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*The Fair and Equitable
Treatment Standard*
in the International Law
of Foreign Investment

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Chapter 5

Actual Situations in which the FET Standard has been Applied

Introduction

The current chapter stems from a thorough analysis of the awards rendered by the arbitral tribunals, under ICSID, SCC, and UNCITRAL rules, as of August 2007. There are thirty-four cases that contain a reasoning of the tribunal on a FET claim.¹ In the elaboration of these discussions various types of materials related to the cases, such as memorials of the parties and separate, individual, or dissenting opinions of arbitrators were used. The decision to combine the cases based on a BIT with those based on NAFTA or on the ECT, was justified by the belief that FET has only one content which is operating at different thresholds, depending on the context. The difference between a bilateral and the NAFTA FET clause stands in the level of treatment it offers, not in the content of the clause as such.² This hypothesis is confirmed by the frequent reference of arbitral tribunals established under NAFTA to decisions rendered by tribunals established under a BIT, and vice versa. Thus, the arbitrators themselves do not make a distinction between the two legal bases. The conclusions of this chapter benefited from the growing number of commentaries scholars produce on individual cases or on specific points of law.

The aim of this chapter is to finally give a concrete content to the FET standard. It is indeed true, as was pointed out various times in this book, that FET, because it is a standard, may not be given a fixed, clear content. However, based on the objective element, ie the indications that the States give to the arbitrators, the standard has been applied to a number of legal situations, which define the content of FET. As held by the claimant in the *Saluka* case, FET, vague as it may

¹ See appendix VII and appendix VIII.

² It has been argued, in chapter 2, that there is no difference between BITs and NAFTA, as far as the content of the FET is concerned. The classical assimilation of the NAFTA article 1105 with the international minimum standard is not only incorrect but it does not solve the question of the content of the FET. For more on this issue, see chapter 2. Dolzer maintained the same view; he argued that 'the general assumption so far is, presumably, that "fair and equitable" must be considered to represent a single, unified standard.' R Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39(1) *The International Lawyer* 87, 91.

be, is 'susceptible of specification through judicial practice and does in fact have sufficient legal content to allow the case to be decided on the basis of law.'³ The role of the judge in the application of FET is crucial, as he is the one identifying the various situations in which the FET has to be applied. This implies that there will always be new situations that may be identified by arbitrators; therefore the list of situations addressed in this chapter is not exhaustive.

A final technical remark is necessary. This chapter should be read in conjunction with appendix VII which presents the different factual situations examined in this chapter and the awards in which they have each been discussed, individually. Since in the body of the text only those cases that are relevant for the argumentation have been mentioned, appendix VII constitutes a useful additional tool in order to achieve a complete picture of how each one of the situations has been dealt with by the different tribunals.

The first arbitral tribunals confronted with the interpretation of the FET standard were either elliptic in their reasoning or extreme in their interpretation of this standard, empowering it, sometimes, with extravagant functions. The persistence of the Investors in raising FET claims gave the opportunity to tribunals to elaborate more, and more reasonably, on the meaning of FET.

Since the FET is a standard, it is natural that it has a variable content that depends on the circumstances of the case as well as more objective elements, like the wording of the clause or the various exceptions found in the annexes of the treaties. The lack of fixed content, which is one of the trademarks of FET, is not a weakness; on the contrary, it constitutes its strength. As was said above, one strategy for dealing with the standard, is to draw up a list of factual situations covered by FET-while being aware that this list is not exhaustive and that other factual situations may arise, in time, with further appearances of FET in the Investors' claims. In *Mondev*, the tribunal confirmed that the standard 'applies to a wide range of factual situations, whether in peace or in civil strife, and to conduct by a wide range of State organs or agencies.'⁴

The factual situations presented in this chapter may be classified in two categories. The first category is composed of the factual situations that are sufficient, on their own, to create obligations for the State; in other words those whose breach alone is sufficient to engage the State's responsibility. They are, in a way, *self-sufficient*. The second category is composed of those situations that may be called *accessories*, because they have to be associated with a *self-sufficient* situation in order to have an influence on the breach of the FET. The type of influence that this second type of situation may have on the first one is comparable to the one that aggravating circumstances have on the main breach. This distinction is useful in giving a picture of the factual situations attached, for the time being, to the

³ *Saluka* case (chapter 2, n 110), §284.

⁴ *Mondev* case (chapter 1, n 3), §95. Further in the award, the tribunal added that 'a judgement of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case', §118.

FET standard. However, in the light of the variety of situations, circumstances, and arrangements encountered in the different arbitration awards, this distinction may, at times, have proved limitative. Therefore it has not been practically used in the following analysis, which examines each one of the situations individually.

5.1 Lack of Respect for the Obligation of Vigilance and Protection

The obligation of vigilance and protection that a State must assume in respect to the foreign investments on its territory is basically an obligation to exercise due diligence. Due diligence is 'nothing more nor less than the reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances.'⁵

The liability of the State is established by 'the mere lack or want of due diligence',⁶ there is no need to establish negligence. In his separate opinion in the *AAPL* case, Judge Asante observed that 'the requirement as to the fair and equitable treatment, full protection and security and non-discrimination treatment all underscore the general obligation of the host State to exercise due diligence in protecting foreign investment in its territories, an obligation that derives from customary international law.'⁷

In *Lauder*, the tribunal accepted that FET 'is related to the traditional standard of due diligence.'⁸ However, this obligation of due diligence is to be seen within certain limits. For example, it may not imply the obligation of the State to intervene in a dispute between two companies. The only duty of the State is 'to keep its judicial system available for the Claimant and any entities he controls to bring their claims, and for such claims to be properly examined and decided in accordance with domestic and international law'.⁹ Interpreted in such a way, the obligation of vigilance and protection recalls the obligation of the State to offer to the foreign Investor a system that respects the due process requirements.

The arbitrators in the *AMT* case interpreted the State obligation to accord FET as 'an obligation of vigilance, in the sense that Zaire as the receiving State of investments made by AMT... shall take all the measures necessary to ensure the full enjoyment of protection and security of its investments and should not be permitted to invoke its own legislation to detract from any such obligation.'¹⁰ The tribunal ruled that it is the State's obligation to show that it took all measures of precaution to protect the investment. It would have been interesting for

⁵ A Freeman, 'Responsibility of States for unlawful acts of their armed forces' (1956), 88 RCADI, 15–16.

⁶ A Amerasinghe, *State Responsibility for Injuries to Aliens* (Oxford: OUP, 1967), 281–282.

⁷ Asante opinion in *AAPL* case (chapter 2, n 108) 639.

⁸ *Lauder* case (chapter 1, n 102), §292

⁹ *Ibid* §314

¹⁰ *AMT* case (Introduction, n 10), §6.05.

the tribunal to tackle the issue of the obligation of result versus an obligation of conduct of the State, but it decided that such a discussion was not useful since the State took no measure at all to protect the investments. In a different case though, the tribunal determined that the State has only an obligation of conduct since it established that the State's obligation is not an 'absolute obligation which guarantees that no damages will be suffered, in the sense that any violation thereof creates automatically a 'strict liability' of the host State.'¹¹

The State has to be vigilant and protect the foreign investment in its territory otherwise it may violate its FET obligation. The tribunal in the *Wena Hotels* case found that 'even if Egypt did not instigate or participate in the seizure of the two hotels, as Wena claims, there is sufficient evidence to find that Egypt was aware of EHC's intentions and took no actions to prevent the seizures or to immediately restore Wena's control over the hotels.'¹² This behaviour of the State was sufficient to be in breach of the FET clause.

To conclude, it seems that there is an obligation within FET to treat foreign Investors in such a way as to allow them to conduct their activity in a hospitable environment. This obligation requires from the State similar behaviour as that required by the more specific standard of 'full protection and security',¹³ in the sense that the State is also obliged to physically protect the Investors and their investments in case of riots or demonstrations of the population which may result in the destruction of the investments. It would indeed not be fair and equitable if the State police and army would not intervene to protect the Investors' property and the Investors themselves, since it is a State obligation to provide for law and order on its territory.

5.2 Denial of Due Process and/or Procedural Fairness

The term denial of due process refers to the more specific notion of judicial denial of justice whereas procedural fairness refers to all types of procedures in which the Investor may be involved with the organs of the State, ie administrative procedures. The actions or omissions of the State that qualify under both of these categories—denial of justice and/or procedural fairness—have been found to violate the FET standard. They will be examined in order.

