

ROLAND KLÄGER

CAMBRIDGE  
STUDIES IN  
INTERNATIONAL  
AND  
COMPARATIVE  
LAW

'Fair and  
Equitable Treatment'  
in International  
Investment Law



CAMBRIDGE

## **'Fair and Equitable Treatment' in International Investment Law**

A breach of fair and equitable treatment is alleged in almost every investor-state dispute. It has therefore become a controversial norm, which touches many questions at the heart of general international law. Roland Kläger sheds light on these controversies by exploring the deeper doctrinal foundations of fair and equitable treatment and reviewing its contentious relationship with the international minimum standard. The norm is also discussed in light of the fragmentation of international law, theories of international justice and rational balancing, and the idea of constitutionalism in international law. In this vein, a shift in the way of addressing fair and equitable treatment is proposed by focusing on the process of justificatory reasoning.

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## **'Fair and Equitable Treatment' in International Investment Law**

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Roland Kläger

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*Meinen Eltern und der Familie*

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## Foreword

International investment law has grown considerably in importance in recent years, as evidenced by the great increase in the number of international investment agreements, in the scholarly literature and even in the number of awards. Nevertheless, the doctrinal foundations of international investment law have remained highly contested: it is easier to draw up a list of disputed than agreed propositions. Dr Kläger's work seeks to address this problem in respect of fair and equitable treatment, a central norm of international investment law. In doing so he discusses fair and equitable treatment in relation to general theories of international law, legal method and even international justice.

In Part I he argues that exploring these doctrinal foundations gives a broader justificatory basis to the fair and equitable treatment standard and thereby conduces to greater consistency and legal certainty. This contrasts with a persistent trend of opinion that fair and equitable treatment is irreducibly vague, and that it authorises international tribunals to conduct an 'all things considered' examination of host State action or inaction. On this view, arguments derived from the general rules of interpretation are of little use in the application of fair and equitable treatment: the only important question is what the current tribunal decides happened and whether it was – at some adjectival level – unfair or inequitable to the investor. By way of reaction, other tribunals (notably in *Glamis Gold*) have constricted the meaning of the formula to an outdated and excessively rigid version of an international minimum standard, based on cases (especially *Neer*) involving a distinct factual matrix. The oversimplification of traditional approaches towards fair and equitable treatment highlights the growing disunity of the law.

The discussion of 'fragmentation', as it has come to be called (as if international law had once been unfragmented and immaculate),



suggests an alternative. Dr Kläger suggests ways to integrate arguments from other sub-systems of international law into international investment law. On this view, vague provisions like fair and equitable treatment serve as gateway clauses allowing a systemic exchange between different sub-systems.

Part II looks at the actual argumentation of arbitral tribunals and the ideas of justice behind their decisions. The notion of fair and equitable treatment already implies an affiliation to underlying perceptions of justice. By reviewing international theories of justice, he argues that the application of fair and equitable treatment is the result of a process of balancing of often conflicting arguments and the competing poles of stability and discretion. It is suggested that there is already a series of argumentation patterns or *topoi* which may be considered as sub-elements or principles of fair and equitable treatment. These principles are further explored with respect to their comparative law background, their contours in arbitral jurisprudence as well as their role and weight in decision making. Thereby, it is argued that the structure, intensity and rationality of arbitral review may converge to achieve a convincing construction of fair and equitable treatment.

In a final Part, the book tries to assess the impact of this conceptual scheme of fair and equitable treatment in the broader context of the international legal system. The author argues that, within the system of international law sources, fair and equitable treatment has not undergone transformation of status so as to become a conventional norm: in other words, he rejects the customary law character of fair and equitable treatment. Nevertheless, the principles underlying the idea of fair and equitable treatment disclose an emerging justificatory deep-structure that resembles some elements of a process of constitutionalisation in this area of law.

This is a valuable attempt to give some rigour to a term which has sometimes seemed devoid of meaning and a jurisdiction consequently controversial and insecure. Whether one shares its conclusions, its aim is surely right – and its appearance in Cambridge Studies in International and Comparative Law consequently to be welcomed.

James Crawford  
Lauterpacht Centre for International Law  
University of Cambridge

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Moreover, I would like to thank Tillmann Rudolf Braun, MPA, and Joachim Steffens for inducting me into the secrets of bilateral investment treaty negotiations at the German Federal Ministry of Economics and Technology. Another important and inspiring experience in the course of toiling over this book has been a stay at the Lauterpacht Centre for International Law at the University of Cambridge. I was fortunate to be a Visiting Fellow at the Centre, offering a great opportunity to have a stimulating exchange with international law scholars from all over the world. Additionally, I am grateful to Isolde Zeiler for her organisational support, as well as to Lewis Enim for language advice. Finally, I would like to thank my parents, my brother, the entire family and Christine Löhr for enabling my academic expeditions and for keeping me grounded at the same time.

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- The decisions are usually also available at one of the following websites: [www.investmentclaims.com](http://www.investmentclaims.com); <http://ita.law.uvic.ca/>; <http://icsid.worldbank.org/ICSID/>; or [www.naftaclaims.com/](http://www.naftaclaims.com/) (all accessed 9 November 2010)
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## Abbreviations

AJIL	American Journal of International Law
AJIL Spec. Suppl.	AJIL Special Supplement
ALI	The American Law Institute
Am. U. Int'l L. Rev.	American University International Law Review
Arb. Int'l	International Arbitration
ArchVR	<i>Archiv des Völkerrechts</i>
ARSP	<i>Archiv für Rechts- und Sozialphilosophie</i>
ASIL	American Society of International Law
ASIL Proc.	ASIL Proceedings of the Annual Meeting
Asper Rev. Int'l Bus. & Trade L.	Asper Review for International Business and Trade Law
AWD	Außenwirtschaftsdienst des Betriebs-Beraters
BCSC	Supreme Court of British Columbia
BIICL	British Institute of International and Comparative Law
BIT	Bilateral investment treaty
Bus. L. Brief (Am. U.)	Business Law Brief (American University)
BYIL	British Yearbook of International Law
Cal. L. Rev.	California Law Review
Can. Bus. L. J.	Canadian Business Law Journal
CARICOM	Caribbean Common Market
Chicago J. Int'l L.	Chicago Journal of International Law
Chinese JIL	Chinese Journal of International Law
CMLR	Common Market Law Review
Cmdnd	Command
Colum. J. Transnat'l L.	Columbia Journal of Transnational Law
Colum. L. Rev.	Columbia Law Review

COMESA	Common Market for Eastern and Southern Africa
Conn. J. Int'l L.	Connecticut Journal of International Law
Cornell Int'l L. J.	Cornell International Law Journal
DR-CAFTA	Central America-Dominican Republic-United States Free Trade Agreement
Duke L. J.	Duke Law Journal
EC	European Community
ECHR	European Convention on Human Rights
ECJ	European Court of Justice
Ecology L. Q.	Ecology Law Quarterly
ECR	European Court Reports
ECtHR	European Court of Human Rights
ECT	Energy Charter Treaty
EJIL	European Journal of International Law
Ent. L. R.	Entertainment Law Review
EU	European Union
EuR	<i>Europarecht</i>
EuZW	<i>Europäische Zeitschrift für Wirtschaftsrecht</i>
FCN treaty	Treaty of friendship, commerce and navigation
FDI	foreign direct investment
Finnish YIL	Finnish Yearbook of International Law
Fla J. Int'l L.	Florida Journal of International Law
Fletcher F. World Aff.	The Fletcher Forum of World Affairs
Fordham Int'l L. J.	Fordham International Law Journal
Fordham L. Rev.	Fordham Law Review
FTA	Free Trade Agreement
FTC	Free Trade Commission
Ga L. Rev.	Georgia Law Review
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GC	Grand Chamber
Geo. Int'l Env'tl L. Rev.	Georgetown International Environmental Law Review
Geo. Mason L. Rev.	George Mason Law Review
German L. J.	German Law Journal
GYIL	German Yearbook of International Law
Harv. Int'l L. J.	Harvard International Law Journal

Harv. L. Rev.	Harvard Law Review
Hastings W.-N. W.	Hastings West-Northwest Journal of Environmental Law and Policy
J. Envtl L. & Pol'y	Environmental Law and Policy
ICC	International Chamber of Commerce
ICCA	International Council for Commercial Arbitration
ICJ	International Court of Justice
ICLQ	International and Comparative Law Quarterly
ICSID	International Centre for Settlement of Investment Disputes
ICSID Rev. - FILJ	ICSID Review - Foreign Investment Law Journal
IIA	international investment agreement
ILJ	Institute for International Law and Justice
IISD	International Institute for Sustainable Development
ILA	International Law Association
ILC	International Law Commission
ILM	International Legal Materials
ILO	International Labour Organization
ILSA J. Int'l & Comp. L.	ILSA Journal of International and Comparative Law
IMF	International Monetary Fund
Ind. J. Global Legal Stud.	Indiana Journal of Global Legal Studies
Int. ALR	International Arbitration Law Review
Int. J. of Cultural Property	International Journal of Cultural Property
Int'l Law.	The International Lawyer
Int'l L. Q.	International Law Quarterly
Int'l Tax & Bus. Law.	International Tax & Business Lawyer
Int. TLR	International Trade Law & Regulation
Iowa L. Rev.	Iowa Law Review
ISO	International Organization for Standardization
ITO	International Trade Organization
J. Int'l Econ. L.	Journal of International Economic Law
J. Transnat'l L. & Pol'y	Journal of Transnational Law & Policy
JWIT	Journal of World Investment & Trade

JWT	Journal of World Trade
JZ	<i>Juristenzeitung</i>
L. & Bus. Rev. Am.	Law and Business Review of the Americas
Law & Contemp. Probs.	Law and Contemporary Problems
Law & Pol'y Int'l Bus.	Law and Policy in International Business
Leiden J. Int'l L.	Leiden Journal of International Law
Maastricht J. Europ. & Comp. L.	Maastricht Journal of European and Comparative Law
MAI	Multilateral Agreement on Investment
Manchester J. Int'l Econ. L.	Manchester Journal of International Economic Law
Max Planck UNYB	Max Planck Yearbook of United Nations Law
MERCOSUR	Mercado Comun del Cono Sur (Southern Cone Common Market)
Mich. J. Int'l L.	Michigan Journal of International Law
Mich. L. Rev.	Michigan Law Review
MIGA	Multilateral Investment Guarantee Agency
Minn. J. Global Trade	Minnesota Journal of Global Trade
Minn. J. Int'l L.	Minnesota Journal of International Law
Minn. L. Rev.	Minnesota Law Review
mn.	Margin number
NAFTA	North American Free Trade Agreement
NAFTA FTC	NAFTA Free Trade Commission
N. C. L. Rev.	North Carolina Law Review
NILR	Netherlands International Law Review
NPM	non-precluded measures
Nw. J. Int'l L. & Bus.	Northwestern Journal of International Law and Business
NYU Envtl L. J.	New York University Environmental Law Journal
NYU J. Int'l L. & Pol.	New York University Journal of International Law and Politics
OECD	Organization for Economic Cooperation and Development
OSPAR	Oslo/Paris Convention (for the Protection of the Marine Environment of the North-East Atlantic)
Pace Envtl L. Rev.	Pace Environmental Law Review

Pac. McGeorge Bus. & Dev. L. J.	Pacific McGeorge Global Business & Development Law Journal
PCA	Permanent Court of Arbitration
PCB	polychlorinated biphenyl
RdC	<i>Recueil des Cours</i>
RGDIP	<i>Revue Générale de Droit International Public.</i>
RIW	<i>Recht der internationalen Wirtschaft</i>
SCC	Stockholm Chamber of Commerce
SchiedsVZ	<i>Zeitschrift für Schiedsverfahren</i>
SLA	Softwood Lumber Agreement
St John's J. Legal Comment.	St John's Journal of Legal Commentary
Suffolk Transnat'l L. Rev.	Suffolk Transnational Law Review
TEU	Treaty on European Union
TDM	Transnational Dispute Management
Tex. Int'l L. J.	Texas International Law Journal
TFEU	Treaty on the Functioning of the European Union
Touro Int'l L. Rev.	Touro International Law Review
TRIMS	Agreement on Trade-Related Aspects of Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
U. C. Davis J. Int'l L. & Pol'y	U. C. Davis Journal of International Law and Policy
UCLA J. Int'l L. & Foreign Aff.	UCLA Journal of International Law and Foreign Affairs
U. Miami Inter-Am. L. Rev.	University of Miami Inter-American Law Review
U. Miami Int'l & Comp. L. Rev.	University of Miami International and Comparative Law Review
UN	United Nations
UNESCO	UN Educational, Scientific and Cultural Organization
UNCITRAL	UN Commission on International Trade Law
UNCTAD	UN Conference on Trade and Development
UNESCO	United Nations Educational, Scientific, and Cultural Organization

UN RIAA	UN Reports of International Arbitral Awards
UNTS	United Nations Treaty Series
U. Pa J. Int'l Econ. L.	University of Pennsylvania Journal of International Economic Law
Urb. Law.	The Urban Lawyer
US	United States
USD	US dollar
US PPI	US Producer Price Index
Va J. Int'l L.	Virginia Journal of International Law
VAT	value-added tax
VCLT	Vienna Convention on the Law of Treaties
Vol.	Volume
Wis. L. Rev.	Wisconsin Law Review
VwVfG	Verwaltungsverfahrensgesetz (German Code of Administrative Procedure)
WTO	World Trade Organization
Yale J. Int'l L.	Yale Journal of International Law
Yale L. J.	Yale Law Journal
ZaöRV	<i>Zeitschrift für ausländisches öffentliches Recht und Völkerrecht</i>

## 1 Introduction

'International economic relations are front page news.'<sup>1</sup> In the aftermath of one of the severest economic crises of the ever-globalising world economy, Schwarzenberger's statement has forfeited nothing of its truth. In the process of managing economic globalisation and crises, international investment law plays an important role. This area of law has contributed many front page stories over the past decades and, most likely, will continue to do so in the future. While early international investment stories often had a post-colonial plot, the emergence of multinational corporations, post-Cold War economic liberalisation, the proliferation of international investment agreements and the establishment of a relatively privatised system of investment dispute settlement procedures have injected the system with new dynamics. Recurring themes of these stories are the perpetual quest for new markets, resources and production sites, as well as the ongoing competition between states to receive private capital flows to foster their economic development. If at the end of a story a conflict between a foreign investor and a host state arises, this may involve a large scale of possible actions, reaching from the technocratic fine-tuning of complex economic regulations to dark politico-economic intrigues or dramatic economic shifts with a whiff of revolution in the air.

In such investment conflicts, the guarantee to provide 'fair and equitable treatment' to foreign investors often takes centre stage. This is especially because fair and equitable treatment is enshrined in virtually all international investment agreements having increased enormously in number and importance. Thus international investment law has

<sup>1</sup> G. Schwarzenberger, 'The Province and Standards of International Economic Law', *Int'l L.Q.* 2 (1948), p. 402 at p. 402.

developed from a highly specialised field of international law possessing a marginal scope of application to one that is of augmenting relevance for international economic relations as a whole. The success story of international investment law is mainly based on the fact that the pertaining treaties comprise a relatively simple set of standards protecting foreign investments abroad. Besides fair and equitable treatment, such standards guarantee, for instance, the payment of compensation in case of expropriation, non-discriminatory treatment, most-favoured-nation and national treatment, full protection and security as well as the abidance to contractual promises between the foreign investor and the host state.

Another important feature contributing to the ascent and singularity of international investment law is constituted by the establishment of an international and independent arbitration procedure. In this vein, many international investment agreements endow foreign investors with the right to sue the host state for an alleged violation of an investment protection standard. The investment arbitration system constitutes an interesting example revealing the legal subjectivity of individuals in international law. Such a dispute settlement mechanism promises, on the one hand, a level of neutrality that appears unachievable before domestic courts and, on the other hand, a degree of efficacy and economic professionalism that is often missing in other areas of international law. Accordingly, the investment arbitration system has produced, within the last decade, a rapidly increasing number of awards dynamically developing international investment law.

Despite this dynamic development, the evolution of international investment law has also faced noticeable obstacles, especially with regard to the negotiation of multilateral investment agreements. These setbacks are mainly due to long-standing political controversies on the protection of foreign investors between traditionally capital-exporting, industrialised countries and traditionally capital-importing, developing countries. Interestingly, political concerns about the system of investment protection have recently also been raised by major developed countries. Even though these controversies could not stop the rise of international investment law in the past, they are nevertheless evinced by the fact that international investment law is still mainly composed of a network of bilateral investment treaties. Additionally, many of the substantive investment protection standards appear to have been intentionally drafted in vague terms in order to conceal differing perceptions on the value of investment protection.

This vagueness is both a blessing and a curse for international investment law. While it ensures the adaptability and flexibility of the investment protection standards, it also entails a certain degree of indeterminacy and even vacuity. Fair and equitable treatment appears as the most vaguely formulated investment protection standard. As such, although this guarantee is frequently discussed in a rapidly growing body of investment arbitration awards and scholarly literature,<sup>2</sup> it is surrounded by some of the most controversial questions of international investment law. Thereby, each of the awards or treatises is confronted with the same challenge to extract some kind of meaning from the terms 'fair and equitable treatment'.

Addressing this challenge by looking up terms in a law dictionary reveals, at best, that the terms 'fair' and 'equitable' are almost devoid of any substantial meaning. This textual indeterminacy, combined with some early far-reaching arbitral decisions, has turned the guarantee of fair and equitable treatment into a prominent cause of action inviting the advancement of an almost infinite range of arguments related to a perceived unfairness or injustice in the investor-state relationship. In the meantime, the debate concerning fair and equitable treatment is beginning to display certain argumentative patterns and sub-elements in which arbitral tribunals have established a violation of fair and

<sup>2</sup> See the following selection: S. Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice', BYIL 70 (1999), p. 99; UNCTAD, *Fair and Equitable Treatment*, UNCTAD/ITE/IIT/11 (Vol. III) (1999); C. Yannaca-Small, 'Fair and Equitable Treatment in International Investment Law', *OECD Working Papers on International Investment* (2004), No. 3; C. Schreuer, 'Fair and Equitable Treatment in Arbitral Practice', *JWIT* 6 (2005), p. 357; R. Dolzer, 'Fair and Equitable Treatment', *Int'l Law* 39 (2005), p. 87; B. Choudhury, 'Evolution or Devolution? - Defining Fair and Equitable Treatment in International Investment Law', *JWIT* 6 (2005), p. 297; M. Kantor, 'Fair and Equitable Treatment', *The Law & Practice of International Courts and Tribunals* 5 (2006), p. 231; M. Klein Bronfman, 'Fair and Equitable Treatment: An Evolving Standard', *Max Planck UNYB* 10 (2006), p. 609; R. Kreindler, 'Fair and Equitable Treatment - A Comparative International Law Approach', *TDM* 3 (2006), issue 3; P. Muchlinski, "'Caveat Investor"? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard', *ICLQ* 55 (2006), p. 527; S. W. Schill, "'Fair and Equitable Treatment" as an Embodiment of the Rule of Law', in R. Hofmann and C. Tams (eds.), *The International Convention on the Settlement of Investment Disputes (ICSID)* (2007), p. 31; K. Hobér, 'Fair and Equitable Treatment', *TDM* 4 (2007), issue 6; G. Mayeda, 'Playing Fair: The Meaning of Fair and Equitable Treatment in Bilateral Investment Treaties', *JWIT* 41 (2007), p. 273; T. J. Westcott, 'Recent Practice on Fair and Equitable Treatment', *JWIT* 8 (2007), p. 409; A. Orakhelashvili, 'The Normative Basis of "Fair and Equitable Treatment"', *ArchVR* 46 (2008), p. 74; and I. Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (2008).



equitable treatment. Nevertheless, the scope and conceptual basis of fair and equitable treatment remain controversial. It is especially contentious as to what extent fair and equitable treatment should enable arbitral tribunals to review sovereign acts of host states interfering with the business of foreign investors. While the opposing sides repeat their arguments in a sedulous manner, they seem to achieve hardly any progress in their common challenge to 'find' the concrete meaning of fair and equitable treatment.

Therefore, this book proposes a shift in the way in which fair and equitable treatment is addressed. Rather than trying to find an intrinsic meaning of fair and equitable treatment, it attempts to track its development and search for conceptual schemes underlying this norm that are capable of justifying arbitral decisions and constructions of fair and equitable treatment. Thereby, the conceptual schemes consist of arguments and patterns of arguments being adduced to defend arbitral or scholarly positions with regard to the normative content and contours of fair and equitable treatment. The process of developing an adequate conceptual basis of fair and equitable treatment therefore includes a critical examination of the validity and persuasiveness of these arguments.

In the following chapters, such a conceptual basis is developed in an eclectic fashion and informed by various conceptual approaches and doctrines that are selectively combined in order to provide a more comprehensive picture of fair and equitable treatment. In this vein, the conceptual basis must take into account the vague nature of fair and equitable treatment and discuss the function of the norm in the context of a relatively fragmented international legal system. Furthermore, the conceptual basis of fair and equitable treatment is explored in light of general theories of justice and more specific theories on the rational balancing of competing arguments and interests.

To this end, the book outlines in Part I some fundamentals for the construction of fair and equitable treatment and addresses the basic question from what sources the arguments to justify a particular decision may be derived. The latter question is especially discussed in light of the ongoing controversy surrounding the equation of fair and equitable treatment with the so-called minimum standard of customary international law and the phenomenon of fragmentation of international law. Part II primarily examines which argumentative patterns for the justification of decisions on fair and equitable treatment exist and how a just balance between competing arguments may be achieved. Thereby, the

emerging sub-elements of fair and equitable treatment and the pertaining arbitral decisions are reviewed using a comparative law background. Subsequently, Part III seeks to specify the position of this conceptual scheme of fair and equitable treatment in the broader context of the international legal system. Accordingly, the position of fair and equitable treatment and its sub-elements is assessed in relation to the system of international law sources as well as the system of other conventional standards of investment protection. Finally, the role of fair and equitable treatment in relation to the idea of constitutionalism in international investment law is discussed.

PART I

The construction of fair and equitable  
treatment

## 2 Fundamentals for the construction of fair and equitable treatment

### A Conventional basis of fair and equitable treatment

'Fair and equitable treatment' is, at first, a conventional rule that is found in international investment treaties. Any analysis and construction of fair and equitable treatment therefore requires the identification of the conventional basis of such a norm and the different approaches to the formulation of particular clauses. Thereby, while most multilateral and bilateral investment agreements seem to deal with fair and equitable treatment, there is no commonly agreed clause with a fixed wording entailing fair and equitable treatment. However, the structure and content of bilateral investment treaties (BITs) exhibit notable similarities and hence allow for some type of generalisation.<sup>3</sup> In respect of multilateral agreements, this also appears true, since these agreements have mainly incorporated the pattern already established in BITs.<sup>4</sup> Nevertheless, certain variations in relation to the concrete drafting approach and the embedding of fair and equitable treatment into an investment agreement exist, which shall be outlined in the following.

#### 1 No reference to fair and equitable treatment

Fair and equitable treatment is acknowledged as one of the most commonly used standards in investment agreements.<sup>5</sup> However, there are several instances, especially in the early days of investment treaty practice, in which the standard has been omitted. These omissions do

<sup>3</sup> See M. Sornarajah, *The International Law on Foreign Investment*, 2nd edn (2004), pp. 217-218; A. F. Lowenfeld, *International Economic Law*, 2nd edn (2008), p. 555; A. Newcombe and L. Paradell, *Law and Practice of Investment Treaties* (2009), p. 65; and S. W. Schill, *The Multilateralization of International Investment Law* (2009), pp. 117-120.

<sup>4</sup> See UNCTAD, *International Investment Rule-Making*, UNCTAD/ITE/IIT2007/3 (2008), p. 19.

<sup>5</sup> See, e.g. R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (1995), p. 58.

not seem to be owed to any aversions against the standard, but rather because the general pattern was not fully established when most of these treaties were concluded.<sup>6</sup> Thus, a number of the BITs negotiated, for example, by the Federal Republic of Germany until the early 1960s do not contain references to fair and equitable treatment.<sup>7</sup> Although some BITs which were concluded later, like the 1977 Japan-Egypt BIT, do not incorporate the standard either, BITs without a reference to fair and equitable treatment continue to be a rare exception.<sup>8</sup> As regards multilateral agreements, it is noticeable that several agreements affecting international investments do not contain references to fair and equitable treatment. In particular, such a reference is missing in trade agreements such as the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Investment Measures (TRIMS). While these instruments do not belong to the inner circle of international investment agreements, they have various elements in common, namely the stipulation of most-favoured-nation treatment and national treatment.<sup>9</sup>

Therefore, where the standard of fair and equitable treatment is not incorporated into an investment agreement, a foreign investor in principle may not recur on the level of protection provided by it. In these cases, the foreign investor can only rely on the other standards of treatment encompassed by the particular investment agreement. However, in case a most-favoured-nation clause is available, an investor may also rely on fair and equitable treatment

<sup>6</sup> Vasciannie (above fn. 2), pp. 113-114.

<sup>7</sup> Among them are, e.g. the first modern BIT between Germany and Pakistan of 1959, and other BITs between Germany and Malaysia, Liberia, Morocco, Thailand (renewed in 2002 containing an express reference to fair and equitable treatment), Togo and Guinea; see M. I. Khalil, 'Treatment of Foreign Investment in Bilateral Investment Treaties', ICSID Rev. - FILJ 8 (1992), p. 339, at pp. 351-355 detecting that only 28 out of 335 BITs surveyed do not contain the standard; see also Vasciannie (above fn. 2), pp. 126-127; and Tudor (above fn. 2), p. 23, stating that out of 365 BITs reviewed only 19 did not refer to fair and equitable treatment.

<sup>8</sup> Confer UNCTAD (above fn. 2), p. 23; and UNCTAD, *Bilateral Investment Treaties 1995-2006*, UNCTAD/ITE/IIT/2006/5 (2007), p. 28.

<sup>9</sup> See F. Tschofen, 'Multilateral Approaches to the Treatment of Foreign Investment', ICSID Rev. - FILJ 8 (1992), p. 384, at pp. 401-404, providing for a more complete list of multilateral agreements and the standards of treatment entailed; see also UNCTAD (above fn. 2), p. 23; and R. Dolzer, 'Wirtschaft und Kultur im Völkerrecht', in W. Graf Vitzthum (ed.), *Völkerrecht*, 4th edn (2007), p. 491, at pp. 509-510, mn. 26-28, admittedly notes that the idea of fairness, although differently shaped, is also included in such trade agreements.

clauses of other investment agreements.<sup>10</sup> Additionally, a foreign investor may receive similar protection from customary international law. The mechanisms of protection that are considered to be part of customary international law in this sense may contain, first, elements of fair and equitable treatment that are accepted as custom and, second, the standard of fair and equitable treatment together with all of its elements if the standard itself has become part of customary international law.<sup>11</sup> Nevertheless, if a host country does not offer fair and equitable treatment to foreign investors in its investment agreements with other countries, there is at first no certainty whether an investor is, in fact, equipped with the same legal guarantees.

## 2 Hortatory references to fair and equitable treatment

Another *modus operandi* towards the formulation of fair and equitable treatment clauses are references to the standard which do not impose direct obligations on host states, but which stipulate fair and equitable treatment only in a preamble or demonstrate in another way the intent that such treatment of foreign investors is considered eligible. The following serve as important examples of this approach: the 1948 Havana Charter for the Establishment of an International Trade Organization (ITO) and the 1985 MIGA Convention. The Havana Charter<sup>12</sup> defines, in its Article 11(2), the means of the ITO regarding the promotion of economic development and economic reconstruction as follows:

The Organisation may, in such collaboration with other inter-governmental organisations as may be appropriate:

- (a) make recommendations for and promote bilateral or multilateral agreements on measures designed
- (i) to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one member country to another.

Accordingly, the ITO would not have been authorised to commit the contracting states to treat foreign investors just and equitably, but

<sup>10</sup> See, e.g. *Rumeli Telekom SA and Telsim Mobil Telekomikasyon Hizmetleri AS v. Kazakhstan*, ICSID Case No. ARB/05/16 (Award of 29 July 2008), at para. 575.

<sup>11</sup> On this question, see below (Chapter 8, section A, '2 Fair and equitable treatment as a norm of customary law?').

