionary* also was adopted in *Occidental v. Ecuador*, a case arising under the United States-Ecuador BIT. In this case, the tribunal found host-state conduct to be arbitrary, although not motivated by political or discriminatory considerations. Ecuador had changed its practice of granting the claimant a refund of the value added tax (VAT) it paid in connection with its oil production business. The tribunal found that Ecuador's actions were not founded on prejudice or preference as opposed to reason or fact. Ecuador simply had been trying to resolve the confusion arising from a variety of practices, regulations, and rules relating to VAT refunds. Yet, the tribunal found that this confusion and lack of clarity had resulted in "some form of arbitrariness," although it never defined the form of arbitrariness that had occurred.[152] In any event, no violation of the provision was found because the tribunal was not persuaded that the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of the investment had been impaired by the measures. The claimant continued to enjoy its rights with respect to its property.[153]

The definition from *Black's Law Dictionary* also was adopted by the tribunal in *Plama Consortium v. Bulgaria*, a case arising under the Energy Charter Treaty. The tribunal, however, in applying the unreasonable or discriminatory measures provision, discussed only the element of discrimination.

A second definition of "arbitrary" that appears in the cases, although less commonly, is based on language used by the International Court of Justice in the *Elettronica Sicula (ELSI)* case.[154] In that case, the Court defined arbitrariness as "not so much something opposed to a rule of law, as something opposed to the rule of law. . . . It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety."[155] This definition was cited by the tribunal in *LG&E v. Argentina*, discussed above. The tribunal found that the measures in that case did not reflect a disregard of the rule of law, but rather were the result of reasoned judgment. As noted above, the tribunal in that case also employed a definition drawn from *Black's Law Dictionary*.

The tribunal adopted the *ELSI* definition as well in *Duke Energy v. Ecuador*, a case arising under the United States-Ecuador BIT. The tribunal held that, although the host

151 Partial Award, para. 612.
152 Award, para. 163.
153 Award, para. 161.
154 *Case concerning Elettronica Sicula* (United States v. Italy), 1989 I.C.J. Rep. 15.
155 *Id.* at 76.

state breached its power purchase agreements with the claimant's investment, contract breaches do not in themselves constitute arbitrary conduct.[156] The conduct of the Minister of Energy and Mines and of the Attorney General in contesting the legality of local arbitration of the investment's claims for payment "complied with local law and can thus not be regarded as arbitrary."[157]

In *Noble Ventures v. Romania*, a case arising under the United States-Romania BIT, the tribunal also adopted the *ELSI* definition.[158] The tribunal found that, in light of the desperate financial circumstances of the claimant's investment, the institution of judicial reorganization proceedings with respect to the investment could not be regarded as arbitrary.[159] Further, because such proceedings are provided by all legal systems, they cannot be regarded as opposed to the rule of law.[160] The proceedings in this case were conducted in accordance with local law. The tribunal observed that its holding might have been different if it had concluded that the host state was responsible under international law for the economic difficulties of the claimant's investment.[161]

In a couple of awards applying this definition, tribunals did find host-state conduct to be arbitrary. In *Azurix v. Argentina*, a case arising under the United States-Argentina BIT, the tribunal cited the definition from *Black's Law Dictionary*, but then held that the *ELSI* definition is "close to the ordinary meaning of arbitrary since it emphasizes the element of willful disregard of the law."[162] The tribunal found that Argentina's actions in encouraging customers of the claimant's water company not to pay their bills, threatening officials who allowed the company to bill its customers, refusing to honor the tariff arrangement in the concession agreement, and refusing access to documents on the basis of which the company was sanctioned were arbitrary actions without basis in law or the concession agreement.

Similar to the award in *Azurix* is that in *Siemens v. Argentina*, a case arising under the Germany-Argentina BIT. After citing the definition from Black's Law Dictionary, the tribunal also found the *ELSI* definition to be "close to the ordinary meaning of the term emphasizing the willful disregard of the law."[163] In that case, the tribunal found that Argentina acted arbitrarily in suspending the contract that it had issued to the claimant's investment to produce national identity cards. Argentina had failed to offer a satisfactory explanation of the decision and thus it "did not seem to be based on reason."[164]