Denial of justice is an important notion of international law that was the object of a number of general studies;¹⁴ it is not our aim to engage at this stage in

¹¹ *AAPL* case, (chapter 2, n 108) 545.

¹² *Wena Hotels Ltd v Egypt* ICSID, ARB/98/4, Award rendered on 8 December 2000 (Leigh. Fadlallah.Wallace), 885.

¹³ For a discussion on the relationship between FET and full protection and security see chapter 6.

¹⁴ The literature on the denial of justice is rich and the issues to be discussed in connection with this notion numerous. For more comprehensive studies on this notion see Garner, 'International Responsibility of States for Judgements of Courts and Verdicts of Juries amounting to denial of

a study of it. Our aim is to determine the situations in which denial of justice to the foreign Investor may constitute violation of FET. We will start with the working definition of the denial of justice used for the purposes of this section. Adede defined the denial of justice as an 'improper administration of civil and criminal justice as regards an alien, including denial of access to courts, inadequate procedures, and unjust decisions.'¹⁵ According to Professor Greenwood, the obligation to 'maintain and make available to aliens, a fair and effective system of justice' is part of customary international law.¹⁶

The notion of denial of justice contains two elements: a procedural element that covers the inaccessibility to the domestic courts and a substantive one that refers to the malfunction of the court action, ie the procedure during the trial and its result, the award.

It is generally accepted that national courts should not deal with claims introduced on the grounds of denial of justice. This is so because it is precisely the conduct of the domestic legal system that is questioned. Such a claim is to be solved in front of an international tribunal. This separation between national and international courts is generally accepted. The same consensus is not found as to the situations that constitute a denial of justice. The most extreme view supported by a number of scholars is restrictive and maintains that only a refusal to consider a case constitutes a denial of justice.¹⁷ Other scholars, while including this restrictive view in theirs, agree also to the revision of national decisions only in so far as they are taken by judicial officers of the host State. Despite these different views, the concept of denial of justice is commonly accepted in modern international law as a notion with full membership.¹⁸

A situation of denial of justice has been interpreted, in various awards, as amounting to a breach of the FET. In *Mondev*, the tribunal held that:

[T]he question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of

justice', (1929) 10 BYIL 181; Freeman, *The International Responsibility of States for Denial of Justice* (Liège: Vaillant-Carmanne, 1938); Adede, 'A Fresh Look at the Meaning of the Doctrine of Denial of Justice under International Law', (1976) 14 *The Canadian Yearbook of International Law* 72; J Paulsson, *Denial of Justice in International Law* (Cambridge: CUP, 2005).

¹⁵ Adede, 'A Fresh Look at the Meaning of the Doctrine of Denial of Justice under International Law', *ibid* 91.

¹⁶ *Loewen* case (chapter 2, n 25), §129, quoting Professor's Greenwood Second Opinion, §79

¹⁷ There are no serious representatives of this view in modern international law. This view deprives the denial of justice of any real meaning. The underlying argument of this position is that once dealt with by the national courts of a State, it would be an affront to national sovereignty for international adjudicators to revise the decision of the national courts.

¹⁸ As Paulsson writes in his study dedicated entirely to the notion of denial of justice, 'international law would not crumble with the disappearance of the expression "denial of justice".' However, this notion allows a number of actions of the State that do not fulfil an acceptable level of fairness or reasonableness or simply, of legality, to be sanctioned. See Paulsson, *Denial of Justice in International Law*, (chapter 5, n 14) 59.

all the facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subject to 'unfair and inequitable treatment'.¹⁹

Also, in *Methanex*, the tribunal stated that due process is incorporated in NAFTA article 1105 (1).²⁰ Finally, the *SD Meyers* award contained the following statement of the tribunal:

Article 1105 of the NAFTA requires the Parties to treat investors of another Party in accordance with international law, including fair and equitable treatment. Article 1105 imports into the NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice.²¹

A number of specific points concerning the modalities in which denial of justice may amount to a breach of FET will be now examined. These include the link between such a breach and local remedies, the procedure before the national court, what has been considered to constitute denial of justice, and, finally, the limits of this claim.

i. Local Remedies

The tribunal in *Loewen* declared that the trial court conduct in the national courts did not amount to a violation of 'fair and equitable treatment' by the US because it had not been established that the US had failed to make adequate remedies reasonably available to the complainants, ie the possibility of appeal. The tribunal concluded that *Loewen* had failed to demonstrate that those remedies, in particular resort to the US Supreme Court, were not reasonably available to it.²² In *Metalclad*, the tribunal appreciated the manner in which the decision was taken to deny a construction permit to the Investor. 'The permit was denied at a meeting of the Municipal Town Council of which *Metalclad* received no notice, to which it received no invitation, and at which it was given no opportunity to appear.'²³ Therefore, one of the elements tribunals will examine in order to appreciate if foreign Investors were offered due process is the availability of the local remedies to them and the possibility to benefit from a standard of review of the decisions that concern them directly.

Tribunals, however, have been careful in analysing the actions and decisions taken by the domestic systems of the host States not to interfere with the sovereignty of the national States to regulate their internal matters. In *Loewen* for

¹⁹ *Mondev* case (chapter 1, n 3).

²⁰ The tribunal examining the relationship between the FET and the non-discrimination principle declared that 'if article 1105 (1) had already included a non-discrimination requirement, there would be no need to insert that requirement in Article 1101 (1) (b), for it would already have been included in the incorporation of Article 1105 (1)'s due process requirement.' See *Methanex* case (chapter 2, n 21).

²¹ *SD Meyers* case (chapter 2, n 132), §134.

²² *Loewen* case (chapter 2, n 25), §167.

²³ *Metalclad* case (chapter 4, n 10), §91.

example, the tribunal declared, '[w]hether the conduct of the trial amounted to a breach of domestic law as well as international law is not for us to determine'.²⁴ The reluctance of the tribunal to recognize, in this case, that the due process obligation was violated contrasts with the very severe terms used by the arbitrators to describe the procedure in the local courts. The reason for this contrast may be, as declared by the tribunal, that 'too great readiness to step... into the domestic arena... will damage... the viability of NAFTA itself'.²⁵ The important element as to the local remedies is their availability to the Investor not their inherent characteristics.

One argument brought by the respondents is that the responsibility of the State for an injury based upon judicial action in a particular case, may be established only when there is an act by the State's judicial system as a whole. In other words, only when the claimant exhausted the local remedies.²⁶ However, in *Mondev*, the tribunal refused to see the denial of justice and the exhaustion of local remedies rules as 'interlocking and inseparable'.²⁷

ii. Procedure Before the Court

There are the cases of denial of justice classically quoted by the literature. The first one was rendered in 1927 and the second is a more recent one from 2004. Ironically, in neither of these two cases did the tribunals find that the action of the State amounted to a denial of justice. However, scholars argue that the reasoning of the tribunals in these two cases contributed substantially to the reflection on this notion.

In *Loewen*, the tribunal noted: 'the whole trial (in local courts) and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment'.²⁸ The positive obligation of the host State under international law is 'to provide a fair

²⁴ *Loewen case* (chapter 2, n 25), §134.

²⁵ *Loewen case* *ibid.*, §242. Needless to say that this reluctance of the Loewen tribunal has been criticized by great part of the commentators. Wallace justifies it by 'fear, exaggerated in my view, of the expected reactions from political leaders in the United States, from the NGOs and others—which might jeopardize the very continuation of Chapter 11 and perhaps even the NAFTA.' D Wallace, 'Fair and Equitable Treatment and Denial of Justice: *Loewen v US and Chattin v Mexico*', in T Weiler (ed) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron May, 2005).

²⁶ *Loewen case* (chapter 2, n 25), §143 et s.

²⁷ *Mondev case* (chapter 1, n 3), §96.

²⁸ *Loewen case* (chapter 2, n 25), §137. These severe terms are not isolated in this decision; the tribunal qualified the award of the national court in such terms at various stages of the reasoning. For example, the tribunal said 'the conduct of the trial by the trial judge was so flawed that it constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood in international law', *ibid.* §54. Further in the award, the arbitrators reiterated their surprise affirming that 'by any standard of measurement the trial... was a disgrace.... By any standard of evaluation, the trial judge failed to afford Loewen the process that was due', *ibid.* §119.

trial of a case to which a foreigner is a party'.²⁹ A fair trial is achieved, in the view of the tribunal, when there is no discrimination against the foreign litigant or when the same does not become the victim of sectional or local prejudice. The general position of tribunals as to the treatment to be offered to foreign Investors in the procedures before the national courts is that this treatment should respect the characteristics of fair trial and due process of law.

iii. What Constitutes a Denial of Justice?

'Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough' to constitute a breach of NAFTA article 1105.³⁰ The error of a national court is not sufficient to breach the due process obligation; what is required is 'manifest injustice' or 'gross unfairness',³¹ 'flagrant and inexcusable violation',³² or 'palpable violation' in which 'bad faith not judicial error seems to be the heart of the matter'.³³ In the *Azinian* case, the tribunal offered another criteria for asserting the respect of the due process obligation by the host State:

A denial of justice could be pleaded if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way... There is a fourth type of denial of justice, namely the clear and malicious misapplication of the law. This type of wrong doubtless overlaps with the notion of 'preference of form' to mask a violation of international law. In the present case, not only has no such wrongdoing been pleaded, but the Arbitral Tribunal wishes to record that it views the evidence as sufficient to dispel any shadow over the bona fides of the Mexican judgments. Their findings cannot possibly be said to have been arbitrary, let alone malicious.³⁴

The same tribunal following the interpretation of De Aréchaga declared that 'the responsibility of the State for acts of judicial authorities may result from three different types of judicial decision. The first is a decision of a domestic court *clearly incompatible with a rule of international law*. The second is what is known traditionally as a "*denial of justice*." The third occurs when, in certain exceptional and well defined circumstances, a State is responsible for a judicial decision contrary to domestic law'.³⁵

²⁹ *Ibid.* §123.

³⁰ *Ibid.* §132.

³¹ Garner, 'International Responsibility of States for Judgements of Courts and Verdicts of Juries amounting to denial of justice', (chapter 5, n 14) 183.

³² Arechaga, 'International Law in the past Third of a Century' (1978), 159 RCADI 282.

³³ O'Connell, *International Law*, (1970) 498.

³⁴ *Robert Azinian v United Mexican States* ICSID, ARB(AF)/97/2, Final Award rendered on 1st November 1999 (Paulsson, Civiletti, Wobeser-Hoepfner) §102–103.

³⁵ The tribunal in *Azinian* uses the interpretation given by Eduardo Jiménez de Aréchaga in his 1978 Hague Course concerning the different circumstances in which the State could be held responsible for the acts of its judicial authorities. *Ibid.* §98.

iv. Limits

The obligation to refrain from treatment towards the Investor that may amount to a denial of justice has also a series of exceptions. The Investor who relies on the national courts of the host States may not address the arbitral tribunal for revision of a negative decision of the domestic courts. The tribunal in *Mondev* noted that if Investors seek local remedies 'and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal'.³⁶ This interpretation was followed by other tribunals. In *Azinian* the tribunal declared that 'the possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seized has plenary appellate jurisdiction'.³⁷ The claim established before an international arbitral tribunal after having made use of the local remedies must be grounded on real legal issues, not on the refusal of the Investor to accept a negative answer to its claim. The occasions in which a claim based on denial of justice may appear like an appeal against a national judgement have to be seen in connection with the relationship between the FET and the issue of exhaustion of local remedies. The *Azanian* tribunal concluded by noting that:

It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints... NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.³⁸

v. Procedural fairness

In *Middle East Cement*, the tribunal applied the provisions of the BIT between Greece and Egypt concerning fair and equitable treatment and full protection and security to a situation concerning the seizure and auction of a ship without prior notification to the owner. The tribunal considered that a 'matter as important as the seizure and auctioning of a ship of the Claimant should have been notified by a direct communication',³⁹ which would have been possible. A prior notification was necessary 'irrespective of whether there was a legal duty or practice to do so'.⁴⁰ It is not surprising to see the tribunal deciding that even in the absence of a legal duty the Investor should have been notified. The tribunal evaluated the behaviour of the State according to the FET standard, which is based on international law not domestic law and found that the host State violated its FET obligation. The tribunal applied FET at a high threshold when estimating that, even in the absence of a legal duty or practice, a direct notification

³⁶ *Mondev* case (chapter 1, n 3), §126.

³⁷ *Azinian* case (chapter 5, n 34) §99.

³⁸ *Ibid* §83.

³⁹ *MTD* case, (chapter 4, n 3), §143

⁴⁰ *Ibid* §143

was to be used. This decision confirms a rather consistent ruling of the tribunals that in the presence of serious procedural shortcomings there is a violation of the FET standard. The treatment of the Investor does not have to fall below 'the level that is unacceptable from the international perspective'.⁴¹

In *Metalclad*, the tribunal considered the manner in which the decision was taken to deny a construction permit to the Investor. 'The permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear'.⁴² Further in the award, the tribunal goes further than the breach of article 1105, it adds the 'the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit'.⁴³

The obligation of procedural fairness is read in a broad manner, including all types of procedures engaged in by the Investor with the organs of the State, not only the judicial procedures. The host State may not justify a procedure because it respects domestic law: the fair and equitable treatment provides a 'basic and general standard which is detached from the host State's domestic law'.⁴⁴

5.3 Non-Observance of the Investor's Legitimate Expectations

The notion of legitimate expectations is not unknown to the international law of foreign investment. Back in 1920, in the *Expropriated Religious Properties* arbitration, the tribunal referred to the notion of legitimated expectations already by reference to the FET. It noted that the award appeared to be fair and equitable and capable of respecting the respective legitimate expectations of the parties.⁴⁵

More recently, in the *Aminoil* case, the legitimate expectations notion was used in the context of the calculation of the compensation. The tribunal was favourable to the use of this notion, it held that:

Both Parties to the present litigation have invoked the notion of 'legitimate expectations' for deciding on compensation. The formula is well advised.⁴⁶

The notion of legitimate expectations is also used in relation to indirect expropriation.⁴⁷ Scholars have already envisaged a possible future autonomy of the

⁴¹ *SD Meyers* case (chapter 2, n 132), §134

⁴² *Metalclad* case (chapter 4, n 10), §91

⁴³ *Ibid* §88.

⁴⁴ *Genin* case (chapter 2, n 109), §367

⁴⁵ *Expropriated Religious Properties* case (chapter 2, n 140) 12.

⁴⁶ *Aminoil* case (chapter 2, n 97), §143.

⁴⁷ For a discussion on the use of the legitimate expectations both in the context of FET and in that of expropriation, see S Fiatta, 'Expropriation and the "Fair and Equitable" Standard', talk

concept; the idea is justified by the fact that in the context of the indirect expropriation the concept operates with different set of qualities and requirements than in the context of the FET, which shows that it has enough resources to adapt to diverse situations.⁴⁸ In the field of indirect expropriation, the requirement of 'deprivation of property' is replaced by the criteria of violation of the 'legitimate expectations' of the Investor. This is to say that the arbitrators may rule in favour of an indirect expropriation on the basis of the violation of the Investor's legitimate expectations, and in the absence of a deprivation of property. Contrary to its operation in the FET scenario, the expectations of the Investor may derive from all types of circumstances, not exclusively from those attributable to the State. In the *Metalclad* case, the tribunal held that:

... expropriation under NAFTA includes ... also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.⁴⁹

However, it is in the context of the FET standard that the legitimate expectations principle is the most frequently encountered. The tribunal in the *Generation Ukraine* case underlined the importance of the concept in the framework of the fair and equitable treatment standard:

Finally, it is relevant to consider the vicissitudes of the economy of the state that is host to the investment in determining the investor's legitimate expectations, the protection of which is a major concern of the minimum standards of treatment contained in bilateral investment treaties.⁵⁰

The foreign Investor is aware of a certain number of elements at the beginning of its investment, concerning the host State. These elements are connected to the social and political situation of that determined State—in other words, the business climate, and also the legislative and administrative framework. These general elements will be taken into account by the Investor not only in his decision to invest in one country rather than in another but also in the every-day contact with the State and its administration. These elements will be the glasses through which the Investor will judge its investment activity in the host State. ICSID tribunals underlined the importance of this preliminary observation phase of the conditions of the host State by foreign Investors and reiterated the fact that the ICSID system is not an insurance system that pays for an imprudent foreign Investor.

These elements contribute to the formation of a set of expectations on the side of the foreign Investor, as to the way in which his investment operation

given at The Fair and Equitable Treatment in Investment Treaty Law Conference, organised by the BIICL, London, (9 September 2005), available at <<http://www.biicl.org>>.