<sup>12</sup> The Havana Charter did not come into effect because it was ultimately not ratified inter alia by the United States.

merely to make recommendations and promote bilateral and multilateral agreements in view of such a treatment of foreign investors.<sup>13</sup>

Similarly, the MIGA Convention, when defining the investments that are deemed to be eligible, states in its Article 12(d):

In guaranteeing an investment, the Agency shall satisfy itself as to:

...  
(iv) the investment conditions in the host country, including the availability of fair and equitable treatment and legal protection for the investment.

Thus, the MIGA Convention does not impose a legal obligation on its signatory states to offer a fair and equitable treatment to foreign investors. Rather, the treaty text requests the MIGA itself and not the host countries to look at the investment conditions in a state in which an investment is made before providing any guarantees to the peculiar investment. The incorporation of the fair and equitable treatment standard into the Convention also addresses the declared purpose of the MIGA, which is the promotion and protection of investments as stipulated under Articles 2 and 23 of the MIGA Convention. However, for host countries Article 12(d) of the Convention may hardly be more than an impulsion as to the embodiment of their own regulatory framework governing the treatment of foreign capital.

Other agreements following such a hortatory approach towards the inclusion of fair and equitable treatment are, for example: the 1972 ICC Guidelines for International Investment,<sup>14</sup> the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment,<sup>15</sup> the 1995 Pacific Basin Charter on International

<sup>13</sup> See Yannaca-Small (above fn. 2), p. 3.

<sup>14</sup> The ICC Guidelines, cited from UNCTAD, *International Investment Instruments: A Compendium*, Vol. III, UNCTAD/DTCI/30 (Vol. III) (1996), p. 287, contain only recommendations that host countries:

Should respect the recognised principles of international law, reflected in many international treaties regarding the treatment of foreign property, concerning in particular:

- i. Fair and equitable treatment for such property.
- <sup>15</sup> Article III(2) of the World Bank Guidelines recommend:
2. Each state will extend to investments established in its territory by nationals of any other state fair and equitable treatment according to the standards recommended in these guidelines.

Useful commentary to the guidelines is provided by, e.g. I. F. I. Shihata, *Legal Treatment of Foreign Investment* (1993).

Investments<sup>16</sup> and the 2000 Cotonou Agreement.<sup>17</sup> Therefore, such non-binding formulations of the fair and equitable treatment standard are quite common in multilateral agreements. However, a hortatory approach can merely create an incentive for signatory states to treat foreign investors fairly and equitably.<sup>18</sup> The frequent appearance of soft formulations of fair and equitable treatment in multilateral agreements related to foreign investment is mainly due to the extremely difficult negotiations of multilateral investment rules, since it was unfeasible until today to reach consensus on an all-embracing multilateral investment regime.<sup>19</sup> The latter may also explain why the hortatory approach is not common in BITs.

For the purposes of the present investigation, hortatory inclusions of the fair and equitable treatment standard only play a minor role, simply because hortatory references, by definition, do not impose legally binding obligations on host states.<sup>20</sup> Hence, in these cases, the stipulation of fair and equitable treatment serves, at the political level, as an incentive or as a notice of intent of signatory states not to treat foreign investors unfairly or inequitably. The focus of legal interest therefore lies on the much more controversial binding references to fair and equitable treatment.

### 3 Legally binding references to fair and equitable treatment

Legally binding references to fair and equitable treatment are contained in the vast majority of investment agreements. However, a closer look at some of these agreements reveals a considerable spectrum of different drafting versions. These variations concern not only the particular

<sup>16</sup> The Pacific Basin Charter on International Investments, cited from UNCTAD (above fn. 14), pp. 377 and 378, using similar wording states as follows:

Host governments should treat international investors impartially, in accordance with national and international law. . . .

In international transfers of funds, governments and international investors should proceed . . . as may be fair and reasonable to both parties concerned.

<sup>17</sup> See Article 15 of Annexe II of the Cotonou Agreement.

<sup>18</sup> See also Klein Bronfman (above fn. 2), p. 625.

<sup>19</sup> Yannaca-Small (above fn. 2), p. 6, admittedly notes in relation to Article 48 of the 1985 Draft UN Code of Conduct on Transnational Corporations that, while the negotiating states could not agree on the whole treaty text, the formulation providing for an equitable treatment of transnational corporations was not in dispute.

<sup>20</sup> See also *Bayindir Insaat Turizm Ticaret ve Sanayi AS v. Pakistan*, ICSID Case No. ARB/03/29 (Award of 24 August 2009), at para. 155.

stipulation of the terms 'fair and equitable treatment', but also the adjacent context into which this formulation is embedded. While in some investment agreements 'fair and equitable treatment' is detached from additional wording, other agreements juxtapose it with other standards. In part, the varying drafting approaches gave rise to differing arbitral interpretations of fair and equitable treatment. As a reaction, this again induced some states to redraft their established patterns of investment agreements, attempting to exert influence on the interpretation of the particular clause by arbitral tribunals. The following sections attempt to sketch some of the existing drafting variations with regard to fair and equitable treatment itself as well as in relation to its adjacent context.<sup>21</sup>

(a) Conventional variations of fair and equitable treatment

When fair and equitable treatment emerged as a feature of treaty practice in the beginning of the second half of the twentieth century, the formulation of 'fair and equitable treatment' had not been established as a standing term for long. Therefore, especially in early treaty practice, alternative formulations of the standard existed. For instance, a reference to 'equitable treatment' can be found in some of the treaties of Friendship, Commerce and Navigation (FCN), between the United States and Greece, Ireland, Israel, Nicaragua, France, Pakistan, Belgium, and Luxembourg; other FCN treaties expressly include 'fair and equitable treatment'.<sup>22</sup> The words 'equitable treatment' are also referred to in Article 22 of the Economic Agreement of Bogotá<sup>23</sup> as well as in some early scholarly writings.<sup>24</sup>

<sup>21</sup> See also the analysis of different drafting approaches in UNCTAD (above fn. 8), pp. 30-33; another in-depth analysis of drafting formulations in bilateral, regional and multilateral agreements is presented by Tudor (above fn. 2), pp. 15-52.

<sup>22</sup> See Vasciannie (above fn. 2), pp. 110-111; to the pertinent provisions of FCN treaties, see also R. R. Wilson, *The International Law Standard in Treaties of the United States* (1953), pp. 92-94.

<sup>23</sup> Article 22(3) of the 1948 Economic Agreement of Bogotá provides:

Los capitales extranjeros recibirán tratamiento equitativo. Los Estados, por lo tanto, acuerdan no tomar medidas sin justificación o sin razón válida o discriminatorias que lesionen los derechos legalmente adquiridos o los intereses de nacionales de otros países en las empresas, capitales, especialidades, artes o tecnologías que éstos hubieren suministrado.

<sup>24</sup> On 'the standard of equitable treatment', see, e.g. G. Schwarzenberger, *Foreign Investments and International Law* (1969), p. 158.

Other variations of the standard do not just omit one element, but change the concrete wording. For example, the 1992 Norway-Lithuania BIT guarantees 'equitable and reasonable treatment'.<sup>25</sup> Additional variations of 'fair and equitable treatment' result from slightly differing translations of this norm into different languages. For instance, 'fair and equitable treatment' is commonly stipulated in French treaties as '*traitement juste et équitable*',<sup>26</sup> in Spanish treaties as '*trato justo y equitativo*',<sup>27</sup> in Italian treaties as '*trattamento giusto ed equo*'<sup>28</sup> and in German treaties as '*gerechte und billige Behandlung*'<sup>29</sup> or as '*faire und gerechte Behandlung*'.<sup>30</sup> Therefore, whatever the substantive differences between the varying formulations may be, it seems that at least the treaty practice is employing them interchangeably.

(b) Fair and equitable treatment in combination with other standards

Variations of drafting appear not only in relation to fair and equitable treatment itself, but also to the way in which fair and equitable treatment is incorporated into a specific clause and is linked to other

<sup>25</sup> See Article III of the 1992 Norway-Lithuania BIT:

Each contracting party shall promote and encourage in its territory investments of investors of the other contracting party and accept such investments in accordance with its laws and regulations and accord them equitable and reasonable treatment and protection ...

<sup>26</sup> See, e.g. Article 4(2) of the 1999 Switzerland-Chile BIT:

Chaque partie contractante assurera sur son territoire un traitement juste et équitable aux investissements des investisseurs de l'autre partie contractante.

<sup>27</sup> See, e.g. Article IV(1) of the 2006 Spain-Mexico BIT:

Cada parte contratante otorgará a las inversiones de inversores de la otra parte contratante, trato acorde con el derecho internacional consuetudinario, incluido trato justo y equitativo, así como protección y seguridad plenas.

<sup>28</sup> See, e.g. Article 2(2) of the 1990 Italy-Argentina BIT:

Ciascuna parte contraente assicurerà sempre un trattamento giusto ed equo agli investimenti di investitori dell'altra ...

<sup>29</sup> See, e.g. Article 2(2) of the 2005 German Model BIT:

Jeder Vertragsstaat wird in seinem Hoheitsgebiet Kapitalanlagen von Investoren des anderen Vertragsstaats in jedem Fall gerecht und billig behandeln und ihnen den vollen Schutz des Vertrags gewähren.

<sup>30</sup> See the German version of Article 10(1) of the Energy Charter Treaty (ECT) (available at [www.encharter.org/fileadmin/user\\_upload/document/GE.pdf](http://www.encharter.org/fileadmin/user_upload/document/GE.pdf), accessed 5 July 2010):

... Diese Bedingungen umfassen die Verpflichtung, den Investitionen von Investoren anderer Vertragsparteien stets eine faire und gerechte Behandlung zu gewähren ...

investment protection guarantees. Sometimes, fair and equitable treatment is stipulated in a clause relatively detached from other components. Examples for such formulations can especially be found in German and Austrian BITs. For instance, Article 2(1) of the 2000 Germany-Botswana BIT provides:

- (1) Each contracting party shall in its territory promote as far as possible investments by nationals or companies of the other contracting state and admit such investments in accordance with its legislation. It shall in any case accord such investments fair and equitable treatment.<sup>31</sup>

In many other clauses, however, fair and equitable treatment is combined with other investment guarantees. Thereby, fair and equitable treatment is juxtaposed with almost all other standards of treatment, especially with the guarantee of protection and security, the obligations of most-favoured-nation and national treatment and the duty to refrain from arbitrary and discriminatory treatment. An example of the combination of fair and equitable treatment with the guarantee of adequate protection and security relates to Article II(2) of the 2001 Cambodia-Cuba BIT, which holds:

Investments of investors of either contracting party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and security in the territory of the other contracting party.<sup>32</sup>

Combinations of fair and equitable treatment with a most-favoured-nation and national treatment obligation can be found in Article 3(2) of the 1986 Switzerland Model BIT:

- (2) Each contracting party shall ensure fair and equitable treatment within its territory of the investments of the nationals or companies of the other contracting party. This treatment shall not be less favourable than that granted by each contracting party to investments made within its territory by its own nationals or companies of the most favoured nation, if this latter treatment is more favourable.<sup>33</sup>

<sup>31</sup> Almost identical language is used in the 1994 Austria Model BIT (reprinted in Dolzer and Stevens (above fn. 5), pp. 167-175); as another example serves Article 3(1) of the 2001 Belgium/Luxembourg-Saudi Arabia BIT; and at the multilateral level Article 159(1) (a) of the 1993 Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA).

<sup>32</sup> Further examples are provided by Article 2(2) of the 1998 Germany Model BIT; Article 3(1) of the 1994 China Model BIT; and Article 9(1) of the 2003 Japan-Vietnam BIT.

<sup>33</sup> See also Article 4(2) of the 1999 Switzerland-Chile BIT; and Article 4 of the 2001 Bangladesh-Iran BIT.

The formulation of these clauses and the combination of the standards indicate that the scope of the different standards is overlapping at least to some extent.<sup>34</sup> Nevertheless, the issue of whether obligations are combined in one clause or stipulated in distinct clauses appears to be a stylistic question rather than one of substance.

In a further group of investment treaties, the contracting parties frequently combine the fair and equitable treatment standard with a duty not to impair the investment by unreasonable or discriminatory treatment. An example to this approach is presented by Article 2(2) of the 2001 Lebanon-Hungary BIT:

2. Investments and returns of investors of either contracting party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other contracting party. Each contracting party shall refrain from impairing by unreasonable or discriminatory measures the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments.<sup>35</sup>

(c) Fair and equitable treatment combined with a reference to general international law

Another class of agreements combines fair and equitable treatment with a reference to international law. An important example of this type of language at the multilateral level is provided by Article 1105(1) of the North American Free Trade Agreement (NAFTA):

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.<sup>36</sup>

Similar references to international law are also common in bilateral state practice. This is especially true for several French and Swiss BITs,

<sup>34</sup> Thereon, see below (Chapter 9, section A, 'Interplay with other standards of investment protection').

<sup>35</sup> Several model BITs follow this approach, among them Article 2(2) of the Hong Kong Model BIT; Article 3(1) of the 1993 Netherlands Model BIT; Article 2(2) of the 1994 UK Model BIT; at the multilateral level, see, e.g. Article 1 of the 1967 OECD Draft Convention on the Protection of Foreign Property; and Article 3(1) of the 1994 MERCOSUR Colonia Protocol.

<sup>36</sup> Further, other important multilateral investment agreements contain references to international law: see, e.g. Article 10(1) of the ECT; and similarly Chapter IV, Article 1.1 of the 1998 OECD Draft Multilateral Agreement on Investment (MAI).

but also for some older US and Canadian BITs.<sup>37</sup> Article 4(1) of the 1998 France-Mexico BIT serves as a suitable example:

1. Either contracting party shall extend and ensure fair and equitable treatment in accordance with the principles of international law to investments made by investors of the other contracting party in its territory or in its maritime area, and ensure that the exercise of the right thus recognised shall not be hindered by law or in practice.

As these two examples show, the linkage to international law is further circumscribed by differing wordings. While fair and equitable treatment sometimes seems to be 'included' in international law, other treaties stipulate fair and equitable treatment 'in accordance with' international law or refer to it as a standard that, 'in no case, shall provide for less protection' than the rules of international law. Occasionally, as in the case of Article 1105 of NAFTA, fair and equitable treatment clauses with reference to international law appear under the title of 'Minimum Standard of Treatment'. These formulations have triggered a chequered discussion as to the role of international law for the construction of fair and equitable treatment. In particular, it has been suggested that the reference to the principles of international law refers to the international minimum standard, which is deemed part of customary international law.<sup>38</sup> However, the controversy with regard to the role of international law in the discourse on fair and equitable treatment is not confined to drafting approaches that include a reference to international law, but has similarly spread to all other drafting approaches.

(d) Fair and equitable treatment combined with a reference to customary international law

In reaction to the controversy pertaining to the relation of fair and equitable treatment to international law, some states have taken a restrictive approach that attempts to limit the scope of fair and equitable treatment to the level of protection that is provided by customary international law. In particular, the United States and Canada have incorporated detailed language into their model BITs, in order to ensure that the standard does not go beyond customary international law. Therefore, the 2004 US Model BIT states the following:

<sup>37</sup> See, e.g. Article 4(1) of the 1971 Switzerland-Uganda BIT; Article II(1) of the 1998 Canada-Costa Rica BIT; and Article II(2)(a) of the 1992 US Model BIT.

<sup>38</sup> On the whole discussion, see below, Chapter 3.

### Article 5: Minimum Standard of Treatment

[Article 5 [Minimum Standard of Treatment] shall be interpreted in accordance with Annex A.]

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
  - (a) 'fair and equitable treatment' includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
  - (b) 'full protection and security' requires each Party to provide the level of police protection required under customary international law.
3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.

### Annex A

#### Customary International Law

The Parties confirm their shared understanding that 'customary international law' generally and as specifically referenced in Article 5 [Minimum Standard of Treatment] and Annex B [Expropriation] results from a general and consistent practice of states that they follow from a sense of legal obligation. With regard to Article 5 [Minimum Standard of Treatment], the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.<sup>39</sup>

The 2004 Canada Model BIT similarly provides:

### Article 5

#### Minimum Standard of Treatment

<sup>39</sup> The language of this US Model BIT is partially borrowed from the 2001 NAFTA FTC Notes of Interpretation relating to Article 1105 of NAFTA; on the FTC Note, see below (Chapter 3, section B, '2 FTC note of interpretation on Article 1105 (1) of NAFTA'). Re. the American policy related to this model BIT, see G. Gagné and J.-F. Morin, 'The Evolving American Policy on Investment Protection', *J. Int'l Econ. L.* 9 (2006), p. 357.



1. Each Party shall accord to covered investments treatment in accordance with the customary international law minimum standard of treatment of aliens, including fair and equitable treatment and full protection and security.
2. The concepts of 'fair and equitable treatment' and 'full protection and security' in paragraph 1 do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.

The language of these clauses shows the clearest preference of the drafting states to limit fair and equitable treatment to the rules of the customary international law minimum standard of treatment. Moreover, at least the US Model BIT further clarifies which customary rules are to be applied and stipulates in detailed terms that the concepts of denial of justice and due process are among those rules. While this version probably provides the most elaborated formulation of fair and equitable treatment, it is heavily based on the states' experience within NAFTA.<sup>40</sup> However, this approach arguably affects the drafting process of non-NAFTA investment agreements, since there are some American free trade agreements<sup>41</sup> as well as other international investment agreements<sup>42</sup> which already follow this NAFTA-influenced pattern.

(e) Fair and equitable treatment contingent on domestic law

A further category of investment treaties takes another, even more restrictive approach than the previous ones. Thereby, fair and equitable treatment is not linked to international law but, on the contrary, is contingent on the domestic legislation of the host country. Article IV of the 1997 CARICOM-Cuba BIT submits an example of this presumably rare drafting pattern:

Each party shall ensure fair and equitable treatment of investments of investors of the other party under and subject to national laws and regulations.<sup>43</sup>

<sup>40</sup> On the idiosyncrasies of the NAFTA discussion, see below (Chapter 3, section B, 'Discussion concerning Article 1105 of NAFTA').

<sup>41</sup> See, e.g. Article 10.5 of the 2004 Central America-Dominican Republic-United States Free Trade Agreement (DR-CAFTA).

<sup>42</sup> Norway presented a model BIT in 2007 which also juxtaposes fair and equitable treatment with customary international law. However, this model BIT has been abandoned in the meantime; see Investment Treaty News of 8 June 2009 (available at [www.investmenttreatynews.org/cms/news/archive/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty.aspx](http://www.investmenttreatynews.org/cms/news/archive/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty.aspx), accessed 5 July 2010).

<sup>43</sup> Cited from UNCTAD (above fn. 8), p. 31.

Obviously, this formulation stands in stark contrast to all other approaches, since it constricts the level of protection secured by fair and equitable treatment to the treatment that is offered by the host state to foreign investors anyway. Irrespective of the discussion regarding the relation between fair and equitable treatment and the minimum standard, it is however generally agreed that the fundamental idea of fair and equitable treatment as well as all other investment protection guarantees is to offer to foreign investors a level of protection that is independent of the host state's domestic law.<sup>44</sup> Consequently, the dependency of fair and equitable treatment on the domestic legislation voids this basic idea of having an independent international standard against which the behaviour of the host state can be assessed. If the meaning of fair and equitable is defined exclusively by the legal framework of the host state, a guarantee of fair and equitable treatment may hardly depict more than a confirmation of benevolence.<sup>45</sup>

(f) Conclusion: increasing variety of treaty language

The review of the conventional basis of fair and equitable treatment endorses the impression that it is indeed a well-established feature in the vast majority of investment agreements.<sup>46</sup> Thereby, fair and equitable treatment obligations are stipulated in a broad range of different kinds of investment agreements, including bilateral FCN treaties, BITS, sectoral agreements like the ECT, and regional trade agreements like NAFTA and many others. Beside all controversy in the detail, it therefore seems that a considerable degree of consensus with respect to the importance of fair and equitable treatment as a standard of investment protection exists.<sup>47</sup> Moreover, it is unlikely that future investment

<sup>44</sup> See Dolzer and Stevens (above fn. 5), p. 58; similarly J. Alenfeld, *Die Investitionsförderungsverträge der Bundesrepublik Deutschland* (1971), p. 69; and Z. A. Kronfol, *Protection of Foreign Investment* (1972), pp. 16-18.

<sup>45</sup> On the signalling effect of fair and equitable treatment, see, e.g. Vasciannie (above fn. 2), p. 99.

<sup>46</sup> Lowenfeld (above fn. 3), p. 475; and N. Rubins and N. S. Kinsella, *International Investment, Political Risk and Dispute Resolution* (2005), p. 213.

<sup>47</sup> See UNCTAD (above fn. 4), p. 43. The relative similarity of investment agreements is not surprising, since the archetypes of the early BITS, which were the US FCN treaties, the 1959 Abs-Shawcross Draft Convention and the 1967 OECD Draft Convention on the Protection of Foreign Property, used quite consistent language: see Schwarzenberger (above fn. 24), p. 158; F. A. Mann, 'British Treaties for the Formation and Protection of Investment', *BYIL* 24 (1981), p. 241 at p. 241; and Vasciannie (above fn. 2), pp. 107-113.

treaties – or a future multilateral investment agreement – will omit a reference to fair and equitable treatment.<sup>48</sup>

Nevertheless, the textual analysis also reveals considerable differentiations as to the drafting of a fair and equitable treatment clause. Arguably, while most textual variations appear quite random, other differences, for instance, the reference to international law, are illustrative of distinctive underlying perceptions of the meaning of fair and equitable treatment. Hence, this linkage to international law forms a focal point of doctrinal debate on the standard of fair and equitable treatment. As a reaction to the controversy surrounding the role of international law in the construction of fair and equitable treatment, some states have redrafted and specified their model BITs in order to limit the standard of treatment to the so-called international minimum standard, which is deemed part of customary international law. Notwithstanding the basic consensus on fair and equitable treatment as a treaty standard, its conventional basis appears more and more diverse and reflects the general trend in international investment rule-making towards increasing variety and complexity.<sup>49</sup>

## B Institutional, economic and functional basis of fair and equitable treatment

In addition to the conventional basis, the construction of fair and equitable treatment is naturally influenced by its wider institutional, economic and functional setting. Such factors enriching the understanding of fair and equitable treatment include the political process that led to the current landscape of international investment law and the rise of investment treaty arbitration. Furthermore, the economic

<sup>48</sup> Fair and equitable treatment is thus considered as to be one of the elements of a future ideal multilateral investment agreement: see F. Panetta, *Ausländische Direktinvestitionen und Welthandelsordnung* (2003), p. 96. It is also included in, e.g. Article 7 of the IISD Model International Agreement of Investment for Sustainable Development: see H. Mann, K. von Moltke, L. E. Peterson and A. Cosby, *IISD Model International Agreement on Investment for Sustainable Development*, 2nd edn (2006), pp. 15–16; as a matter of principle, the eligibility of fair and equitable treatment is also not disputed by C. Huiping, 'Comments on the MAI's General Principles for the Treatment of Foreign Investors and Their Investments', in E. C. Nieuwenhuys and M. M. T. A. Brus (eds.), *Multilateral Regulation of Investment* (2001), p. 67, who views the MAI's provisions for the treatment of investors as being 'too high and unacceptable to developing countries at the present stage' (p. 84), but is not referring to fair and equitable treatment as such.

<sup>49</sup> See UNCTAD (above fn. 4), pp. 28 et seq.

discussion on the effectiveness of investment agreements to promote, in fact, foreign investment flows shall also be taken into account. Finally, the methodological approaches in arbitral jurisprudence and the pertinent function of arbitrators are explored.

### 1 International investment process

The political process of international investment law is shaped by two extreme ideological poles, between those the changeful politico-economic zeitgeist oscillates. Such antagonism notwithstanding, the international investment process has gained considerable momentum yielding an impressive number of international investment agreements.

#### (a) Underlying ideologies

It is important to recognise that there are two diametrically opposed theories<sup>50</sup> underlying the whole debate on foreign investment. The 'classical theory' assumes that foreign investment has mainly positive effects on host countries.<sup>51</sup> The inflow of foreign capital into the host country entails the introduction of new technologies, know-how and management skills that, in time, are diffused in the economy. Furthermore, new foreign facilities create additional employment, strengthen the diffusion of such skills and improve the infrastructure. Local enterprises then benefit not only as component suppliers, but also from the new infrastructure. The additional purchasing power of the people gives further impulses to the national economy. Eventually, this process leads to an enlargement of the government's tax base and thus, overall, provides for great benefits for the society of the host state as a whole.

The ideologically converse 'dependency theory' denies positive effects of foreign investment on the economic development of host countries.<sup>52</sup> Foreign investment is made mainly by multinational corporations which normally have their headquarters in the central developed economies of the world. Such multinational enterprises make host states get more and more caught in a vicious circle, causing them to scale down to peripheral economies serving the interests of home states. In developing states, only the elite classes

<sup>50</sup> Classical Marxist theories are left aside, as they deprecate private property.

<sup>51</sup> See with further references Sornarajah (above fn. 3), pp. 51–57; and with a special focus on multinational enterprises, P. T. Muchlinski, *Multinational Enterprises and the Law*, 2nd edn (2007), pp. 90–91.

<sup>52</sup> See Sornarajah (above fn. 3), pp. 57–59; and Muchlinski (above fn. 51), pp. 92–96.

may benefit from foreign investment building alliances with the new capital, in order to suppress the people. What is more, foreign investors harm the developing state by a potential rise in corruption, additional ecological damage, and a possible severe constriction of sovereignty. In the end, economic development that is independent of the interests of elite circles and the economically advanced is deemed impossible.

Today, irrespective of one's political preferences, it is of course quite well recognised that foreign investment involves both costs and benefits for states.<sup>53</sup> It represents a difficult task for every host economy to maximise the positive effects of such investment. However, the replication of these theories as extreme positions may illustrate the considerable scope of views that have been advanced in this context. Even in the current debate on fair and equitable treatment, many of the arguments available, openly or in disguise, stem from one of these ideological points of origin.

#### (b) The proliferation of international investment agreements

The conflicting ideological positions are also apparent in the political process of negotiating international investment agreements, which clearly displays the oscillation between phases of pro-investor attitude and phases of state-centred thinking.<sup>54</sup> Usually, developed countries in Europe and North America, as traditional capital-exporters, adopted a pro-investor attitude that was favourable to their economic activities abroad. However, quite strong reservations against foreign capital arose

in the aftermath of World War II and decolonisation.<sup>55</sup> Therefore, developed countries felt a need to secure additional and higher standards of legal protection for their investments than those offered under the domestic laws of developing host countries or under customary international law.<sup>56</sup> Furthermore, the negotiation of international investment agreements, especially BITs, appeared as a way to overcome the ideological discussions and reservations concerning the protection of foreign capital. On the other side, many developing countries increasingly appreciated foreign investment as a source of capital and thereby gradually abandoned their besetting hostility towards foreign investment based on the dependency theory. Accordingly, an increasing number of developing countries entered into investment agreements, which were seen as important elements of a favourable investment climate attracting foreign investors.<sup>57</sup>

Especially in the 1990s, this process of the proliferation of international investment agreements accelerated dramatically, leading to a dense network of over 2,600 BITs concluded by the end of 2007.<sup>58</sup> This fundamental change in mind of developing countries, starting in the 1980s, is mainly due to the victory of market ideology facilitated by the collapse of the Soviet bloc and the debt crisis of the 1980s reducing the availability of private lending as the main alternative source of capital.<sup>59</sup> Another factor contributing to this trend was the emergence of developing countries acting as capital-exporters, concluding themselves BITs with other developing countries.<sup>60</sup> The fact that developed countries were increasingly recognising their position of being not only

<sup>53</sup> See, e.g. J. Robbins, 'The Emergence of Positive Obligations in Bilateral Investment Treaties', U. Miami Int'l & Comp. L. Rev. 13 (2006), p. 403 at pp. 408-409; D. R. Bishop, J. Crawford and W. M. Reisman (eds.), *Foreign Investment Disputes* (2005), pp. 7-8; Sornarajah (above fn. 3), pp. 59-65; and Shihata (above fn. 15), pp. 9-12; this may be seen as a 'transformationalist' perspective within the current debate on globalisation - see Muchlinski (above fn. 51), pp. 96-99.