156 *See Impregilo v. Pakistan*, a case arising under the Italy-Pakistan BIT, where the tribunal held that matters of contract performance do not involve *puissance publique* and thus do not violate the prohibition on unreasonable or discriminatory measures. Decision on Jurisdiction, para. 260.
157 Award, para. 382.
158 Award, para. 176.
159 Award, para. 177.
160 Award, para. 178.
161 Award, para. 179.
162 Award, para. 392.
163 Award, para. 318. The similarity in language between the two awards is perhaps attributable to the fact that the same arbitrator served as president of both tribunals.
164 *Id.*

At least one case has adopted a definition drawn from *Neer v. Mexico.*[165] In *Genin v. Estonia*, a case arising under the United States-Estonia BIT, Estonia had revoked the license of the claimant's bank without following generally accepted banking and regulatory practices, such as providing formal notice of the intended revocation, inviting the bank to send a representative to the revocation proceeding, or providing the bank with an opportunity to challenge the revocation in court prior to its public announcement. In order to amount to a violation of the BIT, however, the tribunal found that such irregularities would need to amount to "bad faith, a wilful disregard of due process of law or an extreme insufficiency of action."[166] The tribunal found that the host state's conduct was not arbitrary because it was taken for regulatory reasons justified by the economic circumstances at the time, including in particular the difficulties associated with Estonia's transition to a market economy and its efforts to build a private financial sector. In support of its conclusion, the tribunal also cited the *ELSI* definition. As noted in Section 5.2.3, other tribunals have not followed *Genin* in suggesting that bad faith might be necessary to constitute a violation of the standard.

Not every tribunal relies on the dictionary definition of the terms. As already noted, the tribunal in *Saluka Investments v. Czech Republic*, a case arising under the Netherlands-Czech Republic, relied on the fact that reasonableness principle has the same content under both the fair and equitable treatment standard and the unreasonable or discriminatory measures standard. It held that the reasonableness principle requires "a showing that the State's conduct bears a reasonable relationship to some rational policy. . . ."[167]

One tribunal adopted a unique approach. In *BG Group v. Argentina*, a case arising under the United Kingdom-Argentina BIT, the tribunal distinguished between the terms "arbitrary" and "unreasonable," the only tribunal to do so. It defined arbitrary in accordance with the *ELSI* definition. It held that reasonableness, however, "should be measured against the expectations of the parties" to the BIT.[168] That is, reasonable conduct was that which would be "appropriate behavior in light of the goals of the Treaty."[169] The tribunal then found that Argentina's withdrawal of undertakings and assurances given to investors as an inducement to investment was by definition unreasonable. A change in policy, however, arguably could be a reasonable response to a change in circumstances. Thus, the true ground of the decision may have been that Argentina's change in policy, contrary to its prior assurances, violated the security principle of the BITs rather than the reasonableness principle.

Tribunals do not always define the term "arbitrary" or "unreasonable." One such case was *CME*, discussed above. Similarly, in *MTD Equity v. Chile*, a case arising

165 *U.S.A. (L.F. Neer) v. United Mexican States*, (United States-Mexico), October 15, 1926, 3 *International Law Reports* 213.
166 Award, para. 371.
167 Award, para. 460.
168 Award, para. 342.
169 Award, para. 342 (citing *CME v. Czech Republic*, Partial Award, para. 158).

under the Malaysia-Chile BIT, the tribunal in a very brief discussion found that Chile's encouragement of a foreign investor to invest in a land development project that was contrary to local zoning law was unreasonable. In *Enron v. Argentina*, a case arising under the United States-Argentina BIT, the tribunal held that emergency measures adopted by Argentina during its 2001–2002 financial crisis were not arbitrary because they "were what the Government believed and understood was the best response to the unfolding crisis."[170] Four months later, the tribunal in *Sempra Energy v. Argentina*, another case arising under the United States-Argentina BIT, agreed that the measures were not arbitrary. Echoing the language from Enron,[171] the tribunal found that, although Argentina's emergency measures were unlawful, "[t]hey were not . . . arbitrary in that they responded to what the Government believed and understood to be the best response to the unfolding crisis."[172] In *ADC v. Hungary*, a case arising under the Cyprus-Hungary BIT, the tribunal found with little discussion that under the facts before it the host state's expropriation of the claimant's investment in a way that violated the expropriation provision of the treaty also violated the prohibition on unreasonable or discriminatory measures.[173]

Tribunals rarely discuss the meaning of the word "discriminatory" in this provision. The few relevant cases are discussed in Section 7.3.