⁴⁸ Also supporting this idea of autonomy of the concept is its frequent use in the context of the ECHR, where it has been recognized as having the quality of a fundamental right.

⁴⁹ *Metalclad* case (chapter 4, n 10), §103.

⁵⁰ *Generation Ukraine* case (chapter 2, n 111), §20.37.

will develop in a particular country. These expectations have to be *legitimate* in order to receive protection from international law. It is clear that an Investor who decides to invest in a developing country cannot expect the same level of stability and administrative efficiency as it could find in a developed country.

The respect by the host State for the legitimate expectations of the foreign Investor is, in our opinion, the perfect illustration of the type of content that should be given to the word 'fair'. In *Tecmed*, the arbitral tribunal observed with reference to the 'fair and equitable treatment' provision of the bilateral investment treaty:

This provision of the Agreement, in the light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to take the investment.⁵¹

These expectations are qualified as 'legitimate', 'justified', 'basic',⁵² 'reasonable' or fundamental and all these adjectives are used in such a way that they are interchangeable. Their protection of the Investors' expectations is an integral part, if not the most important element of the FET obligation. If this assertion is criticized by numerous scholars, two recent cases confirm this view. In *Saluka*, the tribunal held that '[t]he standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations which is the dominant element of the standard.'⁵³ Also, in *CME* the tribunal concluded that the host State breached the FET 'by visceration of the arrangements in reliance upon which the foreign investor was induced to invest.'⁵⁴

The difficulty in the debate on legitimate expectations derives from the fact that such a broad concept may cover an infinity of situations and become a *catch-all* concept. In order to avoid falling in this trap, the criteria need to narrow down its meaning and shape it according to the common view.

The most complete definition of the legitimate expectations was given in a recent case, *Thunderbird v Mexico*:

... the concept of 'legitimate expectations' relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honor those expectations could cause the investor (or investment) to suffer damages.⁵⁵

⁵¹ *Tecmed* case (chapter 4, n 59), §154.

⁵² *CME Czech Republic BV v Czech Republic*, SCC, UNCITRAL, Partial Award rendered on 13 January 2001 (Kühn.Schwebel.Händl.) §611 and *Eureka BV v Republic of Poland*, Ad-hoc Tribunal, Partial Award rendered on 19 August 2005 (Fortier.Schwebel.Rajski) §232.

⁵³ *Saluka* case (chapter 2, n 110), §302

⁵⁴ *CME* case (chapter 5, n 52), §155

⁵⁵ *International Thunderbird Gaming v United States of Mexico*, UNCITRAL, Award rendered on 26 January 2006 (Van den Berg.Wälde.Ariosa) §147.

These expectations have an important role to play in the Investor's decision to invest in the host State.⁵⁶ The protection of these expectations is therefore an essential element of the Investor-State relationship.

The criteria followed until now by the various tribunals that had to examine this concept are the following:

- the type of conduct necessary to generate expectations that become legitimate by the authority of this conduct—an authority of the host State;
- the level of the expectations have to be reasonable and justifiable in the light of the conduct of the State and of the general context;
- there has to be a causal link between the failure to respect these expectations and the damage suffered by the Investor.

As to the first point, the type of action that can create legitimate expectations, there is a general understanding that this action has to be directly linked to the government.⁵⁷ The disagreement between Investors and States arises from the type of action that legitimates the expectations of the Investor: may a lack of action or an unclear declaration be the source of legitimate expectations? In the *Thunderbird* case, Mexico argued that for the purposes of the legitimate expectations a licence or a permit is needed. However, the tribunal took a broader approach and considered that legitimate expectations can arise from other actions of the government as well, not necessarily from a licence or a permit.

The tribunals also looked at the behaviour of the authorities during the course of their relationship with the Investor. The authorities usually have numerous occasions to cooperate with the Investor and to rectify his eventual misinterpretations or misrepresentations of the national law. For instance, if the authorities repeatedly act in a way which leads the Investor to believe he is acting in a lawful way, the same authorities may not suddenly decide to treat this behaviour as unlawful, without violating the legitimate expectations of the Investor. In *Metalclad*, the tribunal specifically underlined the fact that the Investor constructed the landfill 'openly and continuously, and with the full knowledge of the federal, state and municipal government.'⁵⁸

The circumstances of the case⁵⁹ are taken into account by the tribunal in considering the actions of the State; they may be of various types and carried out at various moments of the Investor-State relationship.⁶⁰

⁵⁶ *Tecmed* case (chapter 4, n 59), §154.

⁵⁷ In *Metalclad*, the tribunal considered that the expectations of the Investor were legitimate because they were built on 'the representations of the federal government'. *Metalclad* case, (chapter 4, n 10), §87.

⁵⁸ *Ibid.*

⁵⁹ On the importance of taking into account the circumstances of the case, see chapter 7.

⁶⁰ Again, in *Metalclad*, the tribunal noted that the denial of a construction permit was issued 'well after the construction was virtually complete'. *Metalclad* case (chapter 4, n 10), §90. Also, the tribunal looked at the manner in which the decision not to deliver the permit was taken, 'Metaclad received no notice' and 'it was given no opportunity to appear'. *Ibid* §91.

Concerning the second criteria, the expectations of the Investors have to be reasonable and justifiable in the light of circumstances.⁶¹ As the *Waste Management* tribunal concluded, 'it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.'⁶² What is then reasonable? The *Saluka* tribunal gives an example of what is not: expecting 'that the circumstances prevailing at the time the investment is made remain totally unchanged' and not take into account also the host State's legitimate right to regulate domestic matters.⁶³ It is not reasonable either to 'fail to consider parameters such as business risk or industry's regular patterns'.⁶⁴

Apart from the fact that the expectations of the Investor have to be proportionate to the behaviour of the authority, there are also other elements taken into account by the tribunal with regard to the Investor's behaviour.⁶⁵ In *Metalclad*, the tribunal took into account the fact that the Investor did complete his construction before being refused the additional necessary construction permit.⁶⁶ In a very different case, the arbitral tribunal in *Nobel* also took into account the fact that the Investors did not invest a single dollar the host country while their expectations were high.⁶⁷

The idea that the BITs are not 'insurance policies against bad business judgments' is shared by an increasing number of tribunals. The obligation to respect the Investors' expectations exists as long as these expectations are legitimate and they are not used to 'relieve investors of the business risks inherent in any investment'.⁶⁸

The tribunal in *Metalclad* summed up the two first two criteria in a very clear way:

Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. In following the advice of these officials, and filling the municipal permit application on November 15, 1994, Metalclad was merely acting prudently and in full expectation that the permit would be granted.⁶⁹

⁶¹ *Saluka* case (chapter 2, n 110), §304

⁶² *Waste Management* case (chapter 3, n 65), §99.

⁶³ *Saluka* case (chapter 2, n 110), §305.

⁶⁴ *LG&E* case (chapter 5, n 110), §130.

⁶⁵ For a discussion on the behaviour of the investor taken into account by arbitral tribunals, see chapter 7.

⁶⁶ *Metalclad* case (chapter 4, n 10), §90. A very similar case is ongoing and a decision by the arbitral tribunal should be given in the next months. In the *Fraport v Philippines* case, the Investor had completed the construction of the airport terminal when the government decided that the contract was 'void and null ab initio' and refused, for this reason, to respect its contractual obligations. The final award has not yet been rendered.

⁶⁷ *Nobel* case (chapter 3, n 73), §65.

⁶⁸ *Maffezini* case (chapter 4, n 10), §64.

⁶⁹ *Metalclad* case (chapter 4, n 10), §89.

The *Waste Management* tribunal confirmed this view stating that 'in applying the [fair and equitable treatment] standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.'⁷⁰ The legitimate expectations concept 'requires a weighing of the Claimant's legitimate and reasonable expectations on the one hand and the Respondent's legitimate regulatory interest on the other.'⁷¹

A State which built its economic recovery plan, following an economic crisis, on foreign capital and to that end created an attractive legal framework addressing the specific needs of Investors and providing for extensive guarantees, sets a certain level of expectations among Investors. 'The abrogation of these specific guarantees violates the stability and the predictability underlying the standard of fair and equitable treatment.'⁷² In the same manner, the State may not engage in inconsistent behaviour like for example 'reversing to the detriment of the investor prior approvals on which he justifiable relied.'⁷³

As to the third point, the Investor has to be able to prove that the damage he suffered is a direct consequence of a State action.