<sup>54</sup> Re. the history of the BIT movement, see, e.g. J. W. Salacuse, 'BIT by BIT', Int'l Law 24 (1990), p. 655 at pp. 656-664; G. Sacerdoti, 'Bilateral Treaties and Multilateral Instruments on Investment Protection', RdC 269 (1997), p. 251 at pp. 298-302; UNCTAD, *Bilateral Investment Treaties 1959-1999*, UNCTAD/ITE/IIA/2 (2000); K. J. Vandavelde, 'A Brief History of International Investment Agreements', U.C. Davis J. Int'l L. & Pol'y 12 (2005), p. 157; Bishop, Crawford and Reisman (eds.) (above fn. 53), pp. 2-7; T. W. Wälde, 'The Specific Nature of Investment Arbitration', in P. Kahn and T. W. Wälde (eds.), *Les aspects nouveaux du droit des investissements internationaux* (2007), p. 43 at pp. 67-91; R. Dolzer and C. H. Schreuer, *Principles of International Investment Law* (2008), pp. 17 et seq.; Newcombe and Paradell (above fn. 3), pp. 1 et seq.; and Schill (above fn. 3), pp. 25 et seq.

<sup>55</sup> Especially in these times and because of the claim of a New International Economic Order by developing states, the negotiation of a BIT on an ad hoc basis was more feasible since there was no consensus on multilaterally acceptable norms: see, e.g. A. F. Lowenfeld, 'Investment Agreements and International Law', Colum. J. Transnat'l L. 42 (2003), p. 123 at pp. 123-128; and Sornarajah (above fn. 3), pp. 211-217.

<sup>56</sup> An overview of political risks that may affect foreign investment is provided by P. E. Comeaux and S. N. Kinsella, *Protecting Foreign Investment under International Law* (1997), pp. 1-22. They identify five different types of political risks: expropriation, de facto expropriation, currency risk, the risk of political violence and the risk of breach of contract by the host state; similarly, see Rubins and Kinsella (above fn. 46), pp. 1-29.

<sup>57</sup> See UNCTAD (above fn. 54), p. 1; and J. W. Salacuse and N. P. Sullivan, 'Do BITs really work?', Harv. Int'l L.J. 46 (2005), p. 67 at p. 77.

<sup>58</sup> On this 'second stage' of the international investment process, see UNCTAD (above fn. 4), pp. 14 et seq. and 23.

<sup>59</sup> See Vandavelde (above fn. 54), pp. 177-178; and Schill (above fn. 3), p. 62.

<sup>60</sup> On this trend, see, e.g. Dolzer and Schreuer (above fn. 54), p. 21; China has now concluded the second largest number of BITs after Germany, see UNCTAD (above fn. 4), p. 24, figure 4.

capital-exporters but also capital-importers, and more recent tendencies indicating the growing reluctance of developed countries towards further investment liberalisation<sup>61</sup> all contribute to an increasingly fragmented political process, in which the different ideological positions become more and more intermingled. The construction of fair and equitable treatment should correspond to the multi-faceted process, upon which the system of international investment law is built, and should not lopsidedly reflect the one or the other extreme ideological position.

### (c) The dynamics of investment treaty arbitration

The process of the proliferation of international investment agreements already reveals the dynamic evolution of international investment law. However, the proliferation of investment agreements has been accompanied with a further peculiarity having an equally fundamental impact on the development of this field of law. This peculiarity results from the fact that states, from the 1980s onwards, started negotiating investment agreements on a large scale that included special investor-state dispute settlement procedures, distinguishing international investment law from other areas of international law.<sup>62</sup> These investor-state arbitration procedures<sup>63</sup> grant individual investors the right to sue the host state without having to resort to the traditional and cumbersome political instruments of diplomatic protection and without requiring any prior contractual relationship between foreign investor and host state.<sup>64</sup> Rather, investors are usually endowed with the possibility to present their claims directly to an arbitral tribunal deciding cases based on arbitration rules like, among others, the 1965 ICSID Convention<sup>65</sup> or the 1976 UNCITRAL Arbitration Rules. The aim pursued in establishing

<sup>61</sup> Such tendencies are especially expressed by the growing concerns about sovereign wealth funds: see UNCTAD, *Transnational Corporations and the Infrastructure Challenge* (2008), pp. 25–26 and 77; for the German example of a domestic law monitoring sovereign wealth funds, see T. Voland, 'Freitag, der Dreizehnte', *EuZW* (2009), p. 519.

<sup>62</sup> On the exceptionality of the system of international investment arbitration, see Wälde (above fn. 54); and G. Van Harten, *Investment Treaty Arbitration and Public Law* (2007), pp. 8–11.

<sup>63</sup> For a survey of such provisions, see, e.g. C. McLachlan, L. Shore and M. Weininger, *International Investment Arbitration* (2007), pp. 46 et seq.

<sup>64</sup> See especially J. Paulsson, 'Arbitration without Privity', *ICSID Rev. – FILJ* 10 (1995), p. 232.

<sup>65</sup> For a comprehensive commentary, see C. H. Schreuer, *The ICSID Convention: A Commentary* (2001).

such investor-state dispute settlement mechanisms is to provide foreign investors with a powerful procedural position on a par with the responding state in order to counterbalance the investor's subjection to the territorial jurisdiction of the host state.<sup>66</sup>

On this basis, foreign investors initiated the first investment arbitration proceedings in the 1990s and have triggered a whole wave of investment disputes in recent years.<sup>67</sup> This increase in the number of investment claims was due to the overall augmentation of international investment agreements and the growing awareness of the availability of international legal remedies.<sup>68</sup> Thereby, the cases concern a wide range of subject matters, including public services like the energy sector, waste management and water supply, as well as other sectors such as finance, transportation and real estate transactions.<sup>69</sup> In addition, actions have been brought against a broad variety of responding states, mainly against developing states or economies in transition but also and increasingly against developed states.<sup>70</sup> However, beyond the growth in numbers and subject matters, the system of investment treaty arbitration involves special dynamics without which the rise of the system of investment arbitration might not be properly explained.

Arguably, the establishment of investor-state dispute settlement procedures in combination with the relatively vague substantive treaty standards, against which the actions of host states are measured, have generated this inherent dynamics. Exactly this dynamic situation and the resulting case law emerging from investor-state disputes are the driving forces in the development and expansion of international investment law.<sup>71</sup> Thus, only by creating an arbitral jurisdiction the vague treaty obligations acquired teeth, which laid the foundations for the evolution of investment protection standards

<sup>66</sup> See Wälde (above fn. 54), p. 55.

<sup>67</sup> On the statistics, see UNCTAD (above fn. 4), pp. 33–35; and Newcombe and Paradell (above fn. 3), p. 59, noting 290 cases at the end of 2007 of which the majority was filed with ICSID.

<sup>68</sup> See UNCTAD (above fn. 4), p. 33.

<sup>69</sup> See the empirical study of S. D. Franck, 'Empirically Evaluating Claims about Investment Treaty Arbitrations', *N.C.L. Rev.* 86 (2007), p. 1 at pp. 41–43.

<sup>70</sup> A list of responding states is provided by UNCTAD, *Latest Developments in Investor-State Dispute Settlement*, UNCTAD/WEB/ITE/IIA/2008/3, IIA Monitor, No. 1 (2008), Annex 1. Thereby, Canada and the US with twelve cases each at the end of 2007 are ranked at position four of the list. Germany is now also facing its first investment dispute as a responding state; see *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG v. Germany*, ICSID Case No. ARB/09/6 (Request for Arbitration of 30 March 2009).

<sup>71</sup> See Wälde (above fn. 54), p. 46.

from politico-diplomatic to judicially enforceable instruments.<sup>72</sup> This dynamic development affects, in particular, the guarantee of fair and equitable treatment. While fair and equitable treatment was initially no more than a political signal, it is now invoked in virtually all investment disputes and has revealed a 'potential to reach further into the traditional *domaine réservé* of the host state than any one of the other rules of the treaties'.<sup>73</sup>

## 2 The effectiveness of international investment agreements

An economic perspective on the interrelationship between investment protection and investment promotion – the effectiveness of international investment agreements – could provide further guidance for the construction of fair and equitable treatment. This is especially true in light of the dynamics of investment treaty arbitration exposing the quest for the right construction of investment protection standards. Thereby, an economic analysis of the effectiveness of investment agreements could indicate whether fair and equitable treatment should be construed as requiring a high or low level of protection. Arguably, a high level of investment protection would be expedient if it contributed substantially to the creation of favourable investment conditions and thus raised the amount of investment inflow into the specific host country. In contrast, a low level of protection could be more adequate if a high level of investment protection turns out to be unable to influence positively the investment flows. However, the question as to the effectiveness of international investment agreements is highly debatable and is the subject of various empirical studies that have reached differing results. Among the variety of different studies,<sup>74</sup> only some shall receive further attention.

The study of Salacuse and Sullivan specifically addresses the interaction between the different levels of protection of BITs and the amount of FDI inflow.<sup>75</sup> This study compares US BITs providing a presumably high

<sup>72</sup> See *ibid.*, p. 56.

<sup>73</sup> R. Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law', *NYU J Int'l L. & Pol.* 37 (2005), p. 953 at p. 964.

<sup>74</sup> For a comprehensive compilation of different studies, see K. P. Sauvant and L. E. Sachs (eds.), *The Effect of Treaties on Foreign Direct Investment* (2009).

<sup>75</sup> Salacuse and Sullivan (above fn. 57), providing three cross-sectional analyses of FDI inflows to up to 99 developing countries in the years 1998, 1999 and 2000, respectively, as well as a fixed effects estimation of the bilateral flow of FDI from the US to 31 developing countries over the period 1991 to 2000.

level of protection with BITs of other OECD countries guaranteeing a presumably lower level of protection. The authors conclude that, 'in the case of US BITs and to a lesser extent the BITs of other OECD countries, BITs arguably have a positive impact on promoting investment to the signatory state' and that, 'if a developing country truly wishes to promote foreign investment, it is better to sign a BIT with high protection standards, like those advocated by the United States, than one with weaker standards as evidenced by certain other OECD countries'.<sup>76</sup> This result is based on the consideration that an investor will always, under otherwise equal conditions, prefer a not so precarious investment climate. It is also assumed that BITs with higher standards of investment protection create a less risky investment climate. Similarly, a study of Neumayer and Spess states that negotiating additional BITs increases per se a host state's share of FDI.<sup>77</sup> This study also reinforces the impression that the protection of foreign investment generally raises the amount of FDI received by a host state and that the actual level of protection, in fact, serves as a driving force in promoting foreign investment. Neumayer and Spess even find 'some limited evidence that BITs might function as substitutes for good domestic institutional quality'.<sup>78</sup>

Other studies, however, arrive at distinct results. A study based on an earlier paper of UNCTAD is far less optimistic about the role played by BITs in the attraction of outward FDI. This paper attests that BITs only play a 'minor and secondary role' within this process, although it seems to be more likely than not that the signing of a BIT will marginally increase the amount of foreign investment.<sup>79</sup> In a World Bank investigation, Hallward-Driemeier similarly finds 'little evidence that BITs have stimulated additional investment', especially for host countries with weak domestic institutions.<sup>80</sup> Hence, in the process of attracting

<sup>76</sup> Salacuse and Sullivan (above fn. 57), p. 106.

<sup>77</sup> E. Neumayer and L. Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?', *World Development* 33 (2005), p. 1567, including in their study 119 countries and examining data in the period between 1970 and 2002.

<sup>78</sup> Neumayer and Spess (above fn. 77), p. 1568.

<sup>79</sup> UNCTAD, 'The Impact on Foreign Direct Investment of BITs', in K. P. Sauvant and L. E. Sachs (eds.), *The Effect of Treaties on Foreign Direct Investment* (2009), p. 323 at p. 347, studying the impact of 200 BITs on bilateral FDI data, examining years prior and after their conclusion.

<sup>80</sup> M. Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract FDI?', *World Bank Policy Research Working Paper* No. 3121 (2003), p. 22, analysing bilateral FDI outflows from 20 OECD countries to 31 developing countries within the years of 1980 to 2000.

FDI, BITs are said to serve rather as a complement than as a substitute for domestic institutions in the protection of private investments.<sup>81</sup> A further example in this respect is provided by Tobin and Rose-Ackerman, who observe that 'the relationship between BITs and FDI is weak' and 'BITs, by themselves, appear to have little impact on FDI'.<sup>82</sup> The authors conclude – similar to Hallward-Driemeier and in contrast to the results of Neumayer and Spess – that only countries with some minimum level of political stability can derive positive effects from their signing of BITs.

Altogether, it is impossible to derive sufficient guidance from these studies with regard to the question of whether fair and equitable treatment should be construed to guarantee a high or low level of protection. The latter would only be the case if a high level of protection created a more attractive investment climate which, under otherwise equal conditions, would be preferred by foreign investors. However, this point is only made by the study of Salacuse and Sullivan. It is not addressed, at least not directly, by any other studies. Furthermore, the study of Salacuse and Sullivan refers to the higher level of protection provided by US BITs in a quite general way.<sup>83</sup> A closer look at the US BITs reveals that the higher level of protection envisaged by Salacuse and Sullivan relates to the admission of foreign investments and not to their treatment at the post-establishment phase.<sup>84</sup> This, however, provides at best a weak argument in order to maintain that a broad construction of a general treatment clause like fair and equitable treatment would attract additional investments. The force of the argument is further weakened by the fact that other studies have reached differing conclusions.

<sup>81</sup> Hallward-Driemeier (above fn. 80), p. 23.

<sup>82</sup> J. Tobin and S. Rose-Ackerman, 'Foreign Direct Investment and the Business Environment in Developing Countries', *Yale Law School Economics and Public Policy Research Paper No. 293* (2005), p. 31, analysing the impact of BITs on general non-dyadic FDI inflows in the time from 1980 to 2000 and with data from 63 countries averaged over five-year periods.

<sup>83</sup> The authors only declare that the BITs negotiated by the US 'generally exhibit higher standards': Salacuse and Sullivan (above fn. 57), p. 89.

<sup>84</sup> Salacuse and Sullivan are referring to P. Juillard, 'L'évolution des sources du droit des investissements', *RdC* 250 (1994 VI), p. 9 at p. 211, who identifies that conditions of admission are not normally included in BITs and that only US treaties require the host state to admit foreign investment on the basis of national treatment; see also Dolzer and Stevens (above fn. 5), pp. 49–50; and T. McGhie, 'Bilateral and Multilateral Investment Treaties', in D. D. Bradlow and A. Escher (eds.), *Legal Aspects of Foreign Direct Investment* (1999), p. 107 at p. 113.

The effectiveness of international investment agreements thus remains a controversial and difficult question.<sup>85</sup>

However, it is uncontroversial and pointed out by all studies that the level of investment protection as provided by investment agreements is perhaps a relevant, but only a single, jigsaw piece in the creation of a favourable investment climate.<sup>86</sup> Overall, three sets of determinants appear to be of particular importance: the regulatory framework of foreign investments that is influenced not only by international agreements, but equally by domestic regulations; the active promotion of foreign investment by the host country; and, most importantly, the economic factors in the prospective host country.<sup>87</sup> Thus, international investment agreements may be seen as signals or as confidence-building measures showing that a host country is in principle interested in attracting foreign investment.<sup>88</sup> The same is true for fair and equitable treatment clauses indicating to foreign investors that the host state, at least in principle, will refrain from any hostile treatment.<sup>89</sup> However, this frequently emphasised signalling effect remains somewhat diffuse; it is certainly not enough to infer therefrom a specific understanding or construction of fair and equitable treatment.

Moreover, an economic perspective also poses other questions that are not addressed by the mentioned studies. These questions relate to the interrelation of the quality of different investments (portfolio or foreign direct investment), their impact on the development of host countries and the level of protection that should be granted to the different types of investment. Most international investment agreements contain very broad definitions of protected investments,<sup>90</sup>

<sup>85</sup> See also L. E. Sachs and K. P. Sauvant, 'BITs, DTTs, and FDI Flows', in K. P. Sauvant and L. E. Sachs (eds.), *The Effect of Treaties on Foreign Direct Investment* (2009), p. xxvii at p. liv, observing that 'it is difficult to establish firmly the effect of BITs on FDI flows'.

<sup>86</sup> This is also recognised by other authors: see Comeaux and Kinsella (above fn. 56), pp. 18–21; K. J. Vandavelde, 'Investment Liberalization and Economic Development', *Colum. J. Transnat'l L.* 36 (1998), p. 501 at pp. 524–525; McGhie (above fn. 84), pp. 108–109; and J. W. Salacuse, 'Towards a Global Treaty on Foreign Investment', in N. Horn (ed.), *Arbitrating Foreign Investment Disputes* (2004), p. 51 at p. 71.

<sup>87</sup> See Sachs and Sauvant (above fn. 85), pp. xlix–lii; similar elements of a presumably favourable investment climate are described in Shihata (above fn. 15), pp. 12–26.

<sup>88</sup> Salacuse (above fn. 54), p. 673; Dolzer and Stevens (above fn. 5), p. 12; and Sachs and Sauvant (above fn. 85), p. lv.

<sup>89</sup> Vasciannie (above fn. 2), p. 99.

<sup>90</sup> See, e.g. McLachlan, Shore and Weinger (above fn. 63), pp. 163 et seq.

often including portfolio investments.<sup>91</sup> However, not all types of investments are equally beneficial to the development of host countries.<sup>92</sup> Therefore, it is arguable whether all covered investments should receive the same level of protection under an investment agreement. In this vein, fair and equitable treatment could be construed in a way that ensures a higher level of protection to foreign direct investments and a lower level of protection to more volatile portfolio investments.<sup>93</sup> However, since the texts of investment agreements do not usually indicate any such differentiation, arguments in this direction would have to be backed by further economic studies that shed light on the relationship between the level of investment protection and economic development.

### 3 *Functionality of investment arbitration*

The previous sections have revealed the difficulties in the construction of fair and equitable treatment originating from the questionable effectiveness of investment agreements as well as from the combination of vaguely formulated treaty clauses and the considerable dynamics of the system of investment treaty arbitration. These difficulties draw attention to the role and crucial function of arbitral jurisprudence in the construction of fair and equitable treatment. To this end, the following chapters draw closer attention to the methodological approaches used in arbitral jurisprudence and the overall function of arbitrators.

#### (a) *Methodological approaches to fair and equitable treatment*

The different methodological approaches being employed by arbitral tribunals in relation to fair and equitable treatment<sup>94</sup> are characterised by an effort to simplify the norm's concept and to make it easily manageable in an arbitral proceeding. In this respect, one approach is constituted by an attempt to formulate shorthand definitions that are workable in a particular case and to subsume the facts under this definition. Typical examples of such definitions are the following:

Article 1105 imports into the NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice.<sup>95</sup>

<sup>91</sup> See Sornarajah (above fn. 3), pp. 227–228. <sup>92</sup> See *ibid.*, pp. 61–63.

<sup>93</sup> On the distinction between FDI and portfolio investment, see IMF, *Balance of Payments Manual*, 5th edn (1993), pp. 86 et seq.

<sup>94</sup> Confer Dolzer and Schreuer (above fn. 54), at 133.

<sup>95</sup> *S.D. Myers Inc. v. Canada*, UNCITRAL (First Partial Award of 13 November 2000), at para. 134.

Acts that would violate this minimum standard would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.<sup>96</sup>

[I]n terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a pro-active statement – 'to promote', 'to create', 'to stimulate' – rather than prescriptions for a passive behaviour of the state or avoidance of prejudicial conduct to the investors.<sup>97</sup>

The arbitral tribunal considers that this provision of the agreement, in light of the good faith principle established by international law, requires the contracting parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. . . . The foreign investor also expects the host state to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the state to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation.<sup>98</sup>

The deficiency of this approach is obvious: the given definitions vary considerably, not only in their elaborateness, but also with regard to the thresholds and elements they comprise. Furthermore, it usually remains unexplained on which underlying reasons and conceptual basis the tribunals construct these assumptions.<sup>99</sup> Therefore, the definitions embody a high-handedly chosen accumulation of elements which can hardly be said to flow directly from the indeterminate meaning of fair and equitable treatment. However, if no reasons are adduced to justify such definitions, they ultimately represent deficient premises for the process of decision-making on fair and equitable treatment.

<sup>96</sup> *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia*, ICSID Case No. ARB/99/2 (Award of 25 June 2001), at para. 367.

<sup>97</sup> *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile*, ICSID Case No. ARB/01/7 (Award of 25 May 2004), at para. 113.

<sup>98</sup> *Técnicas Medioambientales, TECMED SA v. Mexico*, ICSID Case No. ARB(AF)/00/2 (Award of 29 May 2003), at para. 154.

<sup>99</sup> See also Schill (above fn. 2), p. 37.

Another approach denies the possibility of giving an abstract definition of fair and equitable treatment and rather decides ad hoc and in consideration of the facts whether the standard has actually been breached.<sup>100</sup> While this approach recognises that any definition of fair and equitable treatment, due to its indeterminacy, will at best be able to cover parts of the norm's meaning, it does not provide further explanation as to the doctrinal concept or the underlying rationale.<sup>101</sup> Furthermore, this approach seems to conceal the fact that tribunals often implicitly formulate a definition of fair and equitable treatment, which is subject to the same criticism as the previous approach. Tribunals utilising this second approach may also run the risk of deciding a case solely on the basis of general feelings of justice. It is, however, an important function of legal reasoning to display and grasp these feelings in juristically traceable categories so as to make them rationally revisable – something this approach is unable to do.

A third approach which came into play through the progressive augmentation of arbitral awards dealing with fair and equitable treatment is the reference of tribunals to decisions on fair and equitable treatment rendered by previous tribunals.<sup>102</sup> Due to the lack of a formal rule of *stare decisis* one might fear that this practice could proceed in an uncontrolled manner.<sup>103</sup> However, such fears are mitigated by the existence of a de facto doctrine of precedent furthering the formation of a common legal opinion or a *jurisprudence constante* in international investment arbitration.<sup>104</sup> Moreover, the taking into consideration of other decisions in the area of international investment law and international law in general contributes to an increased quality of legal

<sup>100</sup> See *Mondev International Ltd v. United States*, ICSID Case No. ARB(AF)/99/2 (Award of 11 October 2002), at para. 118, stating that a 'judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case'.

<sup>101</sup> See also Schill (above fn. 2), p. 37.

<sup>102</sup> See, e.g. *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/3 (Award of 30 April 2004), at paras. 89–98; *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/8 (Award of 12 May 2005), at paras. 276–279; and *Azurix Corp. and others v. Argentina*, ICSID Case No. ARB/01/12 (Award of 14 July 2006), at paras. 365–372.

<sup>103</sup> See Schill (above fn. 2), p. 37.

<sup>104</sup> See T. Weiler, 'NAFTA Article 1105 and the Principles of International Economic Law', *Colum. J. Transnat'l L.* 42 (2003), p. 35 at pp. 47–49; McLachlan, Shore and Weininger (above fn. 63), pp. 71–76; T.-H. Cheng, 'Precedent and Control in Investment Treaty Arbitration', *Fordham Int'l L.J.* 30 (2007), p. 1014, at 1031–1037; and Schill (above fn. 3), pp. 321 et seq.; see also the enlightening discussion on the doctrine of *stare decisis* in investment arbitration by the tribunal in *AES Corp. v. Argentina*, ICSID Case No. ARB/02/17 (Decision on Jurisdiction of 26 April 2005), at paras. 18–45.

reasoning.<sup>105</sup> In the course of time, the seeking of guidance by tribunals from prior decisions entails that only convincing ideas and arguments persist in the process of legal discourse. To such an extent, an approach that is also informed by other judicial authorities is certainly welcome, but it cannot dissimulate the fact that the earlier decisions have already applied a deficient legal methodology. An approach that relies mainly on a practice of cross-referencing to previous awards, without questioning their methodological approach, contributes to the multiplication and hence the deepening of these original methodological deficits. Accordingly, the evolution of different lines of jurisprudence, as it is envisaged by this approach, is of importance for the identification of certain argumentative patterns that allow for a classification of individual awards.<sup>106</sup> However, any construction of fair and equitable treatment that solely relies on such methodologically deficient lines of jurisprudence remains ultimately unconvincing if it is not sustained by a more comprehensive doctrinal concept of this norm.

#### (b) The function of arbitrators

Beside the concrete methodological approach applied, the rise of investment treaty arbitration leads to the general question concerning the function and role of arbitrators in this dynamic process. As international investment law is originally based on a model of commercial arbitration, one could be inclined to view the function of arbitrators from this vantage point.<sup>107</sup> Briefly, commercial arbitration may be described as a pragmatic form of dispute settlement between private equals, conducted in a rather informal and case-specific manner and mainly governed by the ideas of supremacy of party autonomy and confidentiality.<sup>108</sup> Therefore, the traditional role of arbitrators is that of a neutral decision-maker achieving outcomes that are fair to both parties, without any mandate or necessity to defend the public interest or to participate in the systematic development of jurisprudence.<sup>109</sup> However, commercial arbitrators also have an obligation of

<sup>105</sup> See T. Weiler, 'NAFTA Investment Arbitration and the Growth of International Economic Law', *Can. Bus. L.J.* 36 (2002), p. 405 at p. 407, alluding to the trend of an emerging jurisprudence of international economic law.

<sup>106</sup> Thereon, see Chapter 5, section A, '1 Topoi in arbitral jurisprudence'.

<sup>107</sup> See A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration*, 4th edn (2004), p. 66, listing BITs as one of the legal systems governing commercial arbitration.

<sup>108</sup> For an overview, see *ibid.*, pp. 1–12. <sup>109</sup> See Van Harten (above fn. 62), pp. 59 et seq.



independence and impartiality in order to produce decisions that appear acceptable and legitimate to the parties.<sup>110</sup>

International investment law deviates markedly from the traditional model of commercial arbitration.<sup>111</sup> This is because international investment disputes mainly involve regulatory questions in the relationship between an individual and the state which are well known in domestic administrative law and which may have a major political impact reaching beyond the directly involved interests of the parties.<sup>112</sup> Consequently, adjudicatory functions related to the objectivity and legitimacy of decision-making, the public interest and overall legal certainty, as well as systemic considerations, play a greater role in international investment law. The difficulties lie, of course, in the question of how to ensure the fulfilment of these functions. Partly, a certain degree of legal certainty and systemic coherence is provided by the adherence to a widely acknowledged *de facto* doctrine of precedent in international investment law.<sup>113</sup>

However, the main part in achieving such perceived objectivity in legal adjudication is usually ascribed to the general rules of interpretation. As it appears impossible to 'find' a predetermined meaning of inherently vague notions like fair and equitable treatment, from which a just decision could be automatically deduced, it is dubious whether such objectivity may be achieved by means of the general rules of interpretation alone. Accordingly, the function of arbitrators cannot be one that creates the impression of a 'mechanical jurisprudence'.<sup>114</sup> Rather than providing a ready and fixed concept that is hidden somewhere behind the text, the parties to international investment agreements by stipulating fair and equitable treatment have only

<sup>110</sup> See S. D. Franck, 'The Role of International Arbitrators', *ILSA J. Int'l & Comp. L.* 12 (2006), p. 499 at pp. 507 et seq.; see also H.-L. Yu and L. Shore, 'Independence, Impartiality, and Immunity of Arbitrators', *ICLQ* 52 (2003), p. 935.

<sup>111</sup> On some particularities due to states as parties, see, e.g. K.-H. Böckstiegel, 'The Role of Arbitrators in Investment Treaty Arbitration', in A. J. van den Berg (ed.), *International Commercial Arbitration*, ICCA Congress Series, Vol. 11 (2003), p. 366, at pp. 373-374; more generally, see Wälde (above fn. 54), pp. 112-117.

<sup>112</sup> See especially Van Harten (above fn. 62), pp. 70-71; on his theory, see furthermore the discussion in Chapter 7, section C, '3(a) Structural bias in investment treaty arbitration'.

<sup>113</sup> See only McLachlan, Shore and Weininger (above fn. 63), pp. 71-76.

<sup>114</sup> On the latter, see R. Pound, 'Mechanical Jurisprudence', *Colum. L. Rev.* 8 (1908), p. 605.

'set the scene and open[ed] the game'.<sup>115</sup> Therefore, the text of investment agreements and the vague formulation of fair and equitable treatment only provide a starting point, but can hardly be said to entail already a unique correct answer to every legal question. Accordingly, it appears equally misguided to burden arbitrators with the task of Dworkin's metaphoric 'Judge Hercules' to search for this one correct answer.<sup>116</sup> As a result, it can hardly be denied that one important function of arbitrators in applying the norms of international investment law is to concretise and to develop further those norms and, thus, to construct a particular normative conception that is applied to specific facts.<sup>117</sup>

In acknowledging this constructive function of arbitrators, a shift in the perspective of addressing fair and equitable treatment appears necessary. Rather than focusing on how to find an intrinsic meaning, an analysis of fair and equitable treatment should trace the modes of constructing fair and equitable treatment and the pertaining justificatory reasoning upon which the particular construction is based.<sup>118</sup> To such an extent, the constructive function of arbitrators correlates with an obligation to provide arguments and reasons to justify a particular construction of fair and equitable treatment.<sup>119</sup> The importance of this 'reasons requirement', as a central factor to ensure the persuasiveness

<sup>115</sup> Wälde (above fn. 54), p. 46.