Tribunals do not always distinguish between unreasonable and discriminatory treatment. In *Eastern Sugar v. Czech Republic*, a case arising under the Netherlands-Czech Republic BIT, the European Union reduced the country sugar quota for the Czech Republic, which in turn reduced the quota allocated to a covered investment. The amount of the investment's quota, however, was reduced by more than the amount of the entire country quota reduction. That is, a single producer was required to bear the entire burden of the country's quota reduction. At the same time, the quota system had been revised to permit new entrants into the system. The tribunal believed that the covered investment, which had done nothing illegal, had been targeted in retaliation for its politically controversial decision to close a plant. The tribunal found, however, that even if the intent was not to punish the foreign investment, the decision to favor new entrants was an unreasonable or discriminatory measure.

In *LLC AMTO v. Ukraine*, a case arising under the Energy Charter Treaty, the tribunal found that the efforts by the tax authorities through a bankruptcy proceeding to collect taxes owed by the claimant's investment were based on nonpayment of taxes dating back to a time before the claimant acquired the investment. Other creditors also participated in the proceeding, which was conducted in accordance with local law. The tribunal found no arbitrary, unreasonable, or discriminatory conduct.[174]

170 Award, para. 281.
171 The similarity in language presumably is attributable to the fact that the same arbitrator served as president of both tribunals.
172 Award, para. 318.
173 Award, para. 445.
174 Award, para. 99.

5.4 THE INTERNATIONAL MINIMUM STANDARD

Some BITs require that the host state provide covered investment with treatment no less favorable than that required by customary international law.[175] Illustrative of these provisions is the language of the Finland-Armenia BIT, which provides that "[i]n any case a Contracting Party shall not accord treatment less favourable than that required by international law." Such a provision performs at least three functions.

First, it incorporates into a BIT all the obligations with respect to covered investment or investors imposed on host states by customary international law. Thus, where this provision appears, a breach of customary international law also violates the BIT. In a sense, this provision is analogous to the observance of obligations provision in that it incorporates a separate set of norms into the BIT, in one case the norms of customary law and in the other case the norms created by the terms of the obligation assumed by the host state. The benefit to the investor of the incorporation into the BIT of the international minimum standard is that it ensures that violations of that standard may be the basis of a claim under the investor-state or state-state disputes provisions. Some BITs confer on investor-state arbitral tribunals jurisdiction over an investment dispute only if it violates the BIT (or perhaps another instrument, such as an investment agreement)[176] and the existence of this provision ensures that a violation of the international minimum standard will satisfy that jurisdictional requirement. Other BITs, however, confer on investor-state arbitral tribunals jurisdiction over any dispute concerning an investment[177] and, in such a case, an investor's claim that the host state's treatment of investment violated customary international law may be within a tribunal's jurisdiction, even in the absence of this provision. In any event, the state-state disputes provision in nearly every case applies only to disputes concerning the interpretation or application of the BIT and thus this provision at a minimum facilitates enforcement of customary law under the state-state disputes provision. The usefulness of including a reference to the international minimum standard, however, is diminished by the fact that other provisions, such as the fair and equitable treatment provision, the unreasonable or discriminatory measures provision, the full protection and security provision, the expropriation provision, the observance of obligations provision, and the war and civil disturbance provision, taken together, incorporate much, if not all, of the international minimum standard.

A second function of this provision is that it serves as a choice of law clause for any dispute under the BIT. Because this provision requires the host state to comply with customary law in its treatment of covered investment, international law governs any dispute arising under the BIT. The usefulness of this function is also diminished to the extent that the requirements of customary international law are separately required by other provisions of the BIT.

175 *See, e.g.*, Finland-Armenia BIT, Art. 2(2); Sweden-Kazakhstan BIT, Art 2(4); Mexico-Iceland BIT, Art. 3(1); Austria-Malaysia BIT, Art. 3(2); United States-Georgia BIT, Art. 2(3)(a).

176 *See* Section 10.2.1.1.

177 *See* Section 10.2.1.1.