The cases in which the concept of legitimate expectations has already been interpreted indicate that the tribunals consider it on a case-by-case basis, according to the criteria of reasonableness. However, there are expectations which are presumed legitimate. This is the case for the expectations derived from the fact that the Investor-State relationship is a long one. In *Saluka*, the tribunal noted 'the expectations of the foreign investor certainly include the observation by the host State of such well-established fundamental standards as good faith, due process, and non-discrimination.'⁷⁴

A link may be drawn between the concept of legitimate expectations and transparency on the one hand and the good faith principle on the other hand. The non-observance of the Investors' legitimate expectations is often a result of a lack of transparency or of good faith the Investor expected to find in the behaviour of the State. The legitimate expectations of the Investors act as a criterion against which the effort of the State is considered. A failure on the part of the State to reach these legitimately shaped expectations results in a breach of the FET standard. Wälde concludes in his separate opinion rendered in the *Thunderbird* case that the legitimate expectations principle evolved from 'an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the "fair and equitable standard".'⁷⁵

⁷⁰ *Waste Management* case (chapter 3, n 65), §98.

⁷¹ *Saluka* case (chapter 2, n 110), §306.

⁷² *LG&E* case chapter 5, n 110 §133.

⁷³ *SD Meyers* case (chapter 2, n 132), §290.

⁷⁴ *Ibid* §306.

⁷⁵ T Wälde, *Separate Opinion in the Thunderbird case* (chapter 5, n 55) §37.

5.4 Coercion and Harassment by the Organs of the Host State

'Under such circumstances, such pressure involves forms of coercion that may be considered inconsistent with the fair and equitable treatment to be given to international investments under Article 4(1) of the Agreement and objectionable from the perspective of international law.'⁷⁶

This situation is to be linked with the one based on discrimination. In general, the claims of the Investors established on the basis of coercion or harassment also argue that the treatment received is far more severe than the one received by national or other foreign Investors. In *Genin* however, the tribunal considered that the special circumstances of the host State justified the intensified controls of Genin's operations.

In *Eureko*, the harassment of the Investors by the Polish authorities was dealt with under the 'full protection and security' standard. The tribunal dismissed the Investor's claim on this ground but maintained that for such an action to be sufficient for engaging the host State's responsibility, it had to be 'repeated and sustained'.⁷⁷ Finally, the tribunal in *Saluka* held that according to the FET the host State 'must grant the investor freedom from coercion or harassment by its own regulatory authorities.'⁷⁸

5.5 Failure to Offer a Stable and Predictable Legal Framework

A successful foreign investment operation relies in great part on the stable framework offered by the host State. Studies that analysed the elements taken into account by a foreign Investor when deciding upon the location of its investment have uniformly confirmed that a stable legislative and administrative framework is essential for a positive decision of the Investor in favour of a specific location. The stability requirement is a prominent characteristic of the FET standard and emerges from almost all the factual situations examined above. However, together with the obligation of due process, the obligation to implement and/or enforce national law as well as the obligation to control local authorities illustrates, in the clearest way, this need for stability.

It is the *GAMI* arbitral tribunal that had the task of deciding whether the failure to implement and enforce national laws could constitute a violation of the FET obligation. Naturally, Mexico argued that an ICSID tribunal does not

⁷⁶ *Tecmed* case (chapter 4, n 59), §163

⁷⁷ *Eureko* case (chapter 5, n 52), §237

⁷⁸ *Saluka* case (chapter 2, n 110), §308.

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⁷¹ *Saluka* case (chapter 2, n 110), §306.

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⁷³ *SD Meyers* case (chapter 2, n 132), §290.

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⁷⁶ *Tecmed* case (chapter 4, n 59), §163

⁷⁷ *Eureko* case (chapter 5, n 52), §237

⁷⁸ *Saluka* case (chapter 2, n 110), §308.

have the mandate to examine the application of national law by national authorities. The tribunal admitted that the role of international law is certainly not to evaluate the content of a national regulatory programme but precisely to inquire whether 'the state abided by or implemented that programme.'⁷⁹ The tribunal added that:

[I]t is no excuse that regulation is costly. Nor does a dearth of able administrators or a deficient culture of compliance provide a defence. Such is the challenge of governance that confronts every country.⁸⁰

The discussion over the content of the national laws and the capacity of the international tribunals to have a say in it had been discussed previously in the *SD Meyers* case. The tribunal in this case considered:

When interpreting and applying the 'minimum standard', a chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.⁸¹

This paragraph illustrates the limit of the tribunal's mandate. The content of a national law and the reasoning that may exist behind it are part of a certain political choice of the host state government and that may not be discussed in front of an arbitral tribunal.

However, the mere failure to implement its own law does not automatically mean that the host State breached the FET standard. The context in which this failure takes place is determinant for the final decision of the tribunal on the breach of the FET. The facts in the *GAMI* case are illustrative of the type of context needed to reach the violation of the FET:

The imposition of a new licence requirement may for example be viewed quite differently if it appears on a blank slate or if it is an arbitrary repudiation of a pre-existing licensing regime upon which a foreign investor has demonstrably relied.⁸²

Finally, one exception should be mentioned here. In the *Olguin* case, the tribunal held that:

... there were considerable omissions on the part of the Paraguay's public bodies, which had the duty to preserve the integrity of that country's financial system, in regard, not only, but especially, to foreign investment... [T]he government accounting bodies of

⁷⁹ *GAMI* case (chapter 3, n 67), §91.

⁸⁰ *Ibid* §94.

⁸¹ *SD Meyers* case (chapter 2, n 132), §261

⁸² *GAMI* case (chapter 3, n 67), §91.

Paraguay clearly appear to have been negligent in regard to their duties to monitor, supervise, or control the agents of their country's financial market, during the period of time in which the facts arose that led to this dispute.⁸³

The tribunal could not, in this case, find a violation of the FET obligation on this basis, given the absence in the BIT of 'strict rules that impose economic sanctions on States that fail to closely monitor their financial entities.'⁸⁴ However, the tribunal judged such rules to be 'desirable' since they do not exist in Paraguay nor in the majority of the countries in the region. The type of situation in which the State could be held responsible on the basis of the FET concerns the obligation to maintain a coherent legislative but also administrative framework.

It seems therefore that precisely this need for stability and predictability serves as a guidance to the application of FET. The tribunals in the *Bogdanov* and the *CMS* cases underlined this feature, while the *Siemens* tribunal considered that predictability is an essential element of stability.⁸⁵ Moreover, the survey of the preambles of BITs in the first chapter concluded that the prototype preamble mentioning FET is drafted as follows: 'Agreeing that fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment...'⁸⁶ The tribunal in *OPEC* declared that 'the stability of the legal and business framework is thus an essential element of fair and equitable treatment.'⁸⁷ Finally, it is the *LG&E* tribunal which was the most direct in connecting the need for consistency and stability to the respect for FET, it stated that the FET standard 'consists of the host State's consistent and transparent behaviour, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework...'⁸⁸

The case in which the failure of the State to provide for a stable and predictable legal framework constituted the core of the claimant's submissions, and thus of the tribunal's conclusions, is the *PSEG* case. The tribunal found that the FET obligation of the State had been breached on three grounds, all part of the stability and predictability obligation.⁸⁹ The first ground was 'an evident negligence on the part of the administration in the handling of the negotiations with the claimants.' This negligent behaviour was composed of lack of an answer from the administration on issues of disagreement, silence while the situation was aggravating, and lack of interest in looking at important communications. The second ground on which FET was breached was the abuse of authority displayed by certain State organs and by the delivery of inconsistent administrative acts.

⁸³ *Eudoro A Olguin v Republic of Paraguay*, ICSID, ARB/98/5, Final Award rendered 26 June 2001 (Oreamuno.Mayora-Alvarado.Rezek) §70.

⁸⁴ *Ibid* §74.

⁸⁵ *Siemens* case—merits (chapter 2, n 2), §274.

⁸⁶ See chapter 1 and appendix II.

⁸⁷ *OPEC* case (chapter 6, n 21), §183.

⁸⁸ *LG&E* case (chapter 5, n 110), §131.

⁸⁹ *PSEG* case (chapter 2, n 52), §246 to §256.