<sup>116</sup> See R. Dworkin, *Taking Rights Seriously* (1977), pp. 105 et seq.; for further discussion on the 'one right answer' thesis, see, e.g. D. N. MacCormick, *Legal Reasoning and Legal Theory* (1978), pp. 246 et seq.; and J. Habermas, *Faktizität und Geltung*, 1st edn (1992), pp. 258 et seq.

<sup>117</sup> See J. L. Brierly, 'The Judicial Settlement of International Disputes', in H. Lauterpacht and C. H. M. Waldock (eds.), *The Basis of Obligation in International Law* (1958), p. 93 at p. 98, observing that '[t]he act of the court is a creative act, in spite of our conspiracy to represent it as something less'; see also R. Alexy, *Recht, Vernunft, Diskurs* (1995), p. 91, holding that any interpretation changes the law and that interpretation therefore represents the creation of law in a broader sense; see comprehensively F. Müller and R. Christensen, *Juristische Methodik*, 9th edn (2004), Vol. 1.

<sup>118</sup> On this shift in the perspective and on different criteria for a rational judicial reasoning, see H.-J. Koch and H. Rüßmann, *Juristische Begründungslehre* (1982); D. Buchwald, *Der Begriff der rationalen juristischen Begründung* (1990); and R. Alexy, H.-J. Koch, L. Kuhlen and H. Rüßmann (eds.), *Elemente einer juristischen Begründungslehre* (2003); in the context of EU law, see M. Nettesheim, 'Art. 1 EGV', in E. Grabitz, M. Hilf and M. Nettesheim (eds.), *Das Recht der Europäischen Union*, 38th edn, (2009), Vol. I, mn. 60 et seq.

<sup>119</sup> See also H. Lauterpacht, *The Development of International Law by the International Court* (1958), pp. 39 et seq.; and O. Schachter, *International Law in Theory and Practice* (1991), p. 45.

and legitimacy of arbitral decisions, is receiving growing attention in international investment law.<sup>120</sup> Moreover, at least within the institutional framework of ICSID governing most of the investment disputes, the duty to provide a reasoned decision also constitutes a formal requirement, which – if disregarded – may lead to the annulment of an arbitral award.<sup>121</sup> Even if the annulment of an award occurs rarely, it is questionable whether the constructive function of arbitrators and the requirement to provide reasons has yet received enough attention in the general discussion on international investment law.<sup>122</sup>

### C Fair and equitable treatment in light of the general rules of interpretation

The foregoing analysis has already revealed that the construction of fair and equitable treatment cannot be based exclusively on the general rules of interpretation. However, within the process of justifying a particular construction by means of reasoning, the rules of interpretation are not useless because they indicate which types of arguments – mainly textual, systemic and purposive arguments – exist.<sup>123</sup> After briefly recapitulating the general rules of interpretation, the suitability of these rules of interpretation for the construction of fair and equitable treatment as a meaningful standard of international investment law shall be discussed.

#### 1 Recapitulating the general rules of interpretation

Any interpretation along the lines of the general rules of interpretation is commonly considered to aim at eliciting a certain intrinsic meaning from the text of an international agreement. Accordingly, *Oppenheim's International Law* holds that the purpose of an interpretation is 'to

<sup>120</sup> See especially G. Aguilar Alvarez and W. M. Reisman (eds.), *The Reasons Requirement in International Investment Arbitration* (2008); see also *Glamis Gold Ltd v. United States*, UNCITRAL (Award of 14 May 2009), at para. 8; and B. Kingsbury and S. W. Schill, 'Investor-State Arbitration as Governance', *IIIJ Working Paper* (2009), No. 6, pp. 44 et seq.

<sup>121</sup> See Article 52(1)(e) of the ICSID Convention; see also Article 32(3) of the UNCITRAL Arbitration Rules reflecting, however, the traditional supremacy of party autonomy in commercial arbitration because this rule requires the giving of reasons only if the parties do not agree otherwise.

<sup>122</sup> See, however, the recently rendered decision of *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16 (Decision on Annulment of 29 June 2010), discussing the failure to state reasons at para. 167.

<sup>123</sup> See D. Buchwald, 'Die canones der Auslegung und rationale juristische Begründung', *ARSP* (1993), p. 16 at pp. 23 et seq.

establish the meaning of the text which the parties must be taken to have intended it to bear in relation to the circumstances with reference to which the question of interpretation has arisen'.<sup>124</sup> To cope with such a considerable task, a variety of rules and techniques has been put forward. As regards international law, three main schools of interpretation may be distinguished:<sup>125</sup> an objective approach centres on the actual text of an agreement and pursues the identification of the ordinary meaning of the words used; a subjective approach looks to the original intention of the parties detached from the text of the agreement, as an independent basis of interpretation; and a further-reaching teleological approach emphasises the object and purpose of an agreement, in order to determine the meaning of a treaty provision. Notwithstanding the different direction of each school of thought, it is widely assumed that the different approaches are not mutually exclusive.<sup>126</sup>

In principle, all three approaches are also comprised by Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT).<sup>127</sup> Article 31(1) of the VCLT consequently declares that a treaty 'shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. The context of a treaty is rendered more precisely in Article 31(2) of the VCLT as encompassing, in particular, the preamble of the treaty and its annexes. According to Article 31(3) of the VCLT, there shall be taken into account together with the context: (a) any subsequent agreement regarding the interpretation of the treaty; (b) any subsequent practice in the application of the treaty; and (c) what must not be overlooked in the context of fair and equitable treatment; 'any relevant rules of international law applicable in the relations between the parties'. Article 32 of the VCLT then refers to the *travaux préparatoires*, as the main source of the subjective element, only as a supplementary means of interpretation if the interpretation according to Article 31 has not produced expedient results.

<sup>124</sup> R. Y. Jennings and A. Watts, *Oppenheim's International Law*, 9th edn (1992), Vol. I, p. 1267.

<sup>125</sup> See with further references M. N. Shaw, *International Law*, 6th edn (2008), p. 932; and M. Fitzmaurice, 'The Practical Working of the Law of Treaties', in M. D. Evans (ed.), *International Law* (2003), p. 173 at p. 186.

<sup>126</sup> See only I. M. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd edn (1984), p. 115.

<sup>127</sup> Article 31 and 32 of the VCLT are generally considered to reflect customary international law: see, e.g. *Sovereignty over Pulau Ligitan and Pulau Sipadan (Indonesia v. Malaysia)*, ICJ (Judgment of 17 December 2002), at para. 37; see also Jennings and Watts (above fn. 124), p. 1271, providing further references.

Thus, the general rules of interpretation as laid down in Articles 31 and 32 of the VCLT seem to provide a universal tool box in determining the meaning encapsulated in a conventional text. This box mainly provides three elements: the text; the context; and the object and purpose of a treaty reflecting a logical progression in the procedure of interpretation.<sup>128</sup> The mainly textual approach in establishing the meaning of the words in question is relatively undisputed.<sup>129</sup> However, it is also established that the ordinary meaning of a term is not to be determined in the abstract, but in the context of the treaty as a whole and in the light of its object and purpose.<sup>130</sup>

## 2 Applying the general rules of interpretation

The abridgement of the general rules of interpretation may suffice in order to obtain a picture of what appears as a *lege artis* interpretation of a conventional norm. Unquestionably, these rules of interpretation are also applicable to fair and equitable treatment<sup>131</sup> and, as such, are frequently cited by arbitral tribunals as a basis for their particular interpretation of the norm.<sup>132</sup> Due to the vagueness of fair and equitable treatment, it is, however, questionable whether an interpretive operation along the coarse lines of the general rules of interpretation is already sufficient for yielding a concept that is readily applicable in an investment dispute. Nevertheless, an attempt is made at exploring the literal meaning, adjacent context and object and purpose of fair and equitable treatment in accordance with Article 31 of the VCLT.

<sup>128</sup> Fitzmaurice (above fn. 125), p. 186.

<sup>129</sup> See *Case Concerning the Territorial Dispute (Libya v. Chad)*, ICJ (Judgment of 3 February 1994), at para. 41, stating that 'interpretation must be based above all upon the text of the treaty'; see also I. Brownlie, *Principles of Public International Law*, 7th edn (2008), p. 631; and W. Graf Vitzthum, 'Begriff, Geschichte und Rechtsquellen des Völkerrechts', in W. Graf Vitzthum (ed.), *Völkerrecht*, 4th edn (2007), p. 1, mn. 123.

<sup>130</sup> Jennings and Watts (above fn. 124), p. 1273.

<sup>131</sup> Confer Dolzer and Stevens (above fn. 5), p. 15; McLachlan, Shore and Weininger (above fn. 63), pp. 66–69 and 221; Wälde (above fn. 54), pp. 106–112; Dolzer and Schreuer (above fn. 54), pp. 31 et seq.; and Newcombe and Paradell (above fn. 3), pp. 109 et seq.

<sup>132</sup> See, e.g. *Sahuka Investments BV v. Czech Republic*, UNCITRAL (Partial Award of 17 March 2006), at para. 296; see also *Glamis Gold Ltd v. United States* (above fn. 120), at para. 20, observing that '[a] tribunal confronted with a question of treaty interpretation can, with little input of the parties, provide a legal answer. It has the two necessary elements to do so, namely the language at issue and the rules of interpretation'.

## (a) Literal meaning of fair and equitable treatment

The question concerning the meaning of the terms 'fair' and 'equitable' is often approached by arbitral tribunals by looking up terms in a law dictionary.<sup>133</sup> A glance at the relevant definitions then discloses that 'equitable' means '[j]ust; consistent with principles of justice and right' and that 'fair' means '[i]mpartial; just; equitable' and '[f]ree from bias or prejudice'.<sup>134</sup> The problem with such a practice is obvious, as it is hardly able to provide any guidance of how to apply fair and equitable treatment in a particular case.<sup>135</sup> Any such definition is, of course, unable to clarify the legal essence of a norm like fair and equitable treatment, since both notions are described by synonymous wording that is as vague as the terms 'fair' and 'equitable' themselves. It is therefore not surprising that the term 'fair and equitable treatment' has rightly been identified as being a pleonasm,<sup>136</sup> which unnecessarily repeats that a foreign investor should be treated in accordance with some sense of justice.

The latter also explains why treaty practice uses the words 'fair', 'equitable', 'just' and 'reasonable' interchangeably. Accordingly, it is generally assumed that only one single obligation of 'fair and equitable treatment' exists, in contrast to two possibly separate concepts – one concerning fairness and the other equity.<sup>137</sup> The synonymous character

<sup>133</sup> See, e.g. *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 113; and *National Grid Plc v. Argentina*, UNCITRAL (Award of 3 November 2008), at para. 168.

<sup>134</sup> See B. A. Garner (ed.), *Black's Law Dictionary*, 8th edn (2004).

<sup>135</sup> Critically also Newcombe and Paradell (above fn. 3), p. 111; and Z. Douglas, *The International Law of Investment Claims* (2009), p. 82.

<sup>136</sup> See already Schwarzenberger (above fn. 24), p. 158.

<sup>137</sup> See Vasciannie (above fn. 2), p. 111; UNCTAD (above fn. 2), pp. 14–15; and Klein Bronfman (above fn. 2), pp. 625; they all refer to A. A. Fatouros, *Government Guarantees for Foreign Investors* (1962), p. 167, fn. 204; and K. J. Vandeveld, *United States Investment Treaties* (1992), p. 76, alluding to the different formulations in the US FCN treaties as to be 'equivalent' expressions; see also Rubins and Kinsella (above fn. 46), p. 213; and Dolzer (above fn. 2), p. 91, who does not consider it impossible to argue in favour of an independent meaning of 'fair' and 'equitable', but negates the existence of state practice in this direction. A different opinion seems to be expressed by T. W. Wälde, 'Investment Arbitration under the Energy Charter Treaty', in N. Horn (ed.), *Arbitrating Foreign Investment Disputes* (2004), p. 193 at p. 207, fn. 18; and T. W. Wälde, 'Energy Charter Treaty-Based Investment Arbitration – Controversial Issues', *JWIT* 5 (2004), p. 373 at p. 385, fn. 35, who views 'fair' and 'equitable' as two slightly distinct concepts. According to Wälde, "fairness" refers to contemporary concepts of good governance', while "equitable" is not just a synonym of "fair" but rather is a reference to the abuse of the formality of law, related, for example, to the English law principle of estoppel, the international law and civil-law concepts of "good faith", "Treu und Glauben", "abus de droit" and "venire contra factum proprium". Nevertheless, Wälde also discusses the fair and equitable treatment clause as a single standard because it is established as such in the treaty practice.

of the mentioned notions has also been affirmed in arbitral jurisprudence in which a possible difference between these notions was considered 'insignificant' for the interpretation of the particular fair and equitable treatment clause.<sup>138</sup>

As fair and equitable treatment represents a general clause, i.e. an open-textured clause phrased in especially broad terms,<sup>139</sup> the search for an intrinsic literal meaning of its terms is naturally foredoomed. Consequently, attempts at describing the literal meaning of fair and equitable treatment often yield circular shorthand definitions, for instance: 'fair and equitable treatment should be understood to be treatment in an even-handed and just manner'.<sup>140</sup> Such a definition merely replaces the terms 'fair' and 'equitable' with equally vague synonyms and contributes nothing to the specification of the terms. Usually, more sophisticated defining attempts also do not escape this circularity and include one or several other vague terms, the meaning of which are questionable or contentious. These definitions focusing on the literal meaning of fair and equitable treatment are thus unable to predetermine precisely a particular arbitral decision applying this norm to a specific factual situation.

#### (b) Adjacent context

An interpretation along the lines of Article 31 of the VCLT furthermore needs to take into account the context of an obligation. Thereby, a look at investment agreements as a whole reveals some indications as to the potential scope of fair and equitable treatment. The vast majority of investment agreements do not contain indications of any exceptions or derogations, limiting the applicability of the fair and equitable

treatment standard.<sup>141</sup> In their practice, most states thus appear to have an 'all-or-nothing' attitude to the standard which may be derived from its nature, as a general statement of desirability for foreign capital.<sup>142</sup> It is also observed that any qualification of such a statement, by having it applied in some cases but not in others, would make the announcement of the state incredible and therefore unattractive to foreign investors.<sup>143</sup> The unconfined implementation of a general standard of treatment appears quite remarkable, since it stands in contrast to the approach taken with regard to other standards of treatment, namely most-favoured-nation and national treatment, which are typically subject to varying lists of exceptions.<sup>144</sup> However, this contextual analysis merely concretises some of the contours of fair and equitable treatment, but does not explain its core meaning.

Beyond this, the review of the conventional basis has already revealed that within the context of a stipulation of fair and equitable treatment, especially the textual reference to international law is subject to considerable controversy. This controversy concerns generally the role of international law and customary law concepts for the construction of fair and equitable treatment and thus relates to a wider context that is further specified in Article 31(3)(c) of the VCLT. However, since these far-reaching questions exceed the context of a particular investment agreement, they are discussed further in separate chapters below.

#### (c) Object and purpose

Together with the context, the object and purpose have to be taken into account. As already declared in the title, in the preamble or in one of the

<sup>138</sup> See *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8 (Award of 11 September 2007), at paras. 277-278. Other tribunals usually do not even discuss whether a possible difference between the meanings of 'fair' and 'equitable' might exist.

<sup>139</sup> On the category and role of 'general clauses' that are well known in national statutory codifications, see, e.g. R. Alexy and R. Dreier, 'Statutory Interpretation in the Federal Republic of Germany', in D. N. MacCormick (ed.), *Interpreting Statutes* (1991), p. 73 at pp. 74-77; and K. Zweigert and H. Kötz, *Introduction to Comparative Law*, 3rd edn (1998), pp. 152-153 and 174. Due to the existence of similarly structured norms in international conventions, it is suggested to apply the notion to these international norms as well. On the function of general clauses, see also Chapter 4, section B, '1 General clauses as gateways'. On the relation between 'general clauses' and 'standards', see Chapter 5, section B, '1 Fair and equitable treatment as a "standard"'.  
<sup>140</sup> *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 113.

<sup>141</sup> Only some US, Indian and Canadian BITs contain certain public policy exceptions, so-called non-precluded measures clauses (NPM clauses), which also limit the applicability of fair and equitable treatment. See W. W. Burke-White and A. von Staden, 'Investment Protection in Extraordinary Times', *Va. J. Int'l L.* 48 (2008), p. 307 at p. 331; and also Chapter 7, section C, '2(b) Intensity of review in times of economic crisis'.

<sup>142</sup> UNCTAD (above fn. 2), pp. 23-24. <sup>143</sup> *Ibid.*, p. 24.

<sup>144</sup> For various examples of such exemptions protecting, inter alia, certain sectors or enterprises in which the host state has a particular national interest, or to correspond to the membership of a contracting state in regional free trade areas, common markets or other economic unions, see Dolzer and Stevens (above fn. 5), pp. 71-76; UNCTAD, *Most-Favoured-Nation Treatment*, UNCTAD/ITE/IIT/10 (Vol. III) (1999), pp. 15-27; and UNCTAD, *National Treatment*, UNCTAD/ITE/IIT/11 (Vol. IV) (1999), pp. 43-54.

first articles of many BITs, investment agreements expressly aim at the 'promotion and protection of foreign investment'.<sup>145</sup> Thus, investment agreements commonly possess a twofold objective: first, there is the aspect of protecting foreign investment against risks resulting from the mere fact of being a foreigner, and from the structurally inferior position of private individuals in relation to a state's power to nationalise foreign assets or to change its laws to the disadvantage of the foreigner.<sup>146</sup> Second, investment agreements comprise the aspect of creating a friendly investment climate in order to encourage the flow of private capital which is recognised by host states not only as a source of capital, but also as a powerful tool that may further their countries' development.<sup>147</sup>

Especially with regard to multilateral investment agreements, often entailing a combination of trade and investment provisions, it is debatable whether a certain shift in the purpose of such agreements has occurred.<sup>148</sup> To this extent, it has been suggested that investment agreements today are increasingly intended to liberalise investment flows.<sup>149</sup> Since certain risks affecting foreign investments have decreased,<sup>150</sup> investment agreements, therefore, seem to represent general instruments of globalisation and liberalisation. However, the intention of promoting and protecting foreign investments has not lost momentum, as the competition in attracting FDI among developing, but also among

<sup>145</sup> A compilation of model agreements from the early 1990s is, e.g. provided by Dolzer and Stevens (above fn. 5), pp. 165–254; another study on more recently concluded BITs is provided by UNCTAD (above fn. 8), see especially pp. 26–28.

<sup>146</sup> See Salacuse (above fn. 54), p. 659.

<sup>147</sup> On the role of economic development as a purpose in the interpretation of investment agreements, see also O. E. García-Bolívar, 'The Teleology of International Investment Law', *JWIT* 6 (2005), p. 751. On the effectiveness of international investment agreements, see already Chapter 2, section B, '2 The effectiveness of international investment agreements'.

<sup>148</sup> See Vandeveld (above fn. 54), p. 183.

<sup>149</sup> See, e.g. Salacuse (above fn. 86), pp. 72–75; and Salacuse and Sullivan (above fn. 57), p. 76, observing that the goal of liberalisation has always been in the mind of developed countries, especially when including provisions in their BITs that facilitate market entry.

<sup>150</sup> For a summary of the largest nationalisations in the twentieth century mainly due to political changes that continued until the 1970s, see Comeaux and Kinsella (above fn. 56), pp. 62–65; and Lowenfeld (above fn. 3), pp. 405–407; according to UNCTAD, *Transnational Corporations and Integrated International Production*, World Investment Report (1993), p. 17, figure 1, the number of nationalisations in the 1970s lay at over eighty, while in the 1990s the number tended towards zero; also Vandeveld (above fn. 86), p. 522 states that 'expropriations have become a rarity in contemporary times'.

developed countries, still continues unabatedly.<sup>151</sup> Moreover, the continued relevance of the promotional and protectional purpose of investment agreements is impressively reinforced in the aftermath of a global economic crisis that massively affected international capital flows.<sup>152</sup>

Fair and equitable treatment provisions exactly address these promotional and protectional aspects of investment agreements. This is particularly because fair and equitable treatment is intended to provide a basic level of protection and to stimulate thereby the flow of foreign investments. Nevertheless, it is dubious what kind of conclusions may be drawn from such a twofold objective. On the one hand, the protectional aspect could be interpreted to demand a sweeping interpretation of fair and equitable treatment, protecting foreign investments as far as possible and according little flexibility to the governments of host states. The promotional aspect, on the other hand, could be understood in two ways: either to correlate with the protectional aspect (the more protection, the more promotion),<sup>153</sup> or to imply a narrower approach towards fair and equitable treatment, arguably leaving more regulatory flexibility and protecting only such investments that are conducive to the development of host states. However, as the analysis of the effectiveness of international investment agreements has provided little assistance in this regard, an analysis of the object and purpose of fair and equitable treatment contributes nominally to the finding of the actual meaning of the norm. At the most, the purpose of fair and equitable treatment indicates two possible ways of constructing the norm pointing in opposite directions.<sup>154</sup>

### 3 Underdetermination of the general rules of interpretation

In conclusion, it appears that the interpretive tools provided by Article 31 of the VCLT are of little value for the identification of the concrete meaning of fair and equitable treatment. Especially the literal meaning of fair and equitable treatment has proved to be so vague that it may

<sup>151</sup> This is shown by the dramatic ascent of the amount of FDI inflow in the 1990s, which after a considerable slump in the years 2001–2003 proceeded again considerably, exceeding in 2007 an overall peak of US\$1,800 billion: see UNCTAD (above fn. 61), p. 3, figure I.1.

<sup>152</sup> The global economic crisis was accompanied by a sharp decline in FDI flows: see UNCTAD, *World Investment Prospect Survey 2009–2011*, UNCTAD/DIAE/IA/2009/8 (2009).

<sup>153</sup> Thereon, see also Chapter 2, section B, '2 The effectiveness of international investment agreements'.

<sup>154</sup> See also Newcombe and Paradell (above fn. 3), pp. 113 et seq.

only be described by similarly vague terms the literal meaning of which is equally questionable. In addition, the adjacent context and the object and purpose are hardly more enlightening. These means of interpretation show, at best, some of the outer contours of the obligation or indicate contradictory approaches of how fair and equitable treatment could be construed. Remaining supplementary means of interpretation like the *travaux préparatoires* are also unable to solve this problem. The latter is because the negotiations relating to investment agreements rarely produce explanatory reports that could serve as supplementary means of interpretation; even if such material were available, it would not deliver a readily applicable formula, but would rather provide evidence that the negotiating parties did not know the meaning of fair and equitable treatment either.<sup>155</sup> Thus, any approach relying exclusively on the general rules of interpretation necessarily suffers from underdetermination,<sup>156</sup> since it is impossible to grasp a presumably existing meaning that is intrinsic to fair and equitable treatment with the coarse tools provided by Article 31 of the VCLT.

Consequently, the vagueness and indeterminacy of fair and equitable treatment represent one of its most characteristic features as a general clause which cannot be easily eliminated simply by applying the general rules of interpretation. Initially, the vagueness of the standard may have been appreciated by states and foreign investors as a virtue that promotes flexibility in the investment process.<sup>157</sup> It is, however, becoming perceptible that, due to the increasing number of investment disputes, the concerns about legal uncertainty in the application of fair and equitable treatment are growing.<sup>158</sup> Such concerns are present in statements describing fair and equitable treatment as the 'black hole' of investment agreements.<sup>159</sup> Although perhaps a little pessimistic, the

<sup>155</sup> See McLachlan, Shore and Weininger (above fn. 63), p. 224; see also *Aguas del Tunari SA v. Bolivia*, ICSID Case No. ARB/02/3 (Decision on Jurisdiction of 21 October 2005), observing in the context of a jurisdictional matter that '[t]his sparse negotiating history thus offers little additional insight into the meaning of the aspects of the BIT at issue, neither particularly confirming nor contradicting the tribunal's interpretation'.

<sup>156</sup> See Buchwald (above fn. 123), p. 20, describing the underdetermination of the rules of interpretation as universally accepted in methodologic literature.

<sup>157</sup> See H. Walker Jr, 'Modern Treaties of Friendship, Commerce and Navigation', *Minn. L. Rev.* 42 (1958), p. 805 at p. 812; Vasciannie (above fn. 2), p. 104; and Schreuer (above fn. 2), p. 365.

<sup>158</sup> See, e.g. Yannaca-Small (above fn. 2), pp. 2-3; and O. Chung, 'The Lopsided International Investment Law Regime and Its Effects on the Future of Investor-State Arbitration', *Va. J. Int'l L.* 47 (2007), p. 953 at p. 961.

<sup>159</sup> C. G. Garcia, 'All the Other Dirty Little Secrets', *Fla. J. Int'l L.* 16 (2004), p. 301 at p. 333.

image of a 'hole' illustratively expresses the valid scepticism about the determinative force of the traditional rules of interpretation and the belief that there is an intrinsic meaning of fair and equitable treatment.

Therefore, the following chapters aim at discussing the particular constructions of fair and equitable treatment and the pertaining justificatory reasons that have been advanced by arbitral tribunals in order to fill this hole. However, in order to explain the existing constructions of fair and equitable treatment, it is furthermore necessary to discuss wherefrom justificatory arguments and reasons may be derived and what kind of limitations on the admissibility of arguments might exist. The latter relates especially to the controversy concerning the limitation of the scope of fair and equitable treatment to the so-called international minimum standard and the more general argumentative relationship between fair and equitable treatment and the wider system of international law.

### 3 Fair and equitable treatment and the international minimum standard

#### A The emergence of a controversy

In the spotlight of a long-standing doctrinal debate stands the question of whether the concept of fair and equitable treatment is limited to the international minimum standard of customary international law, or whether it is to be constructed independently, as a self-contained standard highlighting the plain meaning of 'fair' and 'equitable'. Thereby, proponents of the one side try to limit the range of justificatory arguments on fair and equitable treatment mainly to historical arguments derived from the international minimum standard. Then again, others concentrate on textual arguments based on the wording of fair and equitable treatment. However, before examining the details of each of the different opinions, it appears quite expedient to explore the classical concept of this so-called minimum standard, since it forms the foundation upon which modern perceptions of fair and equitable treatment are grounded.

#### 1 The international minimum standard

The international minimum standard is a chatoyant notion. It is built on the assumption that there is a standing body of customary rules protecting a foreign individual in another country. The minimum standard is thus asserting a level of protection for the foreigner, below which the treatment provided for by the host state must not fall.<sup>160</sup> The law concerning the protection of individuals abroad received a great deal of attention in the late nineteenth and first half of the twentieth century. It was primarily at this time when the basic features of this field of law

<sup>160</sup> See, e.g. Shaw (above fn. 125), p. 824.

were being elaborated.<sup>161</sup> The concept of the minimum standard finds its traditional counterpart in the theory of national treatment, demanding that host states treat aliens favourably, but not more favourably than their own nationals.<sup>162</sup> According to the latter theory, the minimum standard endowing the foreigner with a status more favourable than that of nationals does not conform to the principles of territorial jurisdiction and equality.<sup>163</sup>

The theory of national treatment found its most prominent expression in the doctrine of Carlos Calvo,<sup>164</sup> an Argentinean jurist in the nineteenth century, whose ideas appealed not only in the thinking of the Mexican Revolution, but also lived on in the practice of several, mainly Latin-American, states.<sup>165</sup> The competing American view favouring a minimum standard was uttered by Cordell Hull, US Secretary of State,

<sup>161</sup> The origins of this field of law – in Roman times referred to as *ius gentium* – are intimately connected with the history of public international law in general. The first detailed elaboration of the law of aliens was presented by E. de Vattel, *The Law of Nations or the Principles of the Natural Law*, Translation of the Edition of 1758 by Ch. G. Fenwick (1916); see also I. Kant, *Zum ewigen Frieden* (1795), Third Definitive Article. Among the most influential writers in the first half of the twentieth century, see D. Anzilotti, 'La responsabilité internationale des États à raison des dommages soufferts par des étrangers', *RGDIP* 13 (1906), pp. 5–29 and 285–309; E. M. Borchard, *The Diplomatic Protection of Citizens Abroad or the Law of International Claims* (1922); E. M. Borchard, 'The "Minimum Standard" of the Treatment of Aliens', *Mich. L. Rev.* 38 (1940), p. 445; C. Eagleton, *The Responsibility of States in International Law* (1928); A. Verdross, 'Les règles internationales concernant le traitement des étrangers', *RdC* 37 (1931 III), p. 322; A. H. Roth, *The Minimum Standard of International Law Applied to Aliens* (1949); and K. Doehring, *Die allgemeinen Regeln des völkerrechtlichen Fremdenrechts und das deutsche Verfassungsrecht* (1963). For a more recent perspective, see the articles in K. Hailbronner (ed.), *Die allgemeinen Regeln des völkerrechtlichen Fremdenrechts* (2000).