A third function of this provision is that it provides a general guide to the interpretation of the other provisions of the BIT. Because the provision requires the host state to comply with customary international law in its treatment of covered investment or investors, every provision of the BIT must be interpreted so as not to derogate from the protection provided by customary law. Customary law, of course, provides only a minimum standard. Where the language of a BIT requires more than customary international law requires, the host state must comply with the more rigorous BIT standard as well as the international minimum standard imposed by the BIT. This again is an example of the cumulative nature of BIT obligations.[178] The fair and equitable treatment standard performs a similar role in providing a guide to interpretation of the other provisions of the BIT.[179]

Many of the tribunal awards rendered to date applying this provision arose under BITs that also included requirements of fair and equitable treatment and full protection and security. In such cases, the tribunals often prefer to address whether the host state's conduct violated the somewhat more specific standard of fair and equitable treatment or full protection and security. For example, in *Lauder v. Czech Republic*, a case arising under the United States-Czech Republic BIT, the BIT guaranteed fair and equitable treatment, full protection and security, and treatment in no case less than that required by customary law. The tribunal noted that the claimant had not identified any specific obligation under international law that would provide more protection than the other BIT provisions on which he relied. Thus, the tribunal did not engage in an analysis of whether customary law was violated apart from its analysis of the other general absolute treatment standards alleged to have been violated.

Several tribunals have discussed the meaning of customary international law in the course of arbitrating claims under the NAFTA. Article 1105 of the NAFTA requires that covered investment be treated in accordance with customary international law, which under that article includes the obligations of fair and equitable treatment and full protection and security. As a result, these tribunals have not been required to distinguish carefully between the international minimum standard under customary law and the specific obligations of fair and equitable treatment and full protection and security.

A number of awards, however, have discussed in general terms what is required by customary international law. They are uniform in concluding that customary international law continues to evolve and that the treaty standard refers to customary international law as it exists today.[180]

The international minimum standard clearly incorporates the security principle. This principle is reflected in particular in the obligation of due diligence codified in the full protection and security standard. Awards discussing this standard are discussed in Section 6.3.3. It is reflected as well in the requirement that expropriations meet certain conditions, including payment of compensation. Awards discussing this requirement are discussed in Section 6.5.3. It is also reflected in the rule that unilateral repudiation

178 *See* Section 1.2.

179 *See* Section 5.2.1.

180 *See, e.g., Tecmed v. Mexico* (Spain-Mexico BIT), Award, para. 116; *ADF Group v. United States* (NAFTA), Award, para. 113.

of contracts is unlawful. Awards discussing this rule are discussed in Section 6.4.3. The international minimum standard also incorporates the due process principle, particularly through the prohibition on a denial of justice. Awards discussing the denial of justice doctrine are discussed in Section 10.4.

The international minimum standard incorporates as well the nondiscrimination principle. Awards discussing whether customary law includes a general prohibition on discriminatory treatment of foreign investment are discussed in Section 7.4. Some of the awards that have sought to define the provision requiring compliance with the international minimum standard have equated that provision with the reasonableness principle. As will be seen, the reasonableness principle as reflected in this provision operates the same way as under the fair and equitable treatment provision and the prohibition on unreasonable or discriminatory measures.

For example, in *S.D. Myers v. Canada*, a case arising under the NAFTA, Canada imposed a ban on the export of polychlorinated biphenyls (PCBs). The claimant sought to export the chemicals to the United States for processing at its plant in Ohio and, as a result of the ban, lost that business opportunity. The tribunal held that a breach of customary international law

> occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the rights of domestic authorities to regulate matters within their own borders.[181]

Thus, the tribunal seemed initially to equate a violation of the standard with unreasonable conduct. The tribunal then found that Canada's ban was adopted for the purpose of excluding American companies from the market for PCB disposal and therefore violated the national treatment standard of the NAFTA. It concluded that, under the circumstances of that case, a violation of national treatment also constituted a violation of customary international law, although it acknowledged that a violation of national treatment may not violate customary law in every case. In short, the violation in *S.D. Myers* consisted of an unjustified or unreasonable discrimination.