Finally, the third ground contributing to the breach of FET was the continuing legislative changes, which affected both the conditions governing the project and the tax legislation. These three grounds form part of the need to ensure 'a stable and predictable business environment for the investors to operate in.'⁹⁰

The stability and predictability obligation extends to the treatment received by the Investor not only from the State and its organs but also the legislative framework in general. 'Stability cannot exist in a situation where the law kept changing continuously and endlessly, as did its interpretation and implementation.'⁹¹ The predictability obligation is, as it was shown above, closely linked to the stability one but also to the obligation to respect the legitimate expectations of the Investor which are built on the laws and other signals sent by the State. While the Investor may not expect the overall circumstances present at the time of his investment to remain the same throughout its operations in the host State, he may expect that the State take into account the fact that his decision to invest is based on 'an assessment of the state of the law and the totality of the business environment at the time of the investment.'⁹²

5.6 Unjustified Enrichment

It is not a surprise to find unjust enrichment among the situations to which the FET has been applied; first, because it is a broad equitable concept, fitting perfectly into the inherent objectives of the FET standard, and second, because commercial and financial transactions are areas of law predisposed to the enrichment of one person at the cost of another under perfectly legal circumstances.

The principle has been mostly used before arbitral tribunals in claims for compensation following a nationalization.⁹³ However, in the *Lena Goldfields* arbitration, it was used in the context of the breach of a concession contract.⁹⁴

In the recent *Saluka* case, the claimant invoked the unjustified enrichment principle in order to argue the violation of the FET standard. The tribunal underlined the novelty of such a use for the principle. It added that such an assimilation between the principle and the standard implied that 'an investor would therefore

⁹⁰ Ibid §253.

⁹¹ Ibid §254.

⁹² *Saluka* case (chapter 2, n 110), §301 and §305.

⁹³ In the field of investment law, the concept of unjust enrichment received different interpretations. On the one hand, it has been used to justify the payment of compensation in cases of expropriation and, on the other hand, it has been used against foreign Investors to condemn the exploitation of natural resources based on an unbalanced relationship between the host State and the foreign Investor. With its application, in the field of the FET, the unjust enrichment receives a third function.

⁹⁴ For a discussion on the principle of unjust enrichment in international law, see C Schreuer, 'Unjustified Enrichment in International Law' (1974), 22 *The American Journal of Comparative Law* 282.

also be protected by this standard against unjust enrichment by the host State.'⁹⁵ After analysing the facts of the case, the tribunal dismissed the claim on this point, because it was based on a legally incorrect use of the unjustified enrichment principle. 'The notion of one party being an accessory to an unjustified transfer between two other parties is not part of the concept of unjust enrichment.'⁹⁶

Despite the dismissal of the claim on the basis of unjustified enrichment, we discussed this situation in this section because it is a potential future situation in which the FET may be applied. The tribunal in *Saluka* did not hold that the assimilation between the standard and the principle was unfounded; it dismissed the case on this point because the facts did not support the legal basis. Nevertheless, the inherent equitable character that lies behind the principle of unjust enrichment fits perfectly the objective and meaning of the FET.

5.7 Evidence of Bad Faith

The bona fide obligation implies that the entire relationship between the State and the foreign Investor has to be performed in good faith. Whereas the FET is a unilateral obligation of the State, the bona fide is bilateral, and supposes reciprocal rights and obligations for the parties. In this section the focus will be, exclusively, on the obligation of the State to act in good faith vis-à-vis the investor. Chapter VII will envisage good faith as an obligation of the Investor. This separation of the two obligations was necessary since evidence of bad faith in the behaviour of the Investor would not have an impact on the decision on the breach of FET but rather on the calculation of compensation.

A few words to introduce this broad concept.⁹⁷ Lauterpacht, commenting on the introduction of the good faith principle in the UN Charter, said that 'in a legal instrument in which, because of the incidence of voting procedure, members may often be in the position of having to pronounce upon the extent of their own obligations, the emphasis upon the requirement of good faith in the fulfilment of obligations seems proper and necessary'.⁹⁸ However, for Kelsen, this introduction of the words 'in good faith' was 'superfluous, for it is impossible to fulfil an obligation in bad faith'.⁹⁹

Good faith traditionally occupied an important place in the development of international economic relations. The Charter of Economic Rights and Duties of States stipulates in chapter 1§j that the execution in good faith of international obligations constitutes one of the fundamental elements of international

⁹⁵ *Saluka* case (chapter 2, n 110), §450.

⁹⁶ Ibid §455.

⁹⁷ R Kolb, *La bonne foi en droit international public* (Paris: PUF, 2000).

⁹⁸ Oppenheim, *International Law* (chapter 1, n 5) 370.

⁹⁹ Kelsen, (chapter 2, n 169), p.89.

economic relations.¹⁰⁰ Industrialized States encouraged the mention of this principle since the 1803 (XVII) Resolution of the GA on the Permanent Sovereignty Over Natural Resources (14 December 1962), that agreements concerning foreign investments will be respected in good faith.¹⁰¹

The ICJ acknowledged that the good faith principle is 'one of the basic principles governing the creation and performance of legal obligations.'¹⁰² However, the court has also been very explicit in not recognizing good faith as 'a source of obligation where none would otherwise exist.'¹⁰³ This is to say that good faith relates to the manner in which already-established international obligations are being performed; it does not, usually, constitute an individual substantive obligation.¹⁰⁴

In the context of BITs, the question is whether a bilateral disposition, that provides for the FET obligation to be performed in respect of good faith, adds anything substantial to the content of the FET obligation. This does not seem to be the case. The arbitral tribunal in the *ADF* case concluded that there is no additional substantive content brought by the good faith principle:

An assertion of breach of a customary law duty of good faith adds only negligible assistance in the task of determining or giving content to a standard of fair and equitable treatment.¹⁰⁵

In the view of the tribunal, the good faith principle does not add to or subtract from the substantive content already contained in the requirement of fair and equitable treatment. Another illustration of the co-existence of these two standards under the same clause, without having to be indispensable but rather complementary to each other, is given by the arbitral tribunal in the *Mondev* award. The tribunal observed that:

A state may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.¹⁰⁶

Confirming the previous awards, the tribunal in *Loewen* estimated that bad faith or malicious intention are not essential elements of unfair and inequitable treatment amounting to a breach of international justice.¹⁰⁷ This is to say that a lack of due process leads to a breach of the international obligation of the State to ensure a necessary judicial system even without the need to demonstrate that this breach was done with a bad faith or malicious intention. In *Tecmed*, the tribunal

¹⁰⁰ Charter of Economic Rights and Duties of States (chapter 1, n 39).

¹⁰¹ SM Schwebel, 'The Story of the UN's Declaration on Permanent Sovereignty over Natural Resources', *American Bar Association Journal* (1963), 467.

¹⁰² *Nuclear tests case*, ICJ, ICJ Reports (1974), 268 § 46 and 473 § 49.

¹⁰³ *Borders and Transborder Armed actions case* ICJ, ICJ Reports (1988), 105 § 94.

¹⁰⁴ In the introduction of this section, we mentioned a possible classification of the factual situations in two groups: those that contained an obligation on their own and those that could not create an obligation alone.

¹⁰⁵ *ADF case* (chapter 2, n 48), §191

¹⁰⁶ *Mondev case* (chapter 1, n 3), §116

¹⁰⁷ *Loewen case* (chapter 2, n 25), §132

decided that 'the commitment of fair and equitable treatment... is an expression and part of the bona fide principle recognised in international law, although bad faith from the State is not required for its violation.'¹⁰⁸

Therefore, the general understanding as to the close link between the FET and the good faith obligation appears to be shared also as to the fact that 'a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.'¹⁰⁹ In a more recent case, the tribunal concluded that it 'is not convinced that bad faith or something comparable would even be necessary to find a violation of fair and equitable treatment.'¹¹⁰

Bad faith appears to be considered as an additional, similar to an aggravating element, of a main substantial obligation. The FET standard is an objective standard, it is therefore natural to conclude that bad faith or any other intentional element is needed in order to find that the standard was breached. The breach or not of the FET is subject to the impact of the State measures on the investment.