<sup>162</sup> Brownlie (above fn. 129), pp. 523–524; this standard was mainly favoured by Latin American states such as Mexico, but also by Romania – see Roth (above fn. 161), pp. 62–65; and I. Seidl-Hohenveldern, *Investitionen in Entwicklungsländern und das Völkerrecht mit einer Bibliographie über Staatseingriffe in ausländisches Privateigentum* (1963), pp. 23–25. This theory of national treatment is to distinguish from a national treatment obligation as contained in international investment agreements: see Sornarajah (above fn. 3), p. 319; and Muchlinski (above fn. 51), p. 622. While a national treatment clause prescribes treatment no less favourable than that accorded to nationals, the theory of national treatment as a counterpart to the minimum standard argues vice versa, calling for treatment no more favourable than the one granted to the state's own nationals.

<sup>163</sup> Brownlie (above fn. 129), p. 523.

<sup>164</sup> See C. Calvo, *Le droit international théorique et pratique*, 4th edn (1887/1888).

<sup>165</sup> Lowenfeld (above fn. 3), pp. 393–395; to the extensive literature on the Calvo doctrine, see, e.g. Roth (above fn. 161), pp. 76–80; D. R. Shea, *The Calvo Clause* (1955); W. Burkhardt, *Die Bedeutung ausländischer Direktinvestitionen in einem lateinamerikanischen Entwicklungsland und ihre rechtliche Behandlung* (1971), pp. 116–123; R. Dolzer, *Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht* (1985), pp. 19–23; F. Oschmann, *Calvo-Doktrin und*

in an exchange of notes with the Mexican Government concerning the expropriation of American citizens during the Mexican Revolution. This postulation became famous as the so-called Hull formula claiming for 'prompt, adequate and effective' compensation in case of expropriation of aliens.<sup>166</sup> However, the formula relates only to the amount of due compensation, as one disputed element of the minimum standard. Although the Hull formula seems to have prevailed over time, as it is firmly established in the dense network of international investment agreements,<sup>167</sup> the concept of the minimum standard provided substance for many discussions in the second half of the twentieth century. In particular, the controversy between the two opposing concepts had a revival in the 1970s, when developing countries could achieve a controversial restatement of the Calvo doctrine in the 1974 Charter of Economic Rights and Duties of States.<sup>168</sup> Nevertheless, the universal acceptance of the customary concept of the minimum standard is still not certain, even today.<sup>169</sup>

Apart from the controversy of whether an international minimum standard actually exists, which shall be assumed in the following, a further question relates to the content of the minimum standard.<sup>170</sup>

*Calvo-Klauseln* (1993); and P. Juillard, 'Calvo Doctrine/Calvo Clause', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (2009).

<sup>166</sup> Excerpts from the notes exchanged are reprinted in Lowenfeld (above fn. 3), pp. 397-403; on the whole conflict between the US and Latin American states, see also Sornarajah (above fn. 3), pp. 142-148.

<sup>167</sup> See Dolzer (above fn. 9), p. 519, mn. 44; and M. Herdegen, *Internationales Wirtschaftsrecht*, 8th edn (2009), pp. 273-274.

<sup>168</sup> Article 2(2)(c) of the Charter of Economic Rights and Duties of States provides:

To nationalise, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the state adopting such measures, taking into account its relevant laws and regulations and all circumstances that the state considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalising state and by its tribunals, unless it is freely and mutually agreed by all states concerned that other peaceful means be sought on the basis of the sovereign equality of states and in accordance with the principle of free choice of means.

<sup>169</sup> See Sornarajah (above fn. 3), pp. 140-141 and 328; A. O. Adede, 'The Minimum Standards in a World of Disparities', in R. S. J. Macdonald and D. M. Johnston (eds.), *The Structure and Process of International Law* (1983), p. 1001; Dolzer (above fn. 165), pp. 23-54; G. Dahm, J. Delbrück and R. Wolfrum, *Völkerrecht*, 2nd edn (2002), Vol. I/2, p. 115; M. C. Porterfield, 'An International Common Law of Investor Rights?', *U. Pa. J. Int'l Econ. L.* 27 (2006), p. 79 at pp. 81-84; and S. F. Puvimanasinghe, *Foreign Investment, Human Rights and the Environment* (2007), pp. 87-93. Nevertheless, the existence of the minimum standard is frequently assumed by scholars: see, e.g. K. Hailbronner, 'Der Staat und der Einzelne als Völkerrechtssubjekte', in W. Graf Vitzthum (ed.), *Völkerrecht*, 4th edn (2007), p. 157 at pp. 246-247, mn. 275-278.

<sup>170</sup> See also Brownlie (above fn. 129), pp. 525-526.

Thereby, the identification of the particular state actions that are considered to violate the minimum standard is certainly the more interesting, but also more difficult, question to answer in the present context. In particular, it is questionable whether the minimum standard guarantees protection that goes beyond the rules of compensation for expropriation.<sup>171</sup> In relation to fair and equitable treatment, this enquiry is frequently combined with a reference to the old *Neer* case in which the United States sued Mexico for an alleged failure of the Mexican authorities to carry out an adequate investigation of the murder of Paul Neer:

This claim [was] presented by the United States against the United Mexican States on behalf of L. Fay H. Neer, widow, and Pauline E. Neer, daughter, of Paul Neer, who, at the time of his death, was employed as superintendent of a mine in the vicinity of Guanaceví, State of Durango, Mexico. On November 16, 1924, about eight o'clock in the evening, when he and his wife were proceeding on horseback from the village of Guanaceví to their home in the neighbourhood, they were stopped by a number of armed men who engaged Neer in a conversation, which Mrs. Neer did not understand, in the midst of which bullets seem to have been exchanged and Neer was killed. It is alleged that, on account of this killing, his wife and daughter, American citizens, sustained damages in the sum of \$100,000.00; that the Mexican authorities showed an unwarrantable lack of diligence or an unwarrantable lack of intelligent investigation in prosecuting the culprits; and that therefore the Mexican Government ought to pay to the claimants the said amount.<sup>172</sup>

In its essence, this claim suggests that an unwarrantable lack of diligence and intelligent investigation in criminal prosecution infringed the international law principle of denial of justice. Accordingly, it was presumed that the concept of denial of justice formed one of the elements of the minimum standard.<sup>173</sup> Although such awareness may be helpful for further considerations, it is not necessarily interlinked with a higher degree of precision as the tribunal in the *Neer* case also came to acknowledge; it cited coeval scholars stating that denial of justice itself 'seems to defy any definition'.<sup>174</sup> Nonetheless, the tribunal tried to formulate a standard as follows:

<sup>171</sup> See Sornarajah (above fn. 3), p. 148; Porterfield (above fn. 169), p. 88; and Shaw (above fn. 125), pp. 824-825.

<sup>172</sup> *L.F.H. Neer and Pauline E. Neer (USA v. Mexico)*, General Claims Commission - United States and Mexico Docket No. 136 (Award of 25 October 1926), at pp. 60-61.

<sup>173</sup> The *Neer* tribunal affirmed the existence of a minimum standard stating that 'governmental acts should be put to the test of international standards'; see *ibid.*, at p. 61.

<sup>174</sup> *Ibid.*



[T]he treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency.<sup>175</sup>

Since this formulation constituted a relatively high barrier in order to find a violation of international law,<sup>176</sup> the tribunal consequentially rejected the claim.

The concept of denial of justice was also addressed in the similar *Janes* case.<sup>177</sup> In this case, the tribunal actually approved an infringement of international standards because the Mexican authorities did not proceed against a murderer whose identity had been known for eight years. Another denial of justice was found by the tribunal in the *Roberts* case,<sup>178</sup> concerning an American citizen being imprisoned for an excessively long period of time under 'cruel and inhumane'<sup>179</sup> circumstances. Finally, a comparable claim was advanced in the *Chevreau* case,<sup>180</sup> which related to the detention and treatment of a French citizen by British forces in Persia during war confusion in 1918. However, all of these cases concern the physical injury of aliens in times of civil strife and the subsequent shortcomings in the administration of criminal

<sup>175</sup> *Ibid.*, at pp. 61–62.

<sup>176</sup> See P. G. Foy and R. J. C. Deane, 'Foreign Investment Protection under Investment Treaties', *ICSID Rev. – FILJ* 16 (2001), p. 299 at p. 313.

<sup>177</sup> *Laura M. B. Janes and others (USA v. Mexico)*, General Claims Commission – United States and Mexico (Award of 16 November 1926).

<sup>178</sup> *Harry Roberts (USA v. Mexico)*, General Claims Commission – United States and Mexico (Award of 2 November 1926).

<sup>179</sup> *Ibid.*, at p. 80.

<sup>180</sup> *Madame Chevreau (France v. United Kingdom)*, Permanent Court of Arbitration (Award of 9 June 1931), especially at p. 160; the tribunal recognised the following principles concerning the treatment of aliens:

- (1) The arbitrary arrest, detention or deportation of a foreigner may give rise to a claim in international law. But the claim is not justified if these measures were taken in good faith and upon reasonable suspicion, especially if a zone of military operations is involved.
- (2) In cases of arrest, suspicions must be verified by a serious inquiry, and the arrested person given an opportunity to defend himself against the suspicions directed against him, and particularly to communicate with the consul of his country if he requests it. If there is no inquiry, or if it is unnecessarily delayed, or, in general, if the detention is unnecessarily prolonged, there is ground for a claim.
- (3) The detained person must be treated in a manner fitting his station, and which conforms to the standard habitually practised among civilised nations. If this rule is not observed, there is ground for a claim.

justice. It is, therefore, difficult to determine whether these awards may serve as universal standards in the field of modern, highly intricate economic regulations.<sup>181</sup> The concept of the international minimum standard, in its classic sense, may have produced rules for the compensation for expropriation, the physical protection of aliens and the enforcement of the pertinent laws. Beyond that, however, it is highly questionable whether it entails any further guidelines relating to the protection of economic interests of foreign corporations or individuals.<sup>182</sup>

As the tenacious debate on the minimum standard has for some time been a convoluted exchange of ideological arguments, different ideas have been advanced in order to untangle the Gordian knot. Worth mentioning in this respect is the Second Report on International Responsibility of Special Rapporteur García Amador to the International Law Commission (ILC) in 1957. He, for the first time, linked the question as to the content of the minimum standard with the concept of fundamental human rights.<sup>183</sup> According to Article 5 of his draft codification, representing a combination of the two conflicting approaches, a foreigner would be provided with the same civil rights as enjoyed by a national, which, however, should not fall below fundamental human rights in any case.<sup>184</sup> Although the draft was not able to meet with the approval of the ILC,<sup>185</sup> the coalescence of human rights and the protection of aliens have made considerable progress. In the general field of law concerning the protection of aliens abroad, it has indeed been convincingly submitted that the concept of human rights

<sup>181</sup> See also Sornarajah (above fn. 3), p. 151.

<sup>182</sup> See the results in Roth (above fn. 161), pp. 155–177, especially rules 5, 6 and 7; see also the list in A. Verdross and B. Simma, *Universelles Völkerrecht*, 3rd edn (1984), pp. 802–803; similarly Dahm, Delbrück and Wolfrum (above fn. 169), pp. 119–120; confer furthermore L. B. Sohn and R. R. Baxter, 'Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens', *AJIL* 55 (1961), p. 545.

<sup>183</sup> See F. V. García Amador, 'State Responsibility', Document A/CN.4/106, *ILC Yearbook* (1957 II), p. 104 at pp. 112–116.

<sup>184</sup> *Ibid.*, pp. 112–113; this approach was later named a 'noble synthesis': see M. S. McDougal, H. D. Lasswell and L.-C. Chen, *Human Rights and World Public Order* (1980), p. 762. For further development of this approach, see also R. B. Lillich, *The Human Rights of Aliens in Contemporary International Law* (1984).

<sup>185</sup> See Verdross and Simma (above fn. 182), pp. 803–805; and R. B. Lillich, 'The Current Status of the Law of State Responsibility for Injuries to Aliens', in R. B. Lillich (ed.), *International Law of State Responsibility for Injuries to Aliens* (1983), p. 1 at pp. 17–19. In the meantime, the ILC has completed its work on the Articles on Responsibility of States for Internationally Wrongful Acts in 2001; see thereon comprehensively J. Crawford, *The International Law Commission's Articles on State Responsibility* (2005).

in international law today represents a sophisticated legal framework superposing the debate as regards the minimum standard.<sup>186</sup>

However, the faithful application of this idea on investment matters appears to be less suitable.<sup>187</sup> This is mainly due to the deliberation that international human rights documents – the various regional particularities such as Article 1 of the First Additional Protocol to the 1950 European Convention on Human Rights shall be exempted<sup>188</sup> – scarcely contain fundamental freedoms that protect property or related economic rights.<sup>189</sup> While the 1948 UN Universal Declaration of Human Rights in its Article 17 indeed ensures the right to own property that shall not be deprived arbitrarily, this formulation is hardly capable of settling the old dispute.<sup>190</sup> Later attempts at codifying human rights do not address the more specific question of economic rights given to aliens either,<sup>191</sup> and thus only comprise an abated contribution to the present problem. Moreover, it seems that the concepts of property protection in human rights law and international investment law, due

<sup>186</sup> Dahm, Delbrück and Wolfrum (above fn. 169), pp. 114–119, stating that this reflects the entirely prevailing opinion in legal doctrine; see also Doehring (above fn. 161), pp. 68–85; R. Preiswerk, *La protection des investissements privés dans les traités bilatéraux* (1963), pp. 29–30; McDougal, Lasswell and Chen (above fn. 184), p. 773; Verdross and Simma (above fn. 182), pp. 804–805; K. Ipsen, *Völkerrecht*, 5th edn (2004), p. 812; Shaw (above fn. 125), p. 826; and A. Falsafi, 'The International Minimum Standard of Treatment of Foreign Investors' Property', *Suffolk Transnat'l L. Rev.* 30 (2007), p. 317 at pp. 321–322.

<sup>187</sup> See Brownlie (above fn. 129), pp. 527–528; and Sornarajah (above fn. 3), pp. 152–156; it has also been enunciated that '[t]he question of property rights of aliens has become rather separated from that of the minimum standard as a whole': see D. F. Vagts, 'Minimum Standard', in R. Bernhardt (ed.), *Encyclopedia of Public International Law*, Consolidated Library Edition (1997), Vol. III/V, p. 382 at p. 384.

<sup>188</sup> On the regional human rights regimes, see, e.g. Hailbronner (above fn. 169), pp. 234–245; and Shaw (above fn. 125), pp. 345–396.

<sup>189</sup> See R. B. Lillich, 'Duties of States Regarding the Civil Rights of Aliens', *RdC* 161 (1978 III), p. 329 at pp. 406–408; Dolzer (above fn. 165), pp. 75–128; Jennings and Watts (above fn. 124), pp. 911–927 and 933; C. Ohler, 'Der Schutz des privaten Eigentums als Grundlage der internationalen Wirtschaftsordnung', *JZ* (2006), p. 875 at pp. 878–879; and C. Pfaff, 'Investment Protection by Other Mechanism', in R. Hofmann and C. Tams (eds.), *The International Convention on the Settlement of Investment Disputes (ICSID)* (2007), p. 267 at pp. 290 and 308–309; this seems even more true if corporate property is concerned, as would normally be the case when protecting foreign investments: see K. Hailbronner, 'Foreign Investment Protection in Developing Countries in Public International Law', in T. Oppermann and E.-U. Petersmann (eds.), *Reforming the International Economic Order* (1987), p. 99 at p. 105. On the protection of multinational enterprises by human rights generally, see Muchlinski (above fn. 51), pp. 509–514.

<sup>190</sup> Beside this deficiency there is a contention as to the legal quality of the declaration: see Dolzer (above fn. 165), p. 79.

<sup>191</sup> *Ibid.*, p. 94; and Ohler (above fn. 189), p. 879.

to the distinct functions of the two legal frameworks, still exhibit considerable differences.<sup>192</sup> This makes it difficult to assume that the human rights concept of property actually supersedes the traditional concept of the minimum standard as a whole.<sup>193</sup>

While it is not possible to go into the details of the complex discussion surrounding the protection of aliens abroad and the more modern concept of human rights, it may be summarised that the recognition of the minimum standard has encountered major political resistance throughout its history. Although this resistance might have declined after the 1970s and after the focal point of scholarly attention turned more towards the protection of fundamental human rights, the matter of economy-related obligations of states has always been a controversial issue. To such an extent, the regulation of investments was mainly left to the host state and was only scarcely governed by customary international law rules.<sup>194</sup> The relatively accepted Hull formula, concerning the compensation of expropriated property, might be an exception in this respect. However, aside from that, only the standard as expressed in the *Neer* case has persisted in the modern context of fair and equitable treatment – albeit establishing a very high threshold in order to find an international delinquency. In the end, it is thus especially the indeterminacy of the classical minimum standard that may be detected by recapitulating the discussion on this unsettled concept.<sup>195</sup>

## 2 The equating approach

International investment agreements emanated from the awareness that the classical standards of treatment of aliens, and among these especially the international minimum standard, were highly controversial during

<sup>192</sup> See C. Schreuer and U. Kriebaum, 'The Concept of Property in Human Rights Law and Investment Law', in S. Breitenmoser et al. (eds.), *Human Rights, Democracy and the Rule of Law* (2007), p. 743.

<sup>193</sup> However, this is not to say that well-accepted schemes that apply in human rights law may not enrich the debate relating to fair and equitable treatment. Such initiatives are also deemed feasible and desirable: see, e.g. *ibid.*, p. 762. On the relevance of human rights in international investment law generally, see also H. Mann, *International Investment Agreements, Business and Human Rights* (2008); and furthermore Chapter 7, section A, '4 Sustainable development'.

<sup>194</sup> See Salacuse (above fn. 54), p. 660.

<sup>195</sup> See also Doehring (above fn. 161), pp. 83–85, who does not view the indeterminacy as a compelling argument against the minimum standard as long as the content is at least determinable.

the course of the twentieth century.<sup>196</sup> Accordingly, the standards incorporated in investment agreements aimed at countervailing these uncertainties. The establishment of treaty standards for the protection of foreign capital may thus be considered as the continuation of the attempt of capital-exporting countries to try to assert a basic level of investor rights by other means. To such an extent, establishing a connection between treaty standards of investment protection, such as fair and equitable treatment, and the customary minimum standard of treatment is certainly not surprising. Both instruments – the minimum standard as well as conventional investment protection standards – share the common function of guaranteeing a basic level of legal protection for foreign investors.

However, serious voices from scholars, as well as practice, aim at equating fair and equitable treatment with the international minimum standard.<sup>197</sup> This so-called equating approach is based on the consideration that the formulation of fair and equitable treatment in international investment agreements is vague and indeterminate. To avoid the difficulties in dealing with such a vague norm, the supporters of this approach feel a need to 'fill' the empty notion of fair and equitable treatment with meaning by tying it to an allegedly established and well-known body of substantial legal rules rooted in customary international law.<sup>198</sup> The writings and decisions related to the minimum standard are deemed to constitute such a body of law.

To this end, one of the earliest attempts to establish such a link was made by the commentary to Article 1 of the 1967 OECD Draft Convention on the Protection of Foreign Property, stating that fair and equitable treatment 'conforms in effect to the "minimum standard", which forms part of international law'.<sup>199</sup> A somewhat different position was taken by Schwarzenberger some years earlier, who, commenting on the 1959 Abs-Shwacross Draft Convention, views the minimum standard as being embodied in the investment treaty obligation to

<sup>196</sup> On the international investment process, see also Chapter 2, section B, '1 International investment process'.

<sup>197</sup> See, e.g. Sacerdoti (above fn. 54), p. 341, considering fair and equitable treatment as a conventional definition of the customary minimum standard.

<sup>198</sup> Although not supporting this view, see Vasciannie (above fn. 2), pp. 104–105.

<sup>199</sup> Some years before, Fatouros (above fn. 137), p. 215, noted that contingent standards provide for a level of treatment determined beforehand which 'does not fall below a "minimum standard"'. However, this formulation does not make abundantly clear whether Fatouros wants to equate such standards with *the* minimum standard or whether they just secure a basic level of rights of foreign investors.

ensure the most constant protection and security.<sup>200</sup> Apart from that, fair and equitable treatment was said to be related to the realm of *ius aequum* (equity).<sup>201</sup> Then again, Schwarzenberger's opinion was rejected by a statement from the Swiss Foreign Office in 1979, which considered fair and equitable treatment to be referring to the classic principle of the minimum standard.<sup>202</sup> In conformity with the latter, many scholars subsequently followed this equating approach without giving additional reasoning, or at least seemed to take the equation of the two concepts for granted.<sup>203</sup>

In earlier arbitral practice, the issue was only sparsely discussed. Arbitrator Asante, in his dissenting opinion in the case of *Asian*

<sup>200</sup> Similarly, *Elettronica Sicula SpA ELSI (USA v. Italy)*, ICJ (Judgment of 20 July 1989), at para. 111; on the relation of fair and equitable treatment and full protection and security, see Chapter 9, section A, '4 Full protection and security'.

<sup>201</sup> G. Schwarzenberger, 'The Abs-Shawcross Draft Convention on Investments Abroad', *Current Legal Problems* 14 (1961), p. 213 at pp. 220–221; and Schwarzenberger (above fn. 24), pp. 114–115; similarly Preiswerk (above fn. 186), pp. 23–24; and R. Preiswerk, 'New Developments in Bilateral Investment Protection', *Revue Belge de Droit International* 3 (1967), p. 173 at pp. 185–186, distinguishing fair and equitable treatment from the concept of equity and linking it to the principle of good faith, considering it furthermore to be a 'functional minimum standard . . . quite different however [from] the traditionally known legal minimum standard of the so-called civilized nations'. See also H. Frick, *Bilateraler Investitionsschutz in Entwicklungsländern* (1975), pp. 91–92; and J.-P. Lavie, *Protection et promotion des investissements*, Publications de l'Institut Universitaire de Hautes Etudes Internationales, Genève (1985), pp. 94–95.

<sup>202</sup> See L. Cafilisch, 'La pratique Suisse en matière de droit international public 1979', *Schweizerisches Jahrbuch für internationales Recht* 36 (1980), p. 138 at pp. 178–179. However, this position appears, to some extent, contradictory because it also recognises the rules of the principle of *bonne foi*, and furthermore expresses certain sympathies to the observations of Alenfeld (above fn. 44), who at pp. 68–71 is in doubt as to the universal application of the minimum standard and therefore extracts from fair and equitable treatment no more than a mere obligation of non-harassment. Further writing on the Swiss practice related to fair and equitable treatment is provided by N. Huu-Tru, 'Le réseau Suisse d'accords bilatéraux d'encouragement et de protection des investissements', *RGDIP* 92 (1988), p. 577 at pp. 604–606, who, however, is not expressly equating it to the minimum standard.

<sup>203</sup> With a special focus on French and Swiss BITs which frequently incorporate references to international law, see M.-C. Krafft, 'Les accords bilatéraux sur la protection des investissements conclus par la Suisse', in D. C. Dicke (ed.), *Foreign Investment in the Present and a New International Economic Order* (1987), p. 72 at p. 79; M. P. Notter, *Völkerrechtlicher Investitionsschutz* (1989), p. 123; D. Carreau, T. Flory and P. Juillard, *Droit international économique*, 3rd edn (1990), p. 632; Comeaux and Kinsella (above fn. 56), p. 106; and C. Leben, 'L'évolution du Droit International des Investissements', *Journée d'études* (1999), p. 7 at p. 13; for authors from other backgrounds, see, e.g. P. T. B. Kohona, 'Investment Protection Agreements: An Australian Perspective', *JWT* 21 (1987), p. 79 at p. 91; and M. Krajewski, *Wirtschaftsvölkerrecht* (2006), p. 626. Further references are provided by Vasciannie (above fn. 2), p. 139, fn. 226; and Yannaca-Small (above fn. 2), p. 19.

*Agricultural Products Ltd (AAPL) v. Sri Lanka*, expressed his consent to the commentary to the OECD Draft Convention and stated that fair and equitable treatment demanded the exercise of due diligence as derived from customary international law.<sup>204</sup> The tribunal in the case of *Alex Genin and others v. Estonia* understood fair and equitable treatment 'to require an "international minimum standard" that is separate from domestic law, but that is, indeed, a *minimum* standard'.<sup>205</sup> Although not clearly equating fair and equitable treatment with the international minimum standard, both cases show a tendency to establish a linkage between the minimum standard and fair and equitable treatment, especially as the treaty text expressly refers to 'international law'.<sup>206</sup> In this context, it has been submitted that such a reference incorporates principles of international law – the customary norms of the minimum standard – into the investment treaty in order to make these principles judicially enforceable by means of the investor–state dispute settlement mechanisms contained in such agreements.<sup>207</sup>

In contrast to the previous statements, the equating approach has also encountered criticism for a number of reasons. In particular, the minimum standard pledges to be an accepted and consistent body of law, but this is more than the standard is able to offer in reality. Rather it seems that the minimum standard is as indeterminate as fair and equitable treatment and thus unable to fill fair and equitable treatment with meaning. Moreover, since the minimum standard itself has been a subject of controversy, at least for a considerable period, it has been questioned whether a majority of states would have accepted the

<sup>204</sup> *Asian Agricultural Products Ltd (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3 (Award of 21 June 1990), at pp. 634 and 639; on this point, Asante is agreeing with the tribunal's majority opinion, but provides for further reasons.

<sup>205</sup> *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia* (above fn. 96), at para. 367. Within the same paragraph, the *Genin* tribunal also referred to the case of *American Manufacturing & Trading Inc. (AMT) v. Zaire*, ICSID Case No. ARB/93/1 (Award of 21 February 1997), at para. 6.06, stating that 'protection and security of investment... is thus an objective obligation which must not be inferior to the minimum standard of vigilance and of care required by international law'. However, the latter statement did not refer to the standard of fair and equitable treatment, but rather to the related formulation of 'protection and security'.

<sup>206</sup> Both cases concern disputes under earlier US BITs (Article II(4) of the 1984 US–Zaire BIT and Article II(3)(a) of the 1994 US–Estonia BIT) which contain references to international law.

<sup>207</sup> See K. J. Vandeveld, 'The Bilateral Investment Treaty Program of the United States', *Cornell Int'l L.J.* 21 (1988), p. 201 at pp. 221–222; Vandeveld (above fn. 137), pp. 77–78; and see also Sacerdoti (above fn. 54), pp. 347–348.

equation of the two terms without clear discussion.<sup>208</sup> Thus, if states really believed that the two concepts are interchangeable, they would have indicated this expressly in their agreements.<sup>209</sup> However, this did not happen, at least not in cases where a reference to international law is missing. Moreover, if states had in fact acted on the assumption that there was a customary minimum standard, they could have only incorporated a reference to (customary) international law as the relevant standard in investment treaty relations. Instead, states obviously considered it necessary to stipulate fair and equitable treatment as an investment treaty obligation in its own right.<sup>210</sup> It has thus been argued that the stipulation of fair and equitable treatment alongside a reference to international law rather indicates international law to be complementary to fair and equitable treatment.<sup>211</sup> Irrespective of such criticism, the equating approach has nevertheless received strong support in the context of NAFTA's investment chapter, finally giving this approach a new direction. However, before turning to this special development, the traditionally conflicting, plain meaning approach shall be discussed first.