In *Pope & Talbot v Canada*, another case arising under the NAFTA, the tribunal initially held in its award on the merits that the requirement of fair and equitable treatment was additive to the requirement of treatment in accordance with customary international law in NAFTA Article 1105. A few weeks after that award, on July 31, 2001, the NAFTA parties issued a joint interpretation stating that Article 1105 guarantees only the treatment required by customary international law and that fair and equitable treatment is a component of the international minimum standard under customary law. Accordingly, in its subsequent award on damages, the tribunal undertook to reinterpret Article 1105. Canada had argued that the international minimum standard was the standard adopted in *Neer v. Mexico*. The *Neer* tribunal had required that, for a breach to be found, the treatment "should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of government action so far short of international

181 Partial Award, para. 263.

standards that every reasonable and impartial man would readily recognize its insufficiency."[182] The tribunal found, however, that international law had evolved since the *Neer* case was decided in 1926 and that Article 1105 required application of the evolving standard, not the standard as it existed in the 1920s. The tribunal then noted the definition of arbitrariness adopted by the International Court of Justice in the *ELSI* case:

> Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. . . . It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.[183]

Thus, a tribunal again appeared to equate a violation of customary international law with a violation of the reasonableness principle. The tribunal concluded that the *ELSI* case had lowered the international minimum standard from one of outrage to one of surprise. The tribunal then held, however, that it need not decide the precise formulation of the contemporary international minimum standard because Canada's conduct had met even the higher standard proposed by Canada and would "shock and outrage every reasonable person."[184] Such conduct included imposing very burdensome demands for documents, threats of criminal investigations, and misrepresentations of the facts concerning the investment's situation in internal government memoranda.

In *Mondev v. United States*, yet another case arising under the NAFTA, the tribunal noted that *Neer* and similar cases involved the physical security of aliens and there was insufficient cause to conclude that its standard of outrageous treatment also applied to the treatment of foreign investment. In any event, the tribunal went on to find that international law had evolved since the 1920s. As the tribunal explained,

> there can be no doubt that, by interpreting Article 1105(1) to prescribe 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 under NAFTA, the term "customary international law" refers to customary international law as it stood no earlier than the time at which NAFTA came into force. It is not limited to the international law of the 19th century or even of the first half of the 20th century, although decisions from that period remain relevant. In holding that Article 1105(1) refers to customary international law, the FTC interpretations incorporate current international law, whose content is shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce. Those treaties largely and concordantly provide for "fair and equitable" treatment of, and for "full protection and security" for, the foreign investor and its investments.[185]

In ascertaining the minimum standard, the tribunal found that it was "bound by the minimum standard as established in State practice and in the jurisprudence of

182 *U.S.A. (L.F. Neer) v. United Mexican States*, (United States-Mexico), October 15, 1926, 3 International Law Reports. 213.

183 *Case concerning Elettronica Sicula* (United States v. Italy), 1989 I.C.J. Rep. 15.

184 Award, para. 68.

185 Award, para. 125.

arbitral tribunals."[186] The claim in *Mondev* for a violation of customary international law arose from an alleged denial of justice. The tribunal's assessment of that claim is discussed in Section 10.4.

The tribunal in *Mondev* noted that the law to be applied is the law as it stood "no earlier than" the time at which the NAFTA entered into force.[187] As this language seems to indicate, where customary law continues to evolve after a treaty enters into force, a BIT provision guaranteeing treatment in accordance with customary international law requires treatment in accordance with the standard in its contemporary state, not as it existed at the date of entry into force.[188]

In *ADF Group v. United States*, still another case arising under the NAFTA, the tribunal concurred that the customary international law standard continues to evolve and noted that all three NAFTA parties agreed that Article 1105(1) refers to customary international law "as it exists today."[189] The tribunal then quoted with approval the discussion of *Neer* in *Mondev*. Thus, the tribunal concluded, "[t]here appears no logical necessity and no concordant state practice to support the view that the *Neer* formulation is automatically extendible to the contemporary context of treatment of foreign investors and their investments by a host or recipient state."[190] The tribunal then went on to examine the claimant's argument that a U.S. requirement that steel used in federally funding highway construction projects be manufactured in the United States violated the fair and equitable treatment element of Article 1105(1). As discussed above, the tribunal found that the claimant had not sustained its burden of proof in that regard because it had not demonstrated the unreasonableness of the requirement.

In *Waste Management v. Mexico*, again a case arising under the NAFTA, the claimant concluded a contract with the city of Acapulco under which it would collect and dispose of solid waste. Members of the public, however, opposed the collection program because they were unwilling to pay the fees assessed to finance the program. Eventually, as a result of this opposition, the city ceased to honor its obligations under the contract, including the payments owed to the investment. In determining the applicable standard under Article 1105 the tribunal surveyed several of the awards rendered to date.[191] The tribunal noted that, despite certain differences of emphasis,

> the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it

186 *Id.* at para. 119.
187 *Id.*
188 *Tecmed v. Mexico* (Spain-Mexico BIT), Award, para. 116; *UPS v. Canada* (NAFTA), Award on Jurisdiction, para. 84.
189 Award, para. 179.
190 *Id.* at para. 181.
191 These were the awards in *S.D. Myers v. Canada*, *Mondev v. United States*, *ADF v. United States*, and *Loewen v. United States*, all of which involved disputes under the NAFTA.