However, there are cases when an action accomplished in bad faith is a sufficient ground to recognize a breach of the FET obligation. In *Genin*, the arbitrators found that the acts violating the FET 'include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.'¹¹¹ More directly, in the *Siemens* case, good faith was one of the grounds on which the tribunal concluded that the FET obligation was breached. In this case, the government awarded a contract to the Investor, including as a fundamental provision, the obligation of the government to conclude agreements with its provinces. Subsequently to the signing of the contract, the State argued that the structure of the State did not permit it to fulfil that obligation. The tribunal concluded that such behaviour violated 'the principle of good faith underlying fair and equitable treatment.'¹¹² This view is justified by the difficulty to operate a distinction between a fair and equitable treatment and behaviour in good faith. Dolzer argued that the fair and equitable treatment standard largely overlaps with the meaning of a general good faith clause in its broader setting.¹¹³

5.8 Absence of Transparency

In *Metalclad* the tribunal defined the host State's obligation of transparency¹¹⁴ to include 'the idea that all relevant legal requirements for the purpose of initiating,

¹⁰⁸ *Tecmed case* (chapter 4, n 59).

¹⁰⁹ *Mondev case* (chapter 1, n 3), §116.

¹¹⁰ *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v Argentina* ICSID, ARB/02/1, Decision on Liability rendered on 3 October 2006 (De Mackerle, Rezek, Van den Berg) §129.

¹¹¹ *Genin case* (chapter 2, n 109), §367

¹¹² *Siemens case* (chapter 2, n 2), §308.

¹¹³ R Dolzer, 'Fair and equitable treatment', (chapter 5, n 2), 91.

¹¹⁴ For a general study on the notion of transparency, see United Nations Conference for Trade and Development, (UNCTAD), *Transparency* (2004).

completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters.¹¹⁵ The tribunal added that the Investors should be able to act, on the basis of the existing legal framework, 'in the confident belief that they are acting in accordance with all relevant laws.'¹¹⁶ This last assertion connects the obligation of transparency with the notion of legitimate expectations, since the Investor, acting in accordance with the laws and regulations made available by the host State, is presumed to believe he acts legally. At this point, any damage suffered by the Investor as a result of a law he did not observe or that was applied but to which he did not have access, involves the responsibility of the State—the legitimate expectation of the Investor being that he was respecting the laws.

The tribunal ruled that Mexico violated its obligation to create 'a transparent and previsible framework for the development of Metalclad's projects and investment operations' and therefore failed to treat Metalclad in a fair and equitable manner according to article 1105. In another case, the tribunal interpreted the lack of transparency connected to procedures involving a loan as incompatible with the host State, 'commitment to ensure the investor a fair and equitable treatment.'¹¹⁷

The transparency obligation is closely linked to the obligation of protection of the Investor's legitimate expectations. The tribunal took into account the information made available to Metalclad and which contributed to the establishment of an expectation; the tribunal underlined that 'Metalclad was led to believe'¹¹⁸ and further noted that Metalclad relied 'on the representations of the federal government.'¹¹⁹

Until now, in the cases that have been brought before the tribunals, the obligation of transparency referred to the host State's rules and regulations and their availability to the Investors. The tribunal in *Tecmed* broadened this obligation of transparency, besides the rules and regulations, to 'the goals of the relevant policies and administrative practices or directives.'¹²⁰ This view is also confirmed in *GAMI*. In this case, the actions of the State in the field of sugar production were determined by two parameters: national consumption, and production. The State made public this policy and the Investor was aware of it. Therefore the arbitrators decided that a sudden measure taken by the State, following a change in

¹¹⁵ *Metalclad* case (chapter 4, n 10), §76.

¹¹⁶ *Ibid* §76.

¹¹⁷ *Maffezini* case (chapter 4, n 10), §83

¹¹⁸ *Metalclad* case (chapter 4, n 10), §85.

¹¹⁹ *Ibid* §87. The Supreme Court of British Columbia partially cancelled the NAFTA award arguing that the tribunal relied on the lack of 'transparency' in order to find a violation of article 1105 whereas transparency should be based on chapter 18 NAFTA and only claims under chapter 11 are for an arbitral tribunal to deal with (article 1116–1 allowing Investors to bring complaints on basis chapter 11 exclusively).

¹²⁰ *Tecmed* case (chapter 4, n 59), §154.

one of these parameters that it cannot control, could not be considered as a violation of the FET on the basis of non-transparency.¹²¹

The relevance of respecting the transparency obligation has to be seen in the light of the nature of this investment relationship, which is necessarily prolonged in time. Therefore, the Investor is entitled to 'expect that the government's actions would be free from any ambiguity that might affect the early assessment made by (him) of its real legal situation or the situation affecting its investment and the actions the investor should take to act accordingly.'¹²²

As noted by Dolzer, the relationship between transparency and FET is two-fold: first it is difficult to consider that a non-transparent decision is fair and equitable and second, it is generally accepted that a transparency is a fundamental characteristic of an appropriate investment regime.¹²³

5.9 Arbitrary and Discriminatory Treatment

The arbitrary and discriminatory character of an action or omission of the host State is usually dealt with by the tribunals once the specific wrongdoing of the State is discussed. It seems that this obligation not to treat Investors and their investments in an arbitrary and discriminatory manner is regarded as a narrower obligation, to be treated at a second stage. In the *GAMI* case as well as in the *LG&E* case, this two-step operation is very well illustrated.¹²⁴

The tribunal in *Lauder* considered that for a measure of the host State to be in violation of a BIT article requiring 'neither party shall in any way impair by arbitrary and discriminatory measure' it has to be both arbitrary and discriminatory. It first results from the plain wording of the provision, which uses the word 'and' instead of the word 'or'.¹²⁵ Not all tribunals treat this provision as a whole; some decide to examine each one of the terms separately.¹²⁶

To determine the discriminatory character of a measure or behaviour is usually more straightforward than to determine its arbitrary character. Discrimination may exist either in comparison with the treatment accorded to the nationals of the host State (national treatment) or to other foreign Investors in like circumstances. Generally, the BITs are clear as to which one of these two types of discrimination they refer to. A measure is discriminatory, in the context of the BITs, if the intent or the effect of the measure is to discriminate.¹²⁷ The tribunal

¹²¹ *GAMI* case (chapter 3, n 67).

¹²² *Tecmed* case (chapter 4, n 59), §167.

¹²³ Dolzer, 'Fair and equitable treatment', (chapter 5, n 2) 92.

¹²⁴ *GAMI* case (chapter 3, n 67), §25 and *LG&E* case (chapter 5, n 110), §140 to §163.

¹²⁵ *Lauder* case (chapter 1, n 102), §219.

¹²⁶ The tribunal in the *LG&E* case examines first the discriminatory treatment (§140 to §148) and then, the arbitrary treatment (§149 to §160). *LG&E* case (chapter 5, n 10).

¹²⁷ *LG&E* case, *Ibid*, §146.

in *Saluka* laid down three conditions for a measure or a conduct of the State to be considered discriminatory: 'if (i) similar cases are (ii) treated differently (iii) and without reasonable justification.'¹²⁸ The earlier *ELSI* tribunal found that four conditions were needed for a measure to be discriminatory: (i) an intentional treatment, (ii) in favour of a national, (iii) against a foreign Investor, and (iv) that would not happen under similar circumstances against another national.¹²⁹ The *ELSI* case focused on the breach of the national treatment obligation since it only considered the differential treatment between a foreigner and a national in similar circumstances.

In *Bogdanov*, the arbitrator considered that a restrictive interpretation of the FET clause might indicate that it is 'equivalent to the absence of discriminatory measures, including national treatment and most favoured nation treatment.'¹³⁰ This interpretation indicates that a discriminatory treatment would be sufficient to find a breach of FET. It is not surprising to find such an interpretation since a discriminatory treatment is neither fair nor equitable, although there may be exceptions where discrimination is justified on legal terms and it is not automatically negative.

The Tribunal in *Lauder* held that the FET standard might help prevent 'discrimination against the beneficiary of the standard, where discrimination would amount to unfairness or inequity in the circumstances.'¹³¹ Examining FET, the tribunal started by noting that none of the actions or inactions examined in the context of the prohibition against arbitrary or discriminatory measures 'constitute a violation of the duty to provide fair and equitable treatment'.¹³² '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... discriminatory and exposes the claimant to sectional or racial prejudice...'¹³³ The tribunal in *Methanex* took over this formulation and applied it to the dispute concluding that 'Methanex failed... to establish that California and the California ban on MTBE was discriminatory or in any way exposed it to 'sectional or racial prejudice.'¹³⁴ The link between discrimination and FET is not an automatic one. While a discriminatory measure may also, under certain circumstances, violate the FET obligation, the absence of discrimination does not have any impact on the findings concerning the breach of FET.