### 3 The plain meaning approach

The so-called plain meaning approach rejects the idea that fair and equitable treatment is considered to be congruent with the international minimum standard. It is rather based on the assumption that fair and equitable treatment forms a self-contained standard, which is to be interpreted independently on a case-by-case basis carrying out an assessment whether the state action is both 'fair' and 'equitable'.<sup>212</sup> Mann, who clearly emphasises the fundamental distinction between the customary minimum standard and the conventional obligation to ensure fair and equitable treatment, made an early and formative contribution to this approach by stating:

It is submitted that nothing is gained by introducing the conception of a minimum standard and, more than this, it is positively misleading to introduce it. The terms "fair and equitable treatment" envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and

<sup>208</sup> See Vasciannie (above fn. 2), p. 144; and UNCTAD (above fn. 2), p. 13.

<sup>209</sup> See UNCTAD (above fn. 2), p. 13; and Muchlinski (above fn. 51), pp. 637–638.

<sup>210</sup> See Dolzer and Stevens (above fn. 5), p. 59.

<sup>211</sup> *Ibid.*; similarly, G. Zagel, *Auslandsinvestitionen in Lateinamerika* (1999), p. 164.

<sup>212</sup> See Vasciannie (above fn. 2), p. 103; UNCTAD (above fn. 2), p. 10; and I. A. Laird, 'Betrayal, Shock and Outrage – Recent Developments in NAFTA Article 1105', *Asper Rev. Int'l Bus. & Trade L.* 3 (2003), p. 185 at p. 193.

according to a much more objective standard than any previously employed form of words. A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable. No standard defined by other words is likely to be material. The terms are to be understood and applied independently and autonomously.<sup>213</sup>

This approach meets with the approval of several other scholars and practitioners, at least in relation to investment agreements which do not contain a reference to international law.<sup>214</sup> Thereby, the attempt to construe fair and equitable treatment as an independent norm is mainly based on mistrust of the vague and controversial minimum standard. The adoption of an independent standard of fair and equitable treatment promised to leave the difficult debate on the minimum standard in customary international law behind. Consequently, the plain meaning approach constitutes an attempt to supersede the traditional controversy on the international minimum standard.

However, the difficulties of the plain approach are easily apparent, since it has already been mentioned that the terms 'fair' and 'equitable' are almost devoid of any concrete meaning.<sup>215</sup> Moreover, the Vienna Convention and its general rules of interpretation are often invoked

<sup>213</sup> Mann (above fn. 47), p. 244; repeated in F. A. Mann, *Further Studies in International Law* (1990), p. 238; similar, but more restrictive is F. A. Mann, *The Legal Aspect of Money*, 5th edn (1992), pp. 427 and 526. British BITs do not usually contain references to international law. For a detailed discussion of Mann's statement, especially in the context of Article 1105 of NAFTA, see J. C. Thomas, 'Reflection on Art. 1105 of NAFTA', ICSID Rev. - FILJ 17 (2002), p. 21 at pp. 51-58, submitting that the statement was deeply influenced by Belgium's loss in the *Barcelona Traction* case (*Barcelona Traction, Light and Power Co. Ltd (Belgium v. Spain)*, ICJ (Judgment of 5 February 1970)) and that the statement was later somewhat blindly introduced as an argument into the NAFTA debate.

<sup>214</sup> See K. S. Gudgeon, 'United States Bilateral Investment Treaties', Int'l Tax & Bus. Law. 4 (1986), p. 105 at p. 125, considering fair and equitable treatment to be distinct from a reference to international law. Dolzer and Stevens (above fn. 5), p. 59, in objecting to the equating approach, formulate an *e contrario* argument out of the fact that parties to BITs expressly stipulate fair and equitable treatment instead of relying on customary international law. Sacerdoti (above fn. 54), p. 341, although observing that the international minimum standard is often 'defined as fair and equitable treatment', goes on to say that '[f]air and equitable treatment is spelled out in several multilateral instruments without any reference to an international standard, possibly as a way of avoiding the divergence surrounding the latter and in order to give to it a direct content'. See also Vasciannie (above fn. 2), pp. 104-105 and 144; UNCTAD (above fn. 2), p. 40; and Schreuer (above fn. 2), p. 364, holding that there are no clear indications for the equation of fair and equitable treatment and the minimum standard.

<sup>215</sup> See Chapter 2, section C, '2(a) Literal meaning of fair and equitable treatment'.

as being consistent with the plain meaning approach.<sup>216</sup> This argument poses the question of whether the equating approach disregards those rules by not paying enough deference to the text of investment agreements. However, despite the fact that there are also investment agreements that expressly refer to the international minimum standard,<sup>217</sup> such an argument also disregards the underdetermination of the general rules of interpretation. To such an extent, the underdeterminate rules of the Vienna Convention are neither supportive nor disapproving of the two approaches because the general rules of interpretation merely provide little guidance of how to construct fair and equitable treatment. Arguably, some supporters of the plain meaning approach have therefore also recognised that deciding a case solely on the literal meaning represents a difficult task for arbitrators and endows them with considerable discretion.<sup>218</sup>

In order not to leave arbitrators empty-handed, it has been partly acknowledged that concentration on the plain meaning is insufficient. To this extent, an UNCTAD study suggested that the construction of fair and equitable treatment should be informed by general international law and even by national legal systems.<sup>219</sup> Whereas this suggestion might appear as a way of conciliating the controversy between the plain meaning approach and the equating approach, the whole debate has gained considerable momentum in relation to Article 1105 of NAFTA, after some arbitral tribunals discussed the issue in further detail. In this context, it may also be observed that the support for one or the other side depends heavily on the text of the particular investment agreement and whether it includes a reference to international law.

## B Discussion concerning Article 1105 of the NAFTA

Article 1105(1) of NAFTA,<sup>220</sup> stipulating fair and equitable treatment under a headline referring to the international minimum standard, has been a bone of contention in many investor-state disputes. The

<sup>216</sup> Vasciannie (above fn. 2), p. 103.

<sup>217</sup> See Chapter 2, section A, '3(c) Fair and equitable treatment combined with a reference to general international law' and '3(d) Fair and equitable treatment combined with a reference to customary international law'.

<sup>218</sup> See Vasciannie (above fn. 2), pp. 103-104; and UNCTAD (above fn. 2), pp. 10-11.

<sup>219</sup> See UNCTAD (above fn. 2), p. 12.

<sup>220</sup> The text of Article 1105(1) of NAFTA is reproduced above (Chapter 2, section A, '3(c) Fair and equitable treatment combined with a reference to general international law').

rapid rise of investment treaty arbitration under NAFTA seems to have awoken fair and equitable treatment from its semi-hibernation, making it a prominent feature in investment disputes.<sup>221</sup> Interestingly, the NAFTA debate reveals that the pendulum, after a considerable period of liberalisation since the late 1980s, has swung back again, since within this context developed countries themselves have, for the first time, been the target of investment claims.<sup>222</sup>

### 1 Jurisprudence up to the FTC note of interpretation

The starting point for the intense discussion on Article 1105 of NAFTA relates to a few early decisions of arbitral tribunals that were confronted with the controversy on fair and equitable treatment and the minimum standard. While the question of the connection of fair and equitable treatment to the minimum standard was not directly addressed in the first NAFTA award on the merits,<sup>223</sup> the immediately subsequent awards already had to take a closer look at the issue partly developing their idiosyncratic understanding of fair and equitable treatment.

#### (a) The *Metalclad* and *S.D. Myers* approach

In particular, the arbitral award in *Metalclad Corporation v. Mexico*<sup>224</sup> and the first partial award in *S.D. Myers Inc. v. Canada*<sup>225</sup> gave rise to speculations about a third view independent of the dichotomy between the equating and plain meaning approaches. In this respect, the awards show an imaginative attempt to link fair and equitable treatment and its reference to international law, not only to the customary international law minimum standard, but also to other sources of international law, including general principles of law and even conventional obligations.<sup>226</sup>

<sup>221</sup> Article 1105 of NAFTA has also been described as being the 'alpha and omega of investor-state arbitration under Chapter 11 of NAFTA': see C. H. Brower II, 'Fair and Equitable Treatment under NAFTA's Investment Chapter', Remarks, ASIL Proc. 96 (2002), p. 9 at p. 9.

<sup>222</sup> This change in the attitude of developed countries towards investment arbitration is described by G. Aguilar Alvarez and W. W. Park, 'The New Face of Investment Arbitration: NAFTA Chapter 11', Yale J. Int'l L. 28 (2003), p. 365.

<sup>223</sup> *Robert Azinian and others v. Mexico*, ICSID Case No. ARB(AF)/97/2 (Award of 1 November 1999).

<sup>224</sup> *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1 (Award of 30 August 2000); this award was set aside by a judicial review proceeding at the Supreme Court of British Columbia: see *Mexico v. Metalclad Corp.*, Supreme Court of British Columbia 2001 BCSC 664 (Judgment of 2 May 2001).

<sup>225</sup> *S.D. Myers Inc. v. Canada* (above fn. 95).

<sup>226</sup> Yannaca-Small (above fn. 2), p. 20; and Klein Bronfman (above fn. 2), p. 632.

In the *Metalclad* case,<sup>227</sup> the Mexican company COTERIN operated a transfer station for hazardous waste in La Pedrera in the state of San Luis Potosí.<sup>228</sup> However, after authorising the operation in 1990, federal authorities closed the transfer station in 1991 because of the deposition of 20,000 tons of waste without prior treatment or separation. Subsequently, COTERIN unsuccessfully applied to the municipality for a permit to construct a hazardous waste landfill in La Pedrera. Two years later, COTERIN was nevertheless granted two federal environmental impact authorisations and one land use permit from the state government. In the meantime, the American Metalclad Corporation entered into an option agreement to purchase COTERIN and began consultations with the authorities at the federal and state levels, where Metalclad was told that all necessary permits had been granted and that there existed official support for the project. Acting on this assumption, Metalclad exercised its option and purchased COTERIN, in order to build the landfill. However, in the construction phase, due to the absence of a municipal construction permit, problems with the municipal authorities became apparent. In addition, the opening of the landfill was impeded by protests of the local population and authorities. Therefore, Metalclad negotiated a further agreement (the '*Convenio*') with federal authorities, which included a legal and environmental assessment of the project. The *Convenio* permitted Metalclad to operate the landfill for five years and obliged Metalclad to remediate the contaminations that occurred prior to its purchase of COTERIN. Nevertheless, the municipality ultimately denied the application for the local construction permit because of a previous denial of the

<sup>227</sup> The *Metalclad* case provoked considerable debate, especially regarding environmental regulation, and is, e.g. discussed in: L. J. Dhooge, 'The North American Free Trade Agreement and the Environment', Minn. J. Global Trade 10 (2001), p. 209; W. S. Dodge, 'Metalclad Corporation v. Mexico', AJIL 95 (2001), p. 910; L. E. Godshall, 'In the Cold Shadow of Metalclad: The Potential for Change to NAFTA's Chapter Eleven', N.Y.U. Envtl L.J. 11 (2002), p. 264; J. Harbine, 'NAFTA Chapter 11 Arbitration: Deciding the Price of Free Trade', Ecology L.Q. 29 (2002), p. 371; H. Olasolo, 'Have Public Interests been Forgotten in NAFTA Chapter 11 Foreign Investor/Host State Arbitration?', L. & Bus. Rev. Am. 8 (2002), p. 189; C. N. Seymour, 'The NAFTA Metalclad Appeal', U. Miami Inter-Am. L. Rev. 34 (2002), p. 189; C. Tollefson, 'Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process', Minn. J. Global Trade 11 (2002), p. 183; V. L. Frakes, 'In the Driver's Seat - NAFTA's Chapter 11 as a Judicial Vehicle for the Expansion of Investor Rights', Bus. L. Brief (Am. U.) 1 (2005), p. 49; and T. Weiler, 'Good Faith and Regulatory Transparency: The Story of Metalclad v. Mexico', in T. Weiler (ed.), *International Investment Law and Arbitration* (2005), p. 701.

<sup>228</sup> On the facts of the case, see *Metalclad Corp. v. Mexico* (above fn. 224), at paras. 28-71.

application in 1991 and due to the commencement of construction without permission. Hence, Metalclad buried the project in 1997 and commenced arbitral proceedings under NAFTA.

In defining the scope and content of the fair and equitable treatment obligation in Article 1105(1) of NAFTA, the tribunal did not elaborate on the debate concerning fair and equitable treatment and the minimum standard. On the contrary, the tribunal preferred to try to define the standard by another method and referred to the preamble and to Article 102(1), stipulating the objectives of NAFTA.<sup>229</sup> In doing so, the principle of transparency, stipulated in Article 102(1) and in Chapter 18 of NAFTA, was particularly appreciated by the tribunal as an important objective of NAFTA. Hence, the subsequent construction of fair and equitable treatment drew heavily on the language of the pertinent provisions in Chapter 18 of NAFTA, and since, in the tribunal's view, the conduct of the Mexican authorities could not conform to these transparency requirements, a violation of Article 1105(1) of NAFTA was found.<sup>230</sup>

The *Metalclad* tribunal thus incorporated the obligation to ensure transparency, as laid down elsewhere in the agreement, into the concept of fair and equitable treatment. On this basis, the tribunal constructed fair and equitable treatment in a way that was distinct from the equating and plain meaning approaches and relied on transparency as a conventional law concept that is also known in international trade law.<sup>231</sup> However, a transparency obligation is not indicated in the text of Article 1105 or any of the other provisions of the NAFTA investment chapter, nor is transparency rooted in customary international law. Although the precedence-setting authority of the *Metalclad* award is limited due to a successful judicial review proceeding,<sup>232</sup> a similar approach has been applied in the first partial award in the *S.D. Myers* case.

In the case of *S.D. Myers Inc. v. Canada*,<sup>233</sup> the American investor was conducting business concerning the remediation of a highly toxic

<sup>229</sup> *Ibid.*, at paras. 75–76. <sup>230</sup> *Ibid.*, at paras. 99–101.

<sup>231</sup> Beside the stipulation in Chapter 18 of NAFTA, the concept of transparency is especially known in the context of Article X of the GATT; see also Foy and Deane (above fn. 176), pp. 319–320; on transparency, see also Chapter 7, section B, '2 Transparency'.

<sup>232</sup> *Mexico v. Metalclad Corp.* (above fn. 224).

<sup>233</sup> *S.D. Myers Inc. v. Canada* (above fn. 95); this and the subsequent awards in the case are, e.g. discussed in Foy and Deane (above fn. 176), pp. 321–323; V. Been, 'NAFTA's Investment Protections and the Division of Authority for Land Use and Environmental Control', *Pace Envtl. L. Rev.* 20 (2002), p. 19 at pp. 33–36; Thomas (above fn. 213), pp. 64–71; Laird (above fn. 212), pp. 197–201; C. H. Brower II, '*S.D. Myers, Inc. v. Canada*',

synthetic chemical compound, called polychlorinated biphenyl (PCB), which is nationally and internationally subject to strict environmental regimes.<sup>234</sup> S.D. Myers was one of the most prominent operators in the US market and through a Canadian affiliate extended its activities to the Canadian market in the 1990s, where only one credible competitor was operating. S.D. Myers wanted to incinerate the PCB from Canada in its US facilities. However, due to the fact that US legislation interdicted the importation of PCB, a lobbying campaign was initiated which motivated US authorities to issue an enforcement discretion to S.D. Myers allowing the importation from 1995 to 1997. Since the remediation in the United States turned out to be cheaper than in Canada, several Canadian officials welcomed the opening of the border as an environmentally sound solution. However, this led to a lobbying campaign of the fledgling Canadian disposal industry, persuading the competent Canadian minister to ban the export of PCB from 1995 to 1997 based on alleged dangers to health and the environment. S.D. Myers subsequently presumed that this export ban resulted from the protectionist intent of the Canadian Government and started arbitral proceedings under NAFTA, claiming inter alia a violation of the fair and equitable treatment standard.

In its assessment, the tribunal affirmed the protectionist motive of the Canadian Government and found a violation of the national treatment standard, stipulated in Article 1102 of NAFTA, because the export ban created a competitive disadvantage for S.D. Myers to the benefit of national operators.<sup>235</sup> In turning to Article 1105(1) of NAFTA, the tribunal stated that the obligation 'is similar to clauses contained in BITs' and that the standard 'is a floor below which treatment of foreign investors must not fall'.<sup>236</sup> Moreover, the tribunal went on to cite the *Hopkins* case of the US–Mexican Claims Commission,<sup>237</sup> which is one of the cases relevant for the discussion about the classical minimum standard,<sup>238</sup> and even referred to the pertinent argument of Mann as being an 'over-generalisation'.<sup>239</sup> While this sounds, prima facie, very much like the

AJIL 98 (2004), p. 339; and A. Afilalo, 'Towards a Common Law of International Investment', *Geo. Int'l Envtl. L. Rev.* 17 (2004), p. 51 at pp. 62–65.

<sup>234</sup> On the facts of the case, see *S.D. Myers Inc. v. Canada* (above fn. 95), at paras. 88–195.

<sup>235</sup> *Ibid.*, at paras. 252–256. <sup>236</sup> *Ibid.*, at para. 259.

<sup>237</sup> *George W. Hopkins (USA v. Mexico)*, General Claims Commission – United States and Mexico Docket No. 39 (Award of 31 March 1926).

<sup>238</sup> *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 260. <sup>239</sup> *Ibid.*, at para. 266.

equating approach,<sup>240</sup> the majority of the tribunal went on to determine that based on 'the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well'.<sup>241</sup> However, like the transparency requirement in the *Metalclad* case, the national treatment standard contained in Article 1102 of NAFTA is only a conventional rule. It is, therefore, categorically different from the customary international law rules that are deemed to make up the classical minimum standard.<sup>242</sup>

In conclusion, these two awards seem to represent a third alternative to the two traditionally conflicting views as regards fair and equitable treatment and the minimum standard.<sup>243</sup> At any rate, by introducing arguments based on other conventional concepts into the reasoning on fair and equitable treatment, they reveal a clear tendency to construct the standard with elements obviously transcending the principles of the minimum standard, mainly dating back to the early twentieth century. However, the awards give rise to a number of questions that deserve further consideration. In particular, it is questionable to what extent fair and equitable treatment embraces arguments that are based on other conventional norms. Since the principles of transparency and national treatment are also present in the WTO framework, are violations of WTO law, or at least of its core principles, contrary to the fair and equitable treatment obligation in any case?<sup>244</sup> Do infringements of

<sup>240</sup> Justice Tysoe in the *Metalclad* appeal appears to have understood the *S.D. Myers* tribunal in this direction when stating that the tribunal 'correctly pointed out . . . that in order to qualify as a breach of Article 1105, the treatment in question must fail to accord to international law. . . . In using the words "international law", Article 1105 is referring to customary international law which is developed by common practices of the countries'. See *Mexico v. Metalclad Corp.* (above fn. 224), at para. 62. For further discussion on the *Metalclad* appeal, see Chapter 4, section C, '1(b) The matter of limited jurisdiction'.

<sup>241</sup> *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 266; however, one arbitrator dissented on this specific point, stating at para. 267 that 'a finding of a violation of Article 1105 must be based on a demonstrated failure to meet the fair and equitable requirements of international law. Breach of another provision of the NAFTA is not a foundation for such a conclusion'; see also Foy and Deane (above fn. 176), pp. 321-322; and Thomas (above fn. 213), pp. 65-68.

<sup>242</sup> The national treatment standard is also known from the WTO framework: see Thomas (above fn. 213), pp. 69-70.

<sup>243</sup> This appears to be at least the view of Yannaca-Small (above fn. 2), p. 20; see also Klein Bronfman (above fn. 2), p. 632.

<sup>244</sup> See also Weiler (above fn. 105), pp. 419-421; although referring to other cases this question is also posed by C. O. Verrill Jr, 'Are WTO Violations also Contrary to the Fair and Equitable Treatment Obligations in Investor Protection Agreements?', *ILSA J. Int'l & Comp. L.* 11 (2005), p. 287; see furthermore C. C. Kirkman, 'Fair and Equitable

obligations, laid down in express and detailed terms elsewhere in an investment agreement, automatically implicate a breach of fair and equitable treatment? In the context of NAFTA, as will be discussed below, an attempt has been made to answer these questions in a particular and restrictive way.

#### (b) The *Pope & Talbot* final merits award

Only a few months after the first partial award in *S.D. Myers*, the final merits award in *Pope & Talbot Inc. v. Canada* was rendered,<sup>245</sup> marking a further step in the discussion relating to fair and equitable treatment and the minimum standard.<sup>246</sup> The *Pope & Talbot* case arose from the Canadian implementation of the 1996 US-Canada Softwood Lumber Agreement, which obliged Canada to take regulatory measures to control softwood lumber exports from Canada to the United States. Therefore, Canada issued regulations for some of its provinces, requiring the application for export permits, the payment of administrative fees when such permits were granted and introducing a discretionary mechanism in order to exempt certain exporters from the full fees, based on the allocation of export quota. The quota allocation compiled a three-step fee system, being allocated to primary producers, remanufacturers and new entrants, according to special criteria. The allotments were subject to an annual review. However, it became apparent that this system interfered with the business of the Canadian subsidiary of the American Pope & Talbot company. Pope & Talbot therefore claimed that the regulations violated, inter alia, NAFTA's national treatment and fair and equitable treatment provisions.

Since the fee system did not distinguish between national and foreign exporters, the tribunal could not find a breach of the national treatment

Treatment: *Methanex v. United States and the Narrowing Scope of NAFTA Article 1105*, *Law & Pol'y Int'l Bus.* 34 (2002), p. 343 at pp. 366-367; and Robbins (above fn. 53), pp. 435-437.

<sup>245</sup> *Pope & Talbot Inc. v. Canada*, UNCITRAL (Final Merits Award of 10 April 2001). The case has received considerable attention and is, e.g. discussed in: Foy and Deane (above fn. 176), pp. 323-325; M. J. Belman, 'Fair and Equitable Treatment under NAFTA's Investment Chapter', *Remarks, ASIL Proc.* 96 (2002), p. 12; J. C. Thomas, 'Fair and Equitable Treatment under NAFTA's Investment Chapter', *Remarks, ASIL Proc.* 96 (2002), p. 14; Thomas (above fn. 213), pp. 71-81; P. Dumberry, 'The Quest to Define "Fair and Equitable Treatment" for Investors under International Law', *JWIT* 3 (2002), p. 151; D. A. Gantz, 'Pope & Talbot, Inc. v. Government of Canada - Case Report', *AJIL* 97 (2003), p. 937; Frakes (above fn. 227); and Klein Bronfman (above fn. 2), pp. 651-655.

<sup>246</sup> On the factual background, see *Pope & Talbot Inc. v. Canada* (above fn. 245), at paras. 18-29.



obligation.<sup>247</sup> Similarly, the other NAFTA Chapter 11 claims had already been dismissed in a prior award.<sup>248</sup> To such an extent, as regards fair and equitable treatment, the tribunal could not proceed in its reasoning as the *Metalclad* and *S.D. Myers* tribunals did because of the mere fact that there were no other violations of NAFTA provisions. Although the claimant adopted the arguments of the majority opinion in *S.D. Myers*,<sup>249</sup> the tribunal hence rejected this view<sup>250</sup> and developed an idiosyncratic concept of fair and equitable treatment that seems to be even more far-reaching. The tribunal highlighted that 'the language of Article 1105 grew out of the provisions of bilateral commercial treaties' and for this reason carefully revised the conflicting points of view of the existing debate surrounding fair and equitable treatment and the minimum standard.<sup>251</sup> Thereby, the tribunal initially noticed that the language of Article 1105 of NAFTA suggested fair and equitable treatment to be 'included in the requirements of international law'.<sup>252</sup> Due to the analogy with the language of BITs, it found nevertheless that the fairness elements were 'additive' to the requirements of international law and that the investor was thus 'entitled to the international law minimum, plus the fairness elements'.<sup>253</sup> In this regard, the tribunal expressly subscribed to the view of the supporters of the plain meaning approach and, in this respect, also emphasised the general rules of interpretation.<sup>254</sup>

Based on the foregoing and the presumed intentions of the NAFTA parties, the tribunal found it doubtful that the parties, on the one hand, would endow investors from other NAFTA countries only with a minimum standard, while, on the other hand, providing investors from third states with a higher level of protection as expressed in BITs.<sup>255</sup> Due to the presumably stronger relationship of NAFTA parties to each other than with third states, the tribunal found it compelling to construe

<sup>247</sup> *Ibid.*, at para. 104.

<sup>248</sup> These claims concerned alleged breaches of Articles 1106 and 1110 of NAFTA: see *Pope & Talbot Inc v. Canada*, UNCITRAL (Interim Award of 26 June 2000). The allegations of breaches of NAFTA Chapter 11 provisions were described as 'ambitious if not startling': see Thomas (above fn. 213), p. 74.

<sup>249</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245), at para. 107. <sup>250</sup> *Ibid.*, in fnn. 99 and 108.

<sup>251</sup> *Ibid.*, at para. 110, especially in fn. 105. <sup>252</sup> *Ibid.*, at para. 109.

<sup>253</sup> *Ibid.*, at para. 110. Article 1105 of NAFTA endows 'treatment in accordance with international law, including fair and equitable treatment and full protection and security', while the 1987 US Model BIT to which the tribunal referred stipulates: 'Investment shall at all times be accorded fair and equitable treatment . . . and shall in no case be accorded treatment less than that required by international law'. See also Foy and Deane (above fn. 176), pp. 323-324.

<sup>254</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245), at paras. 113 and 115. <sup>255</sup> *Ibid.*, at para. 115.

Article 1105 of NAFTA in analogy to BIT provisions tending, in the tribunal's eyes, clearly to the additive approach. Additionally, this result was buttressed by the argument that any other construction, in the sense that Article 1105 of NAFTA would assert a lower level of protection than the BIT provisions, would violate NAFTA's national treatment and most-favoured-nation treatment obligations.<sup>256</sup> Having developed this understanding of fair and equitable treatment, the tribunal finally decided that the Canadian regulatory measures were ultimately not unfair or inequitable. Nevertheless, an audit of Pope & Talbot's records, shortly after Pope & Talbot filed its notice of arbitration (called the 'verification review episode'), was ultimately found to have denied such fair and equitable treatment.<sup>257</sup>

The astonishing outcome of the case - that only a peripheral audit caused liability - surely distressed the NAFTA parties, who hence reacted sharply to the award in considering it poorly reasoned and unpersuasive.<sup>258</sup> This criticism regarding the argumentation of the tribunal does not appear to be wholly unjustified. For instance, the tribunal's points were strongly based on the assumption that the pertinent clauses in BITs provide, in any case, for fairness elements beyond the minimum standard. However, this view represents only one possible construction of fair and equitable treatment based on the contentious plain meaning approach. Moreover, even if the tribunal apparently believed the plain meaning approach to be the better stance, the approach only proposes that fair and equitable treatment should be interpreted independent of the minimum standard, in accordance with the literal meaning and on a case-by-case basis. Therefore, this approach does not automatically entail a level of protection higher than the minimum standard; the latter connotation is solely expressed in the prominent statement of Mann.<sup>259</sup> Additionally, the plain meaning approach as well as the general rules of interpretation, to which the tribunal also referred,<sup>260</sup> especially accentuate the wording of the

<sup>256</sup> *Ibid.*, at para. 117.

<sup>257</sup> *Ibid.*, at paras. 156-181; the judicial review period was thus not comprised by Pope & Talbot's original complaints.

<sup>258</sup> See Thomas (above fn. 213), p. 80; and Gantz (above fn. 245), p. 944.

<sup>259</sup> In fact, one argument of the proponents of the plain meaning approach challenges the equation of fair and equitable treatment and the minimum standard on the ground that the minimum standard itself was not accepted by a number of states for a long time. Hence, this argument, although not expressly mentioned, rather tends to the contrary.

<sup>260</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245), at para. 115.

particular agreement. The tribunal, however, refused to follow the express language of Article 1105 of NAFTA and, in lieu thereof, switched to the language of BITs.<sup>261</sup> To this extent, since the tribunal's basic assumption already shows certain frictions, any further arguments built thereupon lose some of their persuasive authority.

These argumentative shortcomings and the further intensification of the trend to construe Article 1105 of NAFTA in an extensive manner evoked fears that fair and equitable treatment was becoming an instrument threatening all kinds of the NAFTA parties' economy-related regulative measures – even if they were, as such, fully compliant with NAFTA, as was the case with Canada's softwood lumber regulations.<sup>262</sup> Hence, NAFTA member states made an attempt to encroach politically upon future NAFTA arbitration proceedings, so as to prevent them from becoming irrepressible.