> is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.[192]

The tribunal observed that the standard "is to some extent a flexible one which must be adapted to the circumstances of each case."[193] As the quoted language indicates, the tribunal did not carefully distinguish between the international minimum standard required by Article 1105(1) and the fair and equitable treatment standard, which Article 1105(1) treats as merely one element of the international minimum standard. Thus, the award has been cited both as evidence of the content of Article 1105(1) and evidence of the content of the fair and equitable treatment standard.

In any event, the claimant alleged that the development bank, Banobras, breached Article 1105(1) in its failure to adhere to a line of credit agreement that would have guaranteed the payments due to claimant's investment. The tribunal found, however, that it need not determine whether Banobras complied because a remedy was available in Mexican courts and, for reasons discussed in Section 10.4, there had been no denial of justice before those courts. Apart from the agreement, Banobras was under no duty to provide a line of credit and therefore did not breach the standard in refusing to grant the claimant a line of credit.

The tribunal did find that the city had failed to fulfill its contractual obligations.[194] The tribunal held, however, that no violation of Article 1105(1) had occurred. The city's conduct was not "wholly arbitrary or grossly unfair."[195] The city's failure of payment was based on a financial crisis it faced and not on any sectoral or local prejudice. The tribunal also observed that nonpayment of a debt would not violate Article 1105, "provided that it does not amount to an outright and unjustified repudiation of the transaction and provided that some remedy is open to the creditor to address the problem."[196] Again, the tribunal associated a violation of the international minimum standard with unreasonable conduct.[197]

In *GAMI Investments v. Mexico*, also a case arising under the NAFTA, the tribunal considered whether Mexico's administration of its regime for regulating sugar production, exports, and prices violated customary international law. The claimant, which owned sugar mills, contended that Mexico's maladministration of the regime, including in particular its failure to enforce its own laws, had injured the claimant's investment. The tribunal quoted language from *S.D. Myers v. Canada*, which stated:

> When interpreting and applying the "minimum standard," a [tribunal formed under the investment chapter of NAFTA] 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

192 Award, para. 98.
193 *Id.* at 99.
194 Award, para. 109.
195 *Id.* at para. 115.
196 *Id.*
197 The reference to "unjustified repudiation of the transaction" appears to be a reference to the security principle as well.

or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.[198]

The tribunal noted that the failure of a government program to achieve its objectives does not necessarily constitute a violation of international law nor is a failure to follow national law ipso facto a violation of international law. Rather, something more than mere illegality is required, such as an "outright and unjustified repudiation" of the regulations.[199] The tribunal found that, while Mexico had poorly administered the sugar regime, its conduct did not violate international law. The regime had not worked as planned and the evidence did not support the conclusion that Mexico had deliberately sought to undermine the regime. As this suggests, Mexico's conduct did not violate the standard because it was reasonable, even if flawed.[200]

In *CME v. Czech Republic*, a case arising under the Netherlands-Czech Republic BIT, the tribunal did not discuss the meaning of the international minimum standard. It held simply that

> the intentional undermining of the Claimant's investment protection, the expropriation of the value of that investment, its unfair and inequitable treatment, the Media Council's unreasonable actions, the destruction of the Claimant's investment security and protection, are together a violation of the principles of international law. . . .[201]

Because certain of these acts, such as an uncompensated expropriation, even alone would have violated customary international law, finding that the acts collectively violate customary law provides little guidance concerning the standard required under that law. The language suggests, however, that the wrongfulness of the Czech Republic's conduct rested on its violation of principles of reasonableness and security.

198 Award, para. 93, quoting *S.D. Myers v. Canada*, First Partial Award of 13 November 2000, para. 260.

199 Award, para.103.

200 In any event, the success of the regime depended upon the conduct of multiple actors and it was not shown that claimant's losses were attributable to the actions of Mexico. As suggested in note 197 *supra*, the reference to repudiation suggests that the tribunal considered the security principle as well.

201 Partial Award, para. 614.