The main difficulty linked to discrimination is that of proof, as was also illustrated in the *LG&E* case. The tribunal found that the incriminating act of the State was indeed discriminatory because it imposed stricter measure on the gas

distribution companies than on any other public utility sectors. However, despite a sectorial discrimination, the Investor did not bring sufficient proof that the measure 'targeted claimants' investments specifically as foreign investments'.¹³⁵ According to the *LG&E* tribunal, the proof brought by the claimant has to be sufficient to show that the measure of the State targeted the particular group to which the Investor belongs, namely that of the foreign Investors. It did not accept sectorial discrimination as breaching the non-discrimination obligation.

As to an arbitrary measure, BITs do not define this term. Tribunals refer either to the general dictionaries of law or they give their own definition. The tribunal in *Lauder* used the definition of arbitrary given by the Black's Law Dictionary: 'arbitrary means "depending on individual discretion... founded on prejudice or preference rather than on reason or fact."¹³⁶ In *Tecmed*, the tribunal defined an arbitrary state action as 'presenting insufficiencies that would be recognised "... by any reasonable and impartial man", or although not in violation of specific regulations, as being contrary to the law because... [it] shocks, or at least surprises, a sense of juridical propriety.'¹³⁷ In the context of foreign investment, an arbitrary treatment is generally understood as not being founded on law but on other reasons which are not objective and fair.

In *Loewen*, the arbitrators relied on the ICJ definition of arbitrariness given in the *ELSI* case and according to which it 'is not so much something opposed to a rule of law... it is wilful disregard of due process of law, an act that shocks, or at least surprises a sense of judicial propriety'.¹³⁸ The ICJ considered the notion of arbitrariness under a specific provision of a BIT but also noted that the Chamber's discussion 'is nevertheless instructive as to the standard of review that the international tribunal must employ when examining whether a State has violated the international minimum standard'. The main idea was, in this context, that 'of arbitrary action being substituted for the rule of law'.¹³⁹

One of the possible illustrations of arbitrariness is a decision taken in violation of the law or at least not grounded on a legal basis. Also, another possible interpretation of arbitrariness is an inconsistent behaviour of the host State. The tribunal in *Tecmed* underlined this expectation of the Investor to see the State 'act consistently, ie without arbitrarily revoking any pre-existing decisions or permits...'¹⁴⁰

It appears that arbitrariness and discrimination reflect violations of the FET; therefore a series of tribunals treated these two issues together. In *MTD*,

¹³⁵ *LG&E* case (chapter 5, n 110), §147.

¹³⁶ *Lauder* case (chapter 1, n 102), §221. The tribunal was extremely brief in exploring the claimant's argument on arbitrariness, lacking an argumentative analysis and simply repeating the wording of the dictionary definition, on the negative. *Ibid* § 231.

¹³⁷ *Tecmed* case (chapter 4, n 59), §154.

¹³⁸ *Loewen* case (chapter 2, n 25), §131.

¹³⁹ The Chamber considered that mere domestic illegality did not equate to arbitrariness at international law. *ELSI* case (chapter 2, n 47), §120 to §130.

¹⁴⁰ *Tecmed* case (chapter 4, n 59), §154.

¹²⁸ *Saluka* case (chapter 2, n 110), §313.

¹²⁹ *ELSI* case (chapter 2, n 47), §61-62.

¹³⁰ *Bogdanov* case (chapter 7, n 24) 16.

¹³¹ *Lauder* case (chapter 1, n 102), §292.

¹³² *Ibid* §293.

¹³³ *Waste Management* case (chapter 3, n 63), §98.

¹³⁴ *Methanex* case (chapter 2, n 21) 274 §26.

for example, after having analysed the claim based on FET, the tribunal was confronted with an additional claim of the Investor, arguing that the same measure was unreasonable and discriminatory. The tribunal decided that 'this claim has been considered... as part of the fair and equitable treatment.'¹⁴¹ The *RFCC* tribunal faced with a claim that the treatment received by the Investor was arbitrary and discriminatory started by establishing that these two obligations were the mirror image of each other.¹⁴²

Each NAFTA Party must to the contrary accept liability if its officials fail to implement or implement regulations in a discriminatory or arbitrary fashion.¹⁴³

The obligation of treating an Investor in a non-arbitrary and non-discriminatory manner has a special status. A State measure does not have to be 'arbitrary and discriminatory' in order to be contrary to the FET. As observed by the *SD Meyers* tribunal the 'minimum standard is a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner.'¹⁴⁴ Similarly, the *LG&E* tribunal found that the measure, which it had previously characterized as being unfair and inequitable, was not arbitrary. It concluded that 'characterizing the measures as not arbitrary does not mean that such measures are characterized as fair and equitable'.¹⁴⁵

At the same time, when it is found that a measure has clearly been arbitrary and discriminatory, the breach of the FET obligation is almost a natural conclusion. In the *Eureko* case, on the basis of the conduct of the State, the tribunal concluded that it acted 'not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character.'¹⁴⁶ Based on this observation, the tribunal had 'no hesitation in concluding that the "fair and equitable treatment" provision'¹⁴⁷ had been violated by the State.

In conclusion, an arbitrary and discriminatory treatment is different from the ordinary treatment received by other national or foreign Investors, and is usually not based on legal grounds but is taken without reasonable justification.¹⁴⁸

Résumé—Achieving Stability in the Investor-State Relationship

The above list of situations in which the FET standard has been applied is not exhaustive. It is based on the existing case law, as of August 2007. There are cases

¹⁴¹ *MTD* case (chapter 4, n 3), §196.

¹⁴² *RFCC Consortium* case (chapter 3, n 64), §51.

¹⁴³ *GAMI* case (chapter 3, n 67), §94.

¹⁴⁴ *SD Meyers* case (chapter 2, n 132), §259.

¹⁴⁵ *LG&E* case (chapter 5, n 110), §162.

¹⁴⁶ *Eureko* case (chapter 5, n 52), §233.

¹⁴⁷ *Ibid* §234.

¹⁴⁸ *Saluka* case (chapter 2, n 110), §498.

in which the facts relied on by the Investor, under his FET claim, qualify for more than one of these situations as there are cases in which a single one of these situations is sufficient to demonstrate the breach of the FET obligation.

Although it is difficult to classify these situations, since they are diverse and touch upon very different areas and stages of the investment, they do have something in common: they all have a negative impact on the foreign investment and on the stability and predictability of the framework in which this investment is operating. This stability may refer to the national legislative, judicial, or administrative framework, to the direct relation between the Investor and the host State, or to the treatment of the Investor in comparison with the other foreign Investors. Thus, the requirements of predictability and stability are a central element of the FET obligation. Without aiming at giving a definition to FET, which would be in clear contradiction with the definition of a standard, there are mainly four categories of acts or omissions of the State which, at the time of this study, appear to constitute violation of FET:

- an act or omission which entirely transforms or alters the legal or business environment;
- an act or omission which results in an arbitrary and discriminatory treatment of the Investor;
- an act or omission which has as a result the failure by the host State to respect its engagements towards the Investor; and
- an act or omission of the State, which impairs the Investor's personal and procedural rights.¹⁴⁹

Generally, it is not an isolated action of the State that will determine whether the FET obligation has been breached but the record as a whole. Proof of good faith in the achievement of the objectives of its laws may for instance counter-balance the disregard by the State of a legal requirement.¹⁵⁰ Moreover, it is consistency that the State has to honour in the course of its actions towards the Investor in all areas of regulation.¹⁵¹

Finally, FET is a positive obligation and should be interpreted as such. As noted by the tribunal in *Siemens*:

It follows from the ordinary meaning of 'fair' and 'equitable' and the purpose and object of the Treaty that these terms denote treatment in an even-handed and just manner, conducive to fostering the promotion and protection of foreign investment and stimulating private initiative. The parties to the Treaty show by their intentions and objectives a positive attitude towards investment.¹⁵²

¹⁴⁹ This last category connects, at least in terms of their roots, FET to the IMS, in the sense that there is a component of protection of the basic rights of the Investor in FET, and this is also the core of the IMS.

¹⁵⁰ *GAMI* case (chapter 3, n 67), §97.

¹⁵¹ Dolzer, 'Fair and equitable treatment' (chapter 5, n 2), at 103.

¹⁵² *Siemens* case—merits (chapter 2, n 2), §290.