## 2 FTC note of interpretation on Article 1105(1) of the NAFTA

A major tool of NAFTA member states to influence investor-state arbitration is the possibility to issue notes of interpretation through the NAFTA Free Trade Commission (FTC). According to Article 1131(2) of NAFTA, these notes shall be binding on arbitral tribunals. Since the NAFTA parties could not prevail with their understanding of fair and equitable treatment in the mentioned awards, an FTC Note of Interpretation of Certain Chapter 11 Provisions was delivered on 31 July 2001, providing in relation to Article 1105 of NAFTA the following instructions to tribunals of future or pending cases:

<sup>261</sup> *Ibid.*, at para. 110; critically, see Thomas (above fn. 213), pp. 77–78; and Gantz (above fn. 245), p. 943. Furthermore, Justice Tysoe in *Mexico v. Metalclad Corp.* (above fn. 224), at para. 65, disagreed with the tribunal in this respect and found that it had violated Article 31(1) of the VCLT because the tribunal '[had] interpreted the word "including" in Article 1105 to mean "plus", which has virtually the opposite meaning'.

<sup>262</sup> Such fears are precisely expressed by the remarks of Thomas (above fn. 245), p. 14, stating that the 'United States developed its bilateral investment treaty [programme] not because the United States thought it required international obligations to police itself, but because it wanted protections for US nationals' investments in states with less well-developed legal systems'. He also observes that: 'there is the concern that if the standard for proving a breach of the international minimum standard is relaxed, the foreign claimant obtains privileged substantive rights, in comparison to the nationals of the state, that were not intended' (p. 17). Obviously, developed states never expected to become respondents themselves in investor-state disputes, considering their own legal systems as a benchmark for the definition of an obligation like fair and equitable treatment. Ironically, Thomas' concerns bear a striking similarity to the pronouncements of the old Calvo doctrine.

1. Article 1105 (1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another party.
2. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105 (1).<sup>263</sup>

In their substance, these clarifications evidently represent reactions of the NAFTA member states to the aforementioned *Metalclad*, *S.D. Myers* and *Pope & Talbot* awards and mainly subscribe to the view of the Supreme Court of British Columbia in the *Metalclad* judicial review.<sup>264</sup> Hence, at least in the context of the NAFTA, this note of interpretation was intended to supersede the long-standing debate surrounding whether fair and equitable treatment should be equated with the international minimum standard or constructed according to its plain meaning detached from the minimum standard. In this respect, NAFTA parties have decided to adopt an understanding of fair and equitable treatment which is as narrow as possible, by only taking into account customary international law sources pertaining to the classical minimum standard of treatment of aliens.

The minimum standard, to which the NAFTA member states are referring in their note of interpretation, is considered to protect only against such conduct reaching the 'egregious' or representing 'gross misconduct, manifest injustice or an outrage, bad faith or the wilful neglect of duty', as formulated in the *Neer* case.<sup>265</sup> However, as already mentioned above, the *Neer* formula constitutes a very high threshold in order to find a breach of fair and equitable treatment.<sup>266</sup> Moreover, the *Neer* case and similar cases of that time concern situations like the

<sup>263</sup> The FTC note has led to further clarifications and adaptations also in other treaties, such as in Article 10.4.2 of the 2003 US–Chile Free Trade Agreement.

<sup>264</sup> See Thomas (above fn. 213), p. 91; and C.H. Brower II, 'Why FTC Notes of Interpretation Constitute a Partial Amendment of NAFTA Article 1105', *Va. J. Int'l L.* 46 (2006), p. 347 at p. 354.

<sup>265</sup> NAFTA member states repeatedly submitted formulations similar to the one used in the *Neer* case as their perception of fair and equitable treatment: see, e.g. *Pope & Talbot Inc. v. Canada* (above fn. 245), at para. 108; see also *Dumberry* (above fn. 245), pp. 682–686.

<sup>266</sup> See Chapter 3, section A, '1 The international minimum standard'.

inhumane detainment of individuals. Within these situations, it might appear relatively easy to determine whether or not a specific action is manifestly unjust. The categories of 'gross misconduct' or 'manifest injustice', however, lose much of their profile when trying to apply them to the field of highly intricate economic regulation<sup>267</sup> – incidentally, a field where the complexity has increased enormously since the 1920s. This certainly raises the question as to the utility of such coarse formulas in modern-day circumstances. Consequently, the note of interpretation has turned out to be anything but settled and has been met with criticism by subsequent scholars and tribunals.

### 3 Debate after the FTC note of interpretation

The discussion concerning the FTC note of interpretation may be divided into two distinct threads: first, it has been questioned whether the FTC note is a legitimate interpretation of Article 1105 of the NAFTA as such or whether it constitutes an unlawful amendment of the agreement, which would not be binding on tribunals. Second, if the note is basically accepted, it has been argued that the body of customary international law, comprised by the minimum standard, is of an evolutionary character and hence has developed since the 1920s.

#### (a) Legitimacy of the FTC note of interpretation

The FTC note raised the question of whether it was a valid and legitimate exercise of the Commission's power according to Article 2001(2) of the NAFTA or whether it rather constituted an amendment of the agreement, being then subject to a special procedure according to Article 2202 of the NAFTA, empowering the NAFTA member states only and not the FTC.<sup>268</sup> Interestingly, the *Pope & Talbot* tribunal, as

<sup>267</sup> See already R. Y. Jennings, 'General Course on Principles of International Law', RdC 121 (1967 II), p. 321 at p. 487, stating that the kind of measure developed in the *Neer* case 'is unhelpful if an attempt is made to apply it for instance to sophisticated economic or financial arrangements or undertakings'; similarly, see Sornarajah (above fn. 3), pp. 329–330.

<sup>268</sup> The issue was discussed in the remarks at the 96th Annual Meeting of the ASIL by Brower II (above fn. 221); Belman (above fn. 245); Thomas (above fn. 245); J. J. Coe, 'Fair and Equitable Treatment under NAFTA's Investment Chapter', Remarks, ASIL Proc. 96 (2002), p. 17; and V. P. Nanda, 'Fair and Equitable Treatment under NAFTA's Investment Chapter', Remarks, ASIL Proc. 96 (2002), p. 19; see also Weiler (above fn. 105), pp. 428–430. Criticism regarding the legitimacy of the note has also been raised in respect of its process and timing: see with further references Brower II (above fn. 264), p. 354. Furthermore, there was some debate about the retroactivity of the note and its effects on pending arbitral proceedings: see Dumberry (above fn. 245), pp. 670–671; and Belman (above fn. 245), p. 13.

one of the main causers of the interpretational note, still had to render its award on damages.<sup>269</sup> It was therefore given the opportunity to comment directly on this issue.

In reviewing the effects of the interpretational note, the *Pope & Talbot* tribunal thereby found that it had 'a duty to consider and decide' whether or not it was bound by the note.<sup>270</sup> In order to ascertain the original intentions of the member states, the tribunal reviewed the *travaux préparatoires*, but had to conclude that the negotiation history did not provide any indication of 'international law' to mean only customary international law.<sup>271</sup> Rather, the term international law, as stipulated in Article 38(1) of the ICJ Statute, entails other sources than mere customary law. Accordingly, the tribunal classified the FTC note not as a binding interpretation, but rather considered it as an invalid amendment.<sup>272</sup> However, the tribunal only made this statement by way of an *obiter dictum*. Proceeding on the assumption that the FTC note represented a valid exercise of power, the tribunal found that, even if applying the standard as expressed in the note, Canada would have breached Article 1105 of the NAFTA.<sup>273</sup>

Other tribunals assessing the validity of the FTC note were much more reluctant in challenging the note and generally accepted the understanding of Article 1105 of the NAFTA as being reflective of the minimum standard.<sup>274</sup> Among these tribunals, some did not impugn the FTC note, simply because they seemed to agree with it,<sup>275</sup> while others did not question the note because the claimants had not considered it necessary to challenge the note's legitimacy or because they retracted their arguments.<sup>276</sup> In a further category of cases, a review of the FTC note's validity has been refused because arbitrators denied

<sup>269</sup> *Pope & Talbot Inc. v. Canada*, UNCITRAL (Award on Damages of 31 May 2002).

<sup>270</sup> *Ibid.*, at para. 23. <sup>271</sup> *Ibid.*, at para. 46. <sup>272</sup> *Ibid.*, at para. 47.

<sup>273</sup> *Ibid.*, at paras. 47 and 65; the tribunal is only able to arrive at the conclusion that Canada would have violated Article 1105 of NAFTA anyway by first making an intermediate step in which it discovered the evolutionary character of the customary minimum standard, at paras. 58–59.

<sup>274</sup> See Brower II (above fn. 264), pp. 355–356.

<sup>275</sup> See *Mondev International Ltd v. United States* (above fn. 100), at para. 121; *United Parcel Service of America Inc. v. Canada*, UNCITRAL (Award on Jurisdiction of 22 November 2002), at para. 97; *Methanex Corp. v. United States*, UNCITRAL (Final Award of 3 August 2005), part IV, chapter C, at paras. 17 and 20; and *International Thunderbird Gaming Corp. v. Mexico*, UNCITRAL (Award of 26 January 2006), at paras. 192–193.

<sup>276</sup> See *Loewen Group Inc. and Raymond L. Loewen v. United States*, ICSID Case No. ARB(AF)/98/3 (Award of 26 June 2003), at para. 127; and *GAMI Investments Inc. v. Mexico*, UNCITRAL (Final Award of 15 November 2004), at para. 92, fn. 14.

their competence to question the binding and overriding character of FTC interpretations.<sup>277</sup> Thus, the NAFTA jurisprudence provides for a somewhat inconsistent picture of its dealing with the FTC note. However, what all of these NAFTA decisions have in common is that they do not aim to object explicitly to the FTC note, independently of their actual assent as regards the content of the note. Even the *Pope & Talbot* tribunal hesitated in repealing the note and rather based its reasoning upon other grounds. This might be also true for most other tribunals which preferred to apply the following juristic artifice than to challenge openly the FTC note of interpretation.<sup>278</sup>

(b) Evolutionary character of the customary minimum standard

Since the FTC note of interpretation tied fair and equitable treatment to the minimum standard, NAFTA tribunals had to search for viable solutions in individual cases upon this basis. In this respect, tribunals apparently considered the *Neer* formula, favoured by the NAFTA member states, as being somewhat out-dated and too coarsely meshed. In applying a juristic artifice, several tribunals therefore highlighted the evolutionary character of the body of law pertaining to the classical minimum standard. The idea of the evolutionary character was already introduced in the first arbitral proceedings confronted with the FTC note. In this respect, the *Pope & Talbot* award on damages rejected a static conception of the minimum standard, which was pleaded for by Canada. Rather, the tribunal found that 'the principles of customary international law were not frozen in amber at the time of the *Neer* decision'.<sup>279</sup> It further substantiated this by stating, 'it is a facet of international law that customary international law evolves through state practice'.<sup>280</sup> The tribunal thereby referred to the enormous number of BITs reflecting the contemporary practice of states.

Subsequently, several tribunals using very similar formulations adopted this idea. The term 'customary international law' has thus been held

<sup>277</sup> This was, e.g. the case in *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1 (Award of 9 January 2003), at para. 177.

<sup>278</sup> It is not the intent of the present work to provide evidence on whether the note of interpretation, in fact, represented an amendment, since it seems to be much more interesting to analyse what tribunals really made of it. Further references concerning the discussion about the FTC note are, e.g. provided by Brower II (above fn. 264), concluding that the note constitutes a partial amendment of Article 1105 of NAFTA; see also Dumberry (above fn. 245), pp. 674-676.

<sup>279</sup> *Pope & Talbot Inc. v. Canada* (above fn. 269), at paras. 57-58. <sup>280</sup> *Ibid.*, at paras. 59-62.

to refer to 'customary international law, as it stood no earlier than the time at which NAFTA came into force', and to be 'not limited to the international law of the nineteenth century or even of the first half of the twentieth century, although decisions from that period remain relevant'.<sup>281</sup> The content of current international law is considered to be 'shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce', incorporating fair and equitable treatment.<sup>282</sup> In a further case, the United States (and the other NAFTA members) apparently accepted the minimum standard of being able to evolve and not being 'frozen in time', albeit the threshold was said to remain high.<sup>283</sup> With references to prior awards, the evolutionary character has also been confirmed by more recent arbitral decisions.<sup>284</sup> Under NAFTA, it appears therefore quite well established that fair and equitable treatment is to be constructed in accordance with the minimum standard, which, however, is said to have evolved beyond the old *Neer* formula.<sup>285</sup>

The specific NAFTA discussion helps to clarify a number of points. It is obvious that states, by issuing the restrictive FTC note of interpretation, and tribunals, by generally accepting the note, are on the one hand not willing to approve fair and equitable treatment as an ever-expanding concept as the famous statement of Mann or the *Pope & Talbot* final merits award might indicate. On the other hand, attempts to the contrary seeking to resolve current, sophisticated investor-state disputes by means of coarse formulas from the 1920s are seen as equally unhelpful. By referring to the evolutionary character of the minimum standard, NAFTA tribunals have developed an idiosyncratic way of dealing with the FTC note of interpretation. To base arbitral decisions on this evolutionary character certainly forms a feasible exercise of arriving at pragmatic and fact-based solutions; it is, however, not free from legal dispute.

<sup>281</sup> *Mondev International Ltd v. United States* (above fn. 100), at para. 125. <sup>282</sup> *Ibid.*

<sup>283</sup> *ADF Group Inc. v. United States* (above fn. 277), at para. 179.

<sup>284</sup> See, e.g. *Waste Management v. Mexico* (above fn. 102), at paras. 91-93; and *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at para. 194.

<sup>285</sup> See also Laird (above fn. 212), pp. 204-214. See however *Glamis Gold Ltd v. United States* (above fn. 120), at paras. 599 et seq. In that case, the tribunal actually applied the restrictive *Neer* formula because it found that the investor had a heavy burden to prove that the minimum standard had evolved in fact since that time. Nevertheless, the tribunal conceded, at para. 616, that 'as an international community, we may be shocked by state actions now that did not offend us previously'.

First of all, it is a truism that customary international law is able to evolve.<sup>286</sup> In this respect, it appears quite remarkable that almost no tribunal has made an effort to explain in more detail how far the minimum standard might have evolved and what shape it is deemed to have today. Most tribunals merely observe that the body of customary international law entailed in this modern-day minimum standard is shaped by the extensive network of BITs. However, it has already become clear that the meaning of fair and equitable treatment provisions in BITs is vague and anything but uncontroversial. Moreover, the indeterminacy of fair and equitable treatment has been the very point of departure for the entire controversy on the relation between fair and equitable treatment and the minimum standard. BITs are thus unable to provide an established body of law that could be easily applied within the concept of the specific NAFTA modern-day minimum standard. Furthermore, NAFTA tribunals do not present any evidence for their assumption that the BIT network has contributed, in fact, to the generation of customary law rules that could be taken into account within the concept of the evolved minimum standard.<sup>287</sup> The enormous number of BITs concluded may indeed indicate the formation of a pertinent state practice, but the existence of a correlative *opinio juris* as the second precondition remains open to conjecture.<sup>288</sup> Consequently, the mere reference to the evolutionary nature of customary international law represents, at the best, a weak argumentative basis for a particular construction of Article 1105 of the NAFTA and similar clauses of BITs.

### C External reception of the NAFTA discussion

The controversy surrounding the relationship between fair and equitable treatment and the international minimum standard has also provoked discussions not only within NAFTA, but also in relation to other international investment agreements following distinct drafting approaches. Naturally, the considerable number of NAFTA awards and the intense discussion on this issue has influenced the debate outside of the NAFTA. However, the emergence of the pragmatic approach of arbitral tribunals in highlighting the evolutionary character of the

<sup>286</sup> See, e.g. Jennings and Watts (above fn. 124), p. 30.

<sup>287</sup> See also Klein Bronfman (above fn. 2), p. 656.

<sup>288</sup> See furthermore Chapter 8, section A, '2 Fair and equitable treatment as a norm of customary law?.'

minimum standard leads to the question of whether the smouldering controversy is still of practical significance.

#### 1 The controversy in non-NAFTA jurisprudence

Arguably, the propositions provided for in this respect by non-NAFTA tribunals appear even more representative of international investment law in general, since these tribunals are not affected by the idiosyncrasies of the NAFTA. In particular, non-NAFTA tribunals need not to be considerate of the FTC note of interpretation, and the jurisprudence is not confined to one single drafting version of fair and equitable treatment. Therefore, it seems interesting to assess whether the question as regards fair and equitable treatment and its relation to the minimum standard is posed with the same acuteness outside of the NAFTA. In this vein, some instructive non-NAFTA decisions will be reviewed.

##### (a) *Occidental Exploration & Production Co. (OPEC) v. Ecuador*

An initial inspection of the issue is provided by the case *Occidental Exploration & Production Co. (OPEC) v. Ecuador*.<sup>289</sup> OPEC, a company registered in the United States, provided oil services to Petroecuador, an Ecuadorian state-owned corporation entrusted with the exploitation of hydrocarbon in Ecuador. Petroecuador, in return, reimbursed OPEC for the value-added tax paid on local acquisitions. In 1999, a modified participation contract was signed between Petroecuador and OPEC, through which OPEC could export oil on its own and was entitled to a participation formula, expressed in terms of a percentage described as 'Factor X'. However, it turned out to be unsettled whether Factor X included a reimbursement of the value-added tax paid by OPEC or OPEC was entitled to tax refunds under Ecuador's laws. OPEC, due to a response from Ecuador's tax authority to a correlative clarification request, believed that it would be entitled to refunds apart from the participation formula and therefore applied to the authority for such refunds, which were granted. However, the tax authority later reneged on its opinion and denied further reimbursements. Moreover, the

<sup>289</sup> *Occidental Exploration and Production Co. v. Ecuador*, London Court of International Arbitration Case No. UN 3467 (Final Award of 1 July 2004), being the first non-NAFTA investment arbitration concerning tax issues; on the factual background, see paras. 25–36; for further discussion on the case, see S. D. Franck, 'Occidental Exploration & Production Co. v. Republic of Ecuador', Case Report, AJIL 99 (2005), p. 675; and Z. Douglas, 'Nothing if Not Critical for Investment Treaty Arbitration: Occidental, Eureka and Methanex', Arb. Int'l 22 (2006), p. 27 at pp. 29–38.

initially granted refunds were annulled and OEPC was ordered to return those amounts because the grant was allegedly based on a mistaken interpretation of the pertinent tax laws. The tax authority argued that Factor X was to include the value-added tax refund and that there was no right to such refunds under Ecuadorian legislation. Since lawsuits before national courts did not produce any relief, OEPC claimed the violation of several provisions of the 1993 US-Ecuador BIT.

The allegedly breached Article II(3)(a) of the BIT ensures fair and equitable treatment in conjunction with a statement that the investment 'shall in no case be accorded treatment less than that required by international law'.<sup>290</sup> Along these lines, the tribunal stated that 'at a minimum fair and equitable treatment must be equated with the treatment required under international law'.<sup>291</sup> The tribunal further assessed 'whether the fair and equitable treatment mandated by the treaty, is a more demanding standard than that prescribed by customary international law'.<sup>292</sup> Thereby, the tribunal extracted the stability and predictability of the legal and business framework as one essential element of fair and equitable treatment, to which the inconsistent behaviour of the tax authority could not conform.<sup>293</sup> However, legal stability and predictability were not only considered to be part of fair and equitable treatment itself, but also to be an obligation under general international law.<sup>294</sup> Hence, the tribunal concluded that the 'question whether there could be a treaty standard more demanding than a customary international law standard that has been painfully discussed in the context of NAFTA ... does not therefore arise in this case'.<sup>295</sup>

Although having the opportunity, the *Occidental* tribunal was obviously unwilling to take sides in the contention concerning the relationship of fair and equitable treatment and the minimum standard. Instead, the tribunal implicitly acknowledged that fair and equitable treatment could indeed demand a different standard from that required under international law, but at the same time, was quite reluctant to ascribe meaning, beyond its notion of international law to the fair and equitable treatment standard.<sup>296</sup> However, the tribunal certainly did not view fair and equitable treatment and the minimum standard as very different concepts, but rather constructed both concepts in a similar way.

<sup>290</sup> The formulation of the clause in the US-Ecuador BIT differs to such an extent from Article 1105(1) of NAFTA.

<sup>291</sup> *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 187.

<sup>292</sup> *Ibid.*, at para. 189. <sup>293</sup> *Ibid.*, at paras. 183-187. <sup>294</sup> *Ibid.*, at paras. 190-191.

<sup>295</sup> *Ibid.*, at para. 192. <sup>296</sup> See also Westcott (above fn. 2), p. 416.

(b) *CMS Gas Transmission Co. v. Argentina*

The controversy was further addressed in *CMS Gas Transmission Co. v. Argentina*,<sup>297</sup> representing one of the cases that arose out of Argentina's financial crisis between 1999 and 2002. In this context, the Argentine Government reacted to the severe capital flight by freezing bank accounts (so-called '*corralito*') and by enacting emergency laws that lifted the currency convertibility, pegging the peso at a one-to-one exchange rate to the US dollar (so-called '*pesification*'). Hence, the peso devalued dramatically to a temporary exchange rate of almost four pesos to one US dollar.<sup>298</sup>

Prior to the crisis, during a phase of privatisation in the 1990s, the American investor CMS purchased a considerable block of shares of the Argentine Transportadora de Gas del Norte (TGN). TGN had been granted a licence for the transportation and distribution of gas for a period of thirty-five years and was allowed to calculate its tariffs in dollars. Furthermore, the regulations envisaged a conversion of TGN's claims into pesos at the time of billing and the adjustment of tariffs every six months, in accordance with the US Producer Price Index (US PPI). As the crisis became apparent, the Argentine Government first suspended and later terminated the adjustment of the gas tariffs according to the US PPI by means of the emergency measures; the respective tariffs were redenominated in pesos at a one-to-one ratio. The devaluation of the peso thus resulted in a considerable loss of income for TGN and caused problems in the performance of external

<sup>297</sup> *CMS Gas Transmission Co. v. Argentina* (above fn. 102), on the facts, see paras. 53-115; the case is discussed in S. W. Schill, 'From Calvo to CMS: Burying an International Law Legacy - Argentina's Currency Reform in the Face of Investment Protection', *SchiedsVZ* (2005), p. 285; R. Happ and N. Rubins, 'Awards and Decisions of ICSID Tribunals in 2005', *GYIL* 48 (2005), p. 581 at pp. 601-609; R. Sharma and J. Fine, 'CMS v. Argentina: A Harbinger of Things to Come', *Int. TLR* 12 (2006), p. 36; V. R. Salgado, 'The Case against Adopting BIT Law in the FTAA Framework', *Wis. L. Rev.* (2006), p. 1025 at pp. 1053-1060; H. Samra, 'Five Years Later: The CMS Award Placed in the Context of the Argentine Financial Crisis and the ICSID Arbitration Boom', *Miami Inter-Am. L. Rev.* 38 (2007), p. 667; and Mayeda (above fn. 2), pp. 275-279.

<sup>298</sup> On the Argentine economic crisis generally and the subsequent wave of arbitrations, see, e.g. P. Di Rosa, 'The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties', *U. Miami Inter-Am. L. Rev.* 36 (2004), p. 41; R. D. Bishop and R. A. Luzi, 'Investment Claims: First Lessons from Argentina', in T. Weiler (ed.), *International Investment Law and Arbitration* (2005), p. 425; Samra (above fn. 297), pp. 673-680; and focusing on the defence of state necessity, S. F. Hill, 'The "Necessity Defense" and the Emerging Arbitral Conflict in its Application to the U.S.-Argentina Bilateral Investment Treaty', *L. & Bus. Rev. Am.* 13 (2007), p. 547.

debts calculated in dollars. CMS alleged that the value of its shares in TGN dropped by 92 per cent due to the Argentine emergency measures and therefore commenced ICSID proceedings.

In assessing the alleged breach of fair and equitable treatment,<sup>299</sup> the CMS tribunal proceeded similarly to the tribunal in the *Occidental* case. Initially, with reference to the treaty preamble, scholarly writings and arbitral decisions, the tribunal detected a stable legal and business environment as an essential element of fair and equitable treatment, which was held to have been disregarded by the Argentine Government through its drastic alteration of the regulatory framework.<sup>300</sup> Secondly, alluding to the NAFTA discussion, the tribunal examined whether fair and equitable treatment was separate and more expansive than customary international law. However, the tribunal found this question ultimately irrelevant, since the evolved international minimum standard was considered to require stability and predictability of the business environment as well.<sup>301</sup> The CMS tribunal, therefore, showed the same reluctance as the *Occidental* tribunal and, by drawing on evolved customary international law, did not feel impelled to make a decision on the relation of fair and equitable treatment and the minimum standard.

In the aftermath of the CMS award, other American investors operating in the privatised Argentine gas sector also began ICSID proceedings based on virtually the same factual background as that in the CMS case. In these cases, *Enron Corp. and others v. Argentina*<sup>302</sup> and *Sempra Energy International v. Argentina*,<sup>303</sup> the tribunals took a very similar view on the relation between fair and equitable treatment and the minimum standard, as the CMS tribunal had already done, stating:

<sup>299</sup> Article II(2)(a) of the 1991 US–Argentina BIT is comparable to the relevant treaty provision in the *Occidental* case.

<sup>300</sup> *CMS Gas Transmission Co. v. Argentina* (above fn. 102), at paras. 273–281. The CMS award was subject to an annulment proceeding. Thereby, the review committee disagreed with the tribunal's findings as regards the breach of the umbrella clause and the necessity plea, but upheld, e.g. the tribunal's assessment of the breach of the fair and equitable treatment standard: see *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/8 (Decision on Annulment of 25 September 2007), especially at paras. 81–85.

<sup>301</sup> *CMS Gas Transmission Co. v. Argentina* (above fn. 102), at paras. 282–284.

<sup>302</sup> *Enron Corp. and Ponderosa Assets LP v. Argentina*, ICSID Case No. ARB/01/3 (Award of 22 May 2007).

<sup>303</sup> *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16 (Award of 28 September 2007). This award has, however, been recently annulled: see *Sempra Energy International v. Argentina* (above fn. 122).

It might well be that in some circumstances in which the international minimum standard is sufficiently elaborate and clear, the standard of fair and equitable treatment might be equated with it. But in other cases, it might as well be the opposite, so that the fair and equitable treatment standard will be more precise than its customary international law forefathers. On many occasions, the issue will not even be whether the fair and equitable treatment standard is different or more demanding than the customary standard, but only whether it is more specific, less generic and spelled out in a contemporary fashion so that its application is more appropriate to the case under consideration. This does not exclude the possibility that the fair and equitable treatment standard imposed under a treaty can also eventually require a treatment additional to or beyond that of customary law. Such does not appear to be the case with the present dispute, however. The very fact that recent interpretations of investment treaties have purported to change the meaning or extent of the standard only confirms that, those specific instruments aside, the standard is or might be a broader one.<sup>304</sup>

### (c) *Saluka Investments BV v. Czech Republic*

The case of *Saluka Investments BV v. Czech Republic*<sup>305</sup> concerned the gradual privatisation of the centralised Czech banking sector during the course of the 1990s. Within this process, the original state bank was divided into four initially state-owned banks – called the 'Big Four' – which were vitally important to the Czech economy. IPB was the first bank of the Big Four to be privatised fully in 1998. The shares were mainly sold to an affiliate of the Japanese Nomura financial services group that subsequently resold the shares in 2000 to another wholly owned subsidiary, Saluka Investments, incorporated in the Netherlands. All Big Four banks, due to a liberal credit policy and inadequate creditors' rights, had significant problems with non-performing loans, forcing regulatory action in mid-1998 in order to protect the stability of the banking sector. However, although all four banks were of comparable strategic importance and similarly exposed to the bad debt problem, only the three other banks which were still mainly state

<sup>304</sup> *Sempra Energy International v. Argentina* (above fn. 303), at para. 302; an almost identical formulation has been used by the *Enron* tribunal – see *Enron Corp. and Ponderosa Assets LP v. Argentina* (above fn. 302), at para. 258.

<sup>305</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), on the facts, see paras. 26 et seq.; the jurisdiction of the tribunal was subject to judicial review, but the complaint was disallowed: see *Tschechische Republik v. Saluka Investment BV*, Schweizerisches Bundesgericht 4P.114/2006 (Judgment of 7 September 2006); for further discussion on the case, see, e.g. Westcott (above fn. 2), pp. 420–422; and S. Fietta, 'Expropriation and the "Fair and Equitable" Standard', *Journal of International Arbitration* 23 (2006), p. 375 at pp. 395–398.

owned could benefit from the so-called revitalisation programme providing for immense amounts of state assistance. Subsequently, IPB struggled with major irregularities, leading the Czech National Bank to put IPB into forced administration in June 2000. Only a few days thereafter, the forced administrator transferred IPB's whole enterprise to CSOB, another of the Big Four banks, receiving a state guarantee from the Ministry of Finance and a promise of indemnity from the Czech National Bank. After the termination of the forced administration in June 2002, Nomura resumed control over IPB, but, according to an arbitration proceeding initiated by the Czech Republic, had to confer its IPB shares to CSOB, which was finally registered as the new owner of the shares in February 2004.

In discussing Saluka's claim concerning fair and equitable treatment,<sup>306</sup> the tribunal provided a copious assessment of the meaning of the standard, before applying it to the facts. Thereby, the tribunal was very well aware of the NAFTA discussion, but seemed to question the practical relevance of the controversy on the relation of fair and equitable treatment and the minimum standard:

Whatever the merits of this controversy between the parties may be, it appears that the difference between the Treaty standard laid down in Article 3.1 and the customary minimum standard, when applied to the specific facts of a case, may well be more apparent than real. To the extent that the case law reveals different formulations of the relevant thresholds, an in-depth analysis may well demonstrate that they could be explained by the contextual and factual differences of the cases to which the standards have been applied.<sup>307</sup>

Nevertheless, the tribunal appeared to be of the opinion that a customary minimum standard required a relatively lower degree of inappropriateness than a treaty standard of fair and equitable treatment.<sup>308</sup> However, leaving aside the differences between customary and treaty standards, the tribunal felt limited to the fair and equitable treatment standard as stipulated in Article 3(1) of the BIT. Since this formulation omits any reference to a customary minimum standard or to international law, the tribunal clearly favoured, *obiter dictum*, the 'autonomous character of a "fair and equitable treatment" standard' in the present

<sup>306</sup> The standard is stipulated in Article 3(1) of the 1991 Netherlands-Czech Republic BIT, also reprinted in *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 280. The standard is not combined with a reference to international law.

<sup>307</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 291.

<sup>308</sup> *Ibid.*, at paras. 292 and 293.

case.<sup>309</sup> Upon this basis, the tribunal, in reliance on the general rules of interpretation, constructed its own standard and ultimately determined that this standard had been infringed.<sup>310</sup>

To some extent, the *Saluka* award stands out from the previously noted cases since it does not refrain from taking sides in the controversial debate. The clear statement of the autonomous character of fair and equitable treatment and the reference to Article 31 of the VCLT display a strong tendency in favour of the plain meaning approach. This impression is further intensified by the tribunal's rejection of an argument of the Czech Republic, suggesting that the customary minimum standard is at least implicitly incorporated in Article 3(1) of the BIT.<sup>311</sup> However, the *Saluka* tribunal palpably distinguished between different BIT formulations, with and without reference to international law, and expressly limited its considerations to the latter,<sup>312</sup> restraining the ability to generalise the award to a certain extent.<sup>313</sup> Nevertheless, the *Saluka* tribunal indicated that it might have come to the same conclusion even if it had had to decide the case on the basis of a clause comprising a reference to international law. To such an extent, it stated that the difference between the conflicting views 'may well be more apparent than real', and that it was mainly the facts upon which a case is to be decided.<sup>314</sup> Altogether, the *Saluka* award, even though showing a quite clear tendency, represents further evidence for the pragmatic and fact-based handling of tribunals concerning the controversy of fair and equitable treatment and the minimum standard.

#### (d) *Azurix Corp. and others v. Argentina*

Another example in this context is represented by the case of *Azurix Corp. and others v. Argentina*.<sup>315</sup> It addresses several problems in the

<sup>309</sup> *Ibid.*, at paras. 294. <sup>310</sup> *Ibid.*, especially at paras. 281 and 309.

<sup>311</sup> *Ibid.*, at para. 295; this argument was based on a reference to *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia* (above fn. 96), at para. 367, considering fair and equitable treatment as *a*, but not necessarily *the*, minimum standard; the *Genin* case pertained to the 1994 US-Estonia BIT that contains an incorporation of international law.

<sup>312</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 294.

<sup>313</sup> See Westcott (above fn. 2), p. 422.

<sup>314</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 291.

<sup>315</sup> *Azurix Corp. and others v. Argentina* (above fn. 102), on the background, see paras. 38-44; for further discussion on the case, see R. Happ and N. Rubins, 'Awards and Decisions of ICSID Tribunals in 2006', GYIL 49 (2006), p. 623 at pp. 637-640; D. Collins, 'Review of 2006 ICSID Decisions', *Manchester J. Int'l Econ. L.* 3 (2006), p. 111 at pp. 111-113; and Westcott (above fn. 2), pp. 422-424.



aftermath of the privatisation of the services of a public utility company providing potable water and sewerage services in the province of Buenos Aires. The US-based Azurix Corporation, acting through two affiliates incorporated in Argentina, was granted a thirty-year concession to operate the drinking and sewage water supply in 1999. However, in 2000, Azurix was confronted with difficulties in maintaining the required water quality, which was threatened by an algae outbreak leading provincial health authorities to warn customers that they should boil their tap water. Azurix accused the province authorities of being responsible for these problems, since they had not completed certain works critical to the algae removal in the water supply infrastructure. Azurix also complained that the authorities had prevented it from applying the contractually specified tariff regime by inciting public panic for political reasons. This alleged malpractice caused financial losses and ultimately the bankruptcy of one of the investor's local affiliates operating the concession. In 2001, Azurix finally filed a claim under the 1991 US-Argentina BIT for presumed violations of several substantive provisions of the BIT.

At first, the tribunal negated an expropriation of Azurix's investment and then turned to the claim concerning fair and equitable treatment.<sup>316</sup> The tribunal thereby explicitly recalled the importance of the Vienna Convention for its interpretation of the vague provision.<sup>317</sup> In a detailed analysis of the wording of the pertinent fair and equitable treatment clause, the tribunal explicitly noticed the possibility to construe the provision – although containing a reference to international law – in a more demanding way than that required by international law.<sup>318</sup> However, the tribunal questioned the substantial difference between both approaches<sup>319</sup> and, in this respect, responded to the broad agreement of NAFTA tribunals concerning the evolving nature of the customary minimum standard.<sup>320</sup> Having said this, the tribunal had no problems in finding a violation of fair and equitable treatment because of the politicisation of the tariff regime.<sup>321</sup>

<sup>316</sup> Like most US BITs, Article II(2)(a) of the 1991 US-Argentina BIT contains a reference to international law.

<sup>317</sup> *Azurix Corp. and others v. Argentina* (above fn. 102), at para. 359.

<sup>318</sup> *Ibid.*, at para. 361; the tribunal thereby dissociated itself from the NAFTA FTC note of interpretation – see para. 363.

<sup>319</sup> *Ibid.*, at paras. 361 and 364. <sup>320</sup> *Ibid.*, at paras. 365–372.

<sup>321</sup> *Ibid.*, at paras. 374–377.

The *Azurix* judgment is of particular interest since it pertains to a fair and equitable treatment clause that is similar to Article 1105(1) of the NAFTA and, above all, highlights the willingness of the tribunal to construct fair and equitable treatment distinct from the standard set forth by customary international law. However, according to the tribunal, the widely accepted evolutionary character of customary international law made any distinction between the two approaches of constructing fair and equitable treatment redundant.<sup>322</sup> In respect thereof, the *Azurix* tribunal is quite in line with the previously noted awards, which altogether expressed their scepticism in finding a difference between the modern-day minimum standard and fair and equitable treatment when considering the facts of a specific case.

## 2 *The disappearance of a controversy?*

In the controversy between the restrictive approach, equating fair and equitable treatment and the minimum standard, and the plain meaning approach, construing fair and equitable treatment as a self-contained norm, most cases reviewed point in the same direction. Although arbitral tribunals within and outside of the NAFTA were aware of this controversy and often discussed it at length in their awards, they were quite reluctant to take sides in the dispute. This is remarkable, since investors almost stereotypically argued in line with the expansive view of the *Pope & Talbot* tribunal, while host states with a similar insistence favoured the restrictive approach taken in the NAFTA FTC note of interpretation. Arguably, to be acceptable to both parties, the tribunals usually aspired to create the impression of taking a pragmatic and fact-specific middle path.<sup>323</sup> While the equating approach nevertheless seems to be strongly connected to fair and equitable treatment clauses similar to Article 1105(1) of the NAFTA, the plain meaning approach appears to be more common in the application of freestanding formulations of fair and equitable treatment.<sup>324</sup> However, by emphasising the

<sup>322</sup> See also Westcott (above fn. 2), pp. 423–424.

<sup>323</sup> See also R. Dolzer, 'Fair and Equitable Treatment in International Law', Remarks, ASIL Proc. 100 (2006), p. 69 at pp. 69–70; and V. Lowe, 'Fair and Equitable Treatment in International Law', Remarks, ASIL Proc. 100 (2006), p. 73 at p. 73.

<sup>324</sup> See, e.g. *National Grid Plc v. Argentina* (above fn. 133), at para. 167, stating that because 'there is no reference to the minimum standard of treatment under international law in the treaty in contrast to the language of NAFTA, the tribunal will proceed to examine the ordinary meaning of the terms "fair" and "equitable"'. See also Kreindler (above fn. 2), p. 13; and Dolzer (above fn. 323), pp. 69–70.

evolutionary character of the customary minimum standard, the tribunals have usually declared that there was no necessity to decide whether fair and equitable treatment diverges from an evolved minimum standard. To this extent, irrespective of the pertinent investment treaty formulation, a real difference as regards the practical outcome between the two approaches when considering the facts of a specific case seems to be non-existent.<sup>325</sup>

Does all this mean that the controversy as to the relation of fair and equitable treatment and the minimum standard is disappearing?<sup>326</sup> Does it further mean that a solid middle ground has been found that provides good reasons for future constructions of fair and equitable treatment? Indeed, it seems that the focus of interest has turned to the content of fair and equitable treatment and the different sub-elements it is considered to entail.<sup>327</sup> However, there are also decisions – especially the one in *Glamis Gold Ltd v. United States*<sup>328</sup> – questioning the juristic artifice that is usually applied in order to achieve the convergence between fair and equitable treatment and the evolved minimum standard. Moreover, it seems that none of the advanced views is capable of providing convincing reasons for their construction of fair and equitable treatment. Rather, it seems that the 'controversy is misguided, and [that] the dichotomy presented by the opposing views is a false one on a number of levels'.<sup>329</sup> Arguably, these misconceptions are based on simplistic premises and a false perspective in addressing fair and equitable treatment.

In particular, the dichotomy is presented as a struggle between a presumably restrictive and clear-cut minimum standard and a far-reaching fair and equitable treatment obligation that is at the disposal of arbitrators.<sup>330</sup> Of course, it is understandable that, within a specific arbitral proceeding, host states fear an excessively demanding standard and foreign investors plead in favour of a level of protection which is as

high as possible. However, the controversy should not be reduced to this struggle of ensuring either a high or low level of protection. On the one hand, the equating approach should to such an extent be considered as a reminder that investors only receive a basic level of protection and that international investment law, as such, is founded on an older debate on the protection of aliens in customary law, of which some arguments are still of relevance.<sup>331</sup> The plain meaning approach, on the other hand, emphasises that the minimum standard has been disputed and indeterminate itself and that, accordingly, other arguments should also be permitted. Consequently, fair and equitable treatment should be construed as representing only one single concept.<sup>332</sup> Any division into distinct constructions of the standard – such as a presumably lower customary minimum standard and a presumably higher self-contained standard – would threaten consistency in international investment law. It would furthermore cause remarkable uncertainties for states and investors in relation to the implications of slightly differing formulations in investment treaties. Additionally, it would encourage forum shopping of investors, in order to receive the highest possible level of protection.

The discussion on fair and equitable treatment and the minimum standard suffers furthermore from a false perspective that focuses on the identification of an intrinsic meaning of the norm. However, the indeterminacy of fair and equitable treatment may not be reduced by construing it as a static reference to customary international law, as it stood at a haphazardly chosen time in the past, nor as a dynamic reference to evolved customary international law. Both approaches entail a number of additional requirements, of which most arbitral decisions fall short. For instance, if fair and equitable treatment is considered as a reference to customary law, it has to be shown that the

<sup>325</sup> See also Westcott (above fn. 2), p. 426.

<sup>326</sup> See explicitly *Duke Energy Electroquil Partners and Electroquil SA v. Ecuador*, ICSID Case No. ARB/04/19 (Award of 12 August 2008), at para. 333, stating that the controversy is overtaken by the latest developments in arbitral jurisprudence. However, there are also other recent decisions discussing the issue at length: see *Merrill & Ring Forestry L.P. v. Canada*, ICSID Administered Case (Award of 31 March 2010), at paras. 182 et seq.

<sup>327</sup> See, e.g. Laird (above fn. 212), p. 190.

<sup>328</sup> *Glamis Gold Ltd v. United States* (above fn. 120); for the facts and further discussion of this case, see also Chapter 7, section A, '4(c) Sustainable development in arbitral jurisprudence'.

<sup>329</sup> McLachlan, Shore and Weininger (above fn. 63), p. 203. <sup>330</sup> See also *ibid.*

<sup>331</sup> The 'overlap' between fair and equitable treatment and the minimum standard is well accepted: see, e.g. Mayeda (above fn. 2), p. 287. It is submitted that the old cases on state responsibility related to the classical minimum standard provide guidance in investment disputes concerning the issues of compensation for expropriation, responsibility for destruction or violence by non-state actors and denial of justice, while only the latter is considered to be linked to fair and equitable treatment: see Sornarajah (above fn. 3), pp. 329–330. See also Tudor (above fn. 2), pp. 65–68, determining a certain incompatibility between the international minimum standard and fair and equitable treatment.

<sup>332</sup> The need for certain uniformity regarding the construction of fair and equitable treatment is also acknowledged by Wälde (above fn. 137), p. 385; Dolzer (above fn. 73), p. 961; and Fietta (above fn. 305), pp. 397–398. See also *Merrill & Ring Forestry L.P. v. Canada* (above fn. 326), at para. 212.

rule ultimately applied is in fact accepted as (evolved) customary law and transferable to the particular dispute. A mere reference to the vague minimum standard or the evolving nature of customary law remains to such an extent discarnate and thus unconvincing. Similarly, the often-invoked *Neer* formula is of little use for the concretisation of fair and equitable treatment, since it merely exchanges the notions of 'fair' and 'equitable' with equally indeterminate and subjective terms like 'egregious' and 'shocking'.<sup>333</sup> All of these notions are general clauses demanding additional reasons in order to justify a particular arbitral decision.

In conclusion, any limitations of the reasoning on fair and equitable treatment either to historical arguments derived exclusively from the minimum standard or to textual arguments related only to the notions of 'fair and equitable' should be rejected. This is not only because the (evolved) minimum standard as well as the pure literal meaning of fair and equitable treatment are insufficient in justifying a particular construction of fair and equitable treatment, but also because it oversimplifies the complexity of international law. Moreover, it seems that most arbitral decisions on fair and equitable treatment, irrespective of the particular approach they follow, are also relying on other arguments.<sup>334</sup> As neither the equating approach nor the plain meaning approach are able to concretise this open-textured norm, it is necessary to consider a broader spectrum of possible arguments to provide a more solid justificatory basis for the construction of fair and equitable treatment.

<sup>333</sup> See, e.g. the shorthand definition based on the *Neer* formula employed by the tribunal in *Glamis Gold Ltd v. United States* (above fn. 120), at para. 616. The limited value of the *Neer* case is also confirmed by the tribunal in *Merrill & Ring Forestry L.P. v. Canada* (above fn. 326), at para. 197, stating that this and similar cases only marginally deal with matters relating to business, trade or investments.

<sup>334</sup> See O. K. Fauchald, 'The Legal Reasoning of ICSID Tribunals', *EJIL* 19 (2008), p. 301.

## 4 The role of international law in the construction of fair and equitable treatment

### A Fragmentation and international investment law

International investment law is part of international economic law and therefore also a component of general international law. Such a truism may be proved by a glance within any textbook.<sup>335</sup> Nevertheless, it appears to be worth mentioning here, since international investment law has evolved into a very specialised field of international law that is mainly governed by a dense network of investment treaties and practised by a growing, but still limited, community of arbitrators, counsellors and scholars.<sup>336</sup> Moreover, the conclusion of BITs was intended, at least partly, to displace the vague customary international law regime, which had previously dominated the regulation of foreign investments.<sup>337</sup> In addition, the growing body of arbitral case law is gradually becoming a self-referential system that is displaying an increased momentum of its own, with a diminishing necessity to consider external sources of law or other judicial decisions. To such an extent, the emergence of international investment law as a specialised field of international law as well as the consolidation and deepening of its standards entails a certain decoupling from the general rules of international law. Therefore, modern international investment law not only forms a spearhead of legal and economic globalisation,<sup>338</sup> contributing to a global streamlining of investment-related regulations, but has also

<sup>335</sup> See, e.g. Lowenfeld (above fn. 3); and W. Graf Vitzthum (ed.), *Völkerrecht*, 4th edn (2007).

<sup>336</sup> See also Dolzer and Schreuer (above fn. 54), pp. 1-3.

<sup>337</sup> Re. the history of the BIT movement, see Chapter 2, section B, '1 International investment process'.

<sup>338</sup> On international investment law and legal globalisation generally, see F. Beveridge (ed.), *Globalization and International Investment* (2005); and P. S. Berman (ed.), *The Globalization of International Law* (2006).

evolved as a highly specialised and relatively autonomous sphere of international law.

This phenomenon applies not only to international investment law, but represents a general pattern in (post-)modern international law and has attracted considerable attention under the title 'fragmentation of international law'.<sup>339</sup> The term 'fragmentation' describes a process which reflects the rapid augmentation of international law and the emergence of increasingly specialised and relatively autonomous rules, rule-complexes and spheres of legal practice, such as human rights law, environmental law, trade law and international investment law.<sup>340</sup> Legal fragmentation is deemed dependent upon more fundamental processes of fragmentation within a global society, characterised by an accelerated functional differentiation of society into relatively autonomous social systems.<sup>341</sup> Such a global societal differentiation entails the proliferation of heterogeneous legal orders that structure each specific sphere of social action, leading altogether to a global legal pluralism.

The causes for the fragmentation of international law lie not only in the specialised and decentralised methods of norm creation, representing the codes of specific social sub-systems, but also result from the diversification of international courts, quasi-courts and tribunals, each of them applying and advancing its own legal regime.<sup>342</sup> Such independent judicial bodies typically lack a hierarchical structure and operate on

<sup>339</sup> See especially the final report and conclusions of the ILC study group on fragmentation, finalised by M. Koskenniemi, *Fragmentation of International Law*, UN Document A/CN.4/L.682 (2006); ILC, 'Conclusions of the Work of the Study Group on the Fragmentation of International Law', ILC Report A/61/10, Chapter XII (2006); see also P.-M. Dupuy, 'The Danger of Fragmentation or Unification of the International Legal System and the International Court of Justice', *NYU J. Int'l L. & Pol.* 31 (1999), p. 791; G. Hafner, 'Pros and Cons Ensuing from Fragmentation of International Law', *Mich. J. Int'l L.* 25 (2004), p. 849; A. Fischer-Lescano and G. Teubner, 'Regime Collisions', *Mich. J. Int'l L.* 25 (2004), p. 999; A. Fischer-Lescano and G. Teubner, *Regime-Kollisionen* (2006); and C. Thiele, 'Fragmentierung des Völkerrechts als Herausforderung für die Staatengemeinschaft', *ArchVR* 46 (2008), p. 1.

<sup>340</sup> See Koskenniemi (above fn. 339), p. 11; and Thiele (above fn. 339), p. 3.

<sup>341</sup> On 'functional differentiation' within a system of a world society, see N. Luhmann, 'Die Weltgesellschaft', *ARSP* 57 (1971), p. 1 at pp. 17-22; see also Fischer-Lescano and Teubner, 'Regime Collisions' (above fn. 339), pp. 1004-1017; and Fischer-Lescano and Teubner, *Regime-Kollisionen* (above fn. 339), p. 24.

<sup>342</sup> See Dupuy (above fn. 339), pp. 791-792; Fischer-Lescano and Teubner, *Regime-Kollisionen* (above fn. 339), p. 8; S. Oeter, 'The International Legal Order and its Judicial Function', in P.-M. Dupuy et al. (eds.), *Völkerrecht als Wertordnung* (2006), p. 583 at pp. 590-593; and Thiele (above fn. 339), pp. 13-14.

the basis of peculiar international agreements, which only assign them with a restricted scope of jurisdiction.<sup>343</sup> Therefore, the fragmentation of international law is not only characterised by the creation of specialised legal norms as primary rules of a legal sub-system, but also by the emergence of different secondary rules that ensure the observance of the pertinent primary rules through the establishment of particular enforcement mechanisms and dispute settlement institutions.<sup>344</sup>

The consequences arising from this process of fragmentation, for the international legal system as a whole, and the means of addressing the challenges it poses are quite controversial. On the one hand, some consider the increasing specialisation as a tribute which the profession pays to the maturity of the legal system.<sup>345</sup> This means that the specialisation of international regulations appears as a natural and positive development which is necessarily interlinked with the evolution and expansion of international law and which provides for tailored norms and suitable solutions for an idiosyncratic set of problems.<sup>346</sup> Moreover, a specialised and decentralised approach to international law-making may accommodate various needs and concerns of states, especially regarding cases in which global consensus-building encounters difficulties and in which, therefore, the establishment of a unified global regime appears utopian.<sup>347</sup> Remarkably, such problems have long been apparent in the process of negotiating international investment agreements, ultimately leading to the proliferation of BITs and the emergence of international investment law as a specialised field.

On the other hand, the process of fragmentation is also submitted to denote an erosion of general international law, involving an overall decrement of legal certainty in the international legal system.<sup>348</sup> Furthermore, the process of fragmentation exposes frictions and contradictions between the various legal sub-systems and triggers the imposition of mutually exclusive obligations on states.<sup>349</sup> Although such conflicts of different treaty regimes are not a new phenomenon,<sup>350</sup> due to the expansion of international law, the potential for norm conflicts seems to have increased substantially within recent years.<sup>351</sup> For instance, such conflicts between norms of different legal sub-systems

<sup>343</sup> Thiele (above fn. 339), p. 14. <sup>344</sup> See Hafner (above fn. 339), pp. 856-858.

<sup>345</sup> T. M. Franck, *Fairness in International Law and Institutions* (1995), p. 4. <sup>346</sup> *Ibid.*, p. 859.

<sup>347</sup> Koskenniemi (above fn. 339), p. 15. <sup>348</sup> See Thiele (above fn. 339), p. 3.

<sup>349</sup> Hafner (above fn. 339), p. 851.

<sup>350</sup> See already C. W. Jenks, 'The Conflict of Law-Making Treaties', *BYIL* 30 (1953), p. 401.

<sup>351</sup> On the question of what is a 'conflict', see Koskenniemi (above fn. 339), pp. 17-20.

are detected between state immunity and human rights obligations, international trade regulations and international environmental regulations, and international maritime law and international fishery treaties.<sup>352</sup> Similar conflicts have also become apparent between international investment law and environmental regulations,<sup>353</sup> the protection of human rights,<sup>354</sup> measures to promote public health<sup>355</sup> and the protection of cultural heritage.<sup>356</sup>

Hence, the fragmentation of international law describes a process which indeed characterises the correlation between international investment law, other specialised areas of law and general international law.<sup>357</sup> Of course, the initial statement that international investment law forms part of general international law remains true. However, it is important to reiterate that certain frictions may emerge within an international legal system consisting of increasingly developed sub-systems. Consequently, in order to preserve coherence or at least compatibility<sup>358</sup> within such a pluralistic legal system, the means by which frictions and conflicts of norms are mitigated or even avoided need to be assessed. Thereby, it has been submitted that the Vienna Convention is already equipped with a series of maxims and techniques which help to address these conflicts. Among these, the maxims of *lex specialis derogat*

<sup>352</sup> See Hafner (above fn. 339), pp. 851–854; on the tensions between international trade law and international environmental protection, see, e.g. Lowenfeld (above fn. 3), pp. 388 et seq.

<sup>353</sup> See, e.g. *Metalclad Corp. v. Mexico* (above fn. 224); *S.D. Myers Inc. v. Canada* (above fn. 95); and *Methanex Corp. v. United States* (above fn. 275). The impact of international investment law on environmental regulations is strongly criticised: see, e.g. Dhooge (above fn. 227); M. Yee, 'The Future of Environmental Regulation after Article 1110 of NAFTA', *Hastings W.-N.W.J. Envtl. L. & Pol'y* 9 (2002), p. 85; and A. Alvarez-Jiménez, 'The Methanex Final Award', *Journal of International Arbitration* 23 (2006), p. 427.

<sup>354</sup> See, e.g. *Piero Foresti, Laura de Carli and others v. South Africa*, ICSID Case No. ARB(AF)/07/01 (Registered on 8 January 2007); see also L. Liberti, 'Investissements et droits de l'homme', in P. Kahn and T. W. Wälde (eds.), *Les aspects nouveaux du droit des investissements internationaux – New Aspects of International Investment Law* (2007), p. 791.

<sup>355</sup> See M. A. Orellana, 'Science, Risk and Uncertainty', in P. Kahn and T. W. Wälde (eds.), *Les aspects nouveaux du droit des investissements internationaux – New Aspects of International Investment Law* (2007), p. 671.

<sup>356</sup> See, e.g. *Parkerings-Compagniet AS v. Lithuania* (above fn. 138); and *Glamis Gold Ltd v. United States* (above fn. 120); see also V. S. Vadi, 'Cultural Heritage and International Investment Law', *Int. J. of Cultural Property* 15 (2008), p. 1.

<sup>357</sup> See also A. van Aaken, 'Fragmentation of International Law', *Finnish YIL XVII* (2006), p. 91.

<sup>358</sup> To this end, see Fischer-Lescano and Teubner (above fn. 339), pp. 24 and 170–171, arguing that the fragmentation of law is not to be resolved as such since it is due to underlying societal fragmentation processes. Accordingly, law is at best deemed capable of establishing a normative regime's compatibility.

*legi generali* and *lex posterior derogat legi priori* are especially important.<sup>359</sup> However, as regards the prevention of norm conflicts, systemic relationships between different legal norms or norm-complexes may be established via the processes of legal construction of norms and legal reasoning.<sup>360</sup> It is exactly within these processes where open-textured norms such as fair and equitable treatment have an important role to play.

## B Impulses from international law for the construction of fair and equitable treatment

If the international legal system comprises different specialised sub-systems, questions in relation to the interaction of these sub-systems arise. In the context of fair and equitable treatment, it appears especially important to clarify the possibility of such interactions, since a reference to international law is a widespread and controversial feature of treaty provisions as well as in the overall discussion on fair and equitable treatment. In order to analyse the possible repercussions of international law upon the construction of fair and equitable treatment, it is at first necessary to discuss the ability of vague general clauses to serve as gateways for a process of systemic interaction and for the building of inter-systemic linkages between the different sub-systems.

### 1 General clauses as gateways

Indeterminate general clauses like fair and equitable treatment appear especially appropriate in order to serve as gateways for a number of compelling reasons. At first, it can be discerned that international law not merely consists of static rules and their exceptions, but is better described as a normative system which develops through a continuous process.<sup>361</sup> Moreover, this perception of international law as a proceeding system is said to be coercive if international law will contribute to, as well as cope with, social processes in a changing political world.<sup>362</sup> Accordingly, these dynamics represent an essential characteristic of international law, even if its norms are captured in static treaty texts. Flexibility thereby ensures the ability of a specific treaty regime to adapt

<sup>359</sup> See Koskenniemi (above fn. 339), pp. 30 et seq. and 115 et seq.; and Thiele (above fn. 339), pp. 5–10.

<sup>360</sup> See A. van Aaken, 'Defragmentation of Public International Law through Interpretation', *Ind. J. Global Legal Stud.* 16 (2009), p. 483; on networking between different legal regimes, see also Fischer-Lescano and Teubner, *Regime-Kollisionen* (above fn. 339), pp. 57–65.

<sup>361</sup> See, e.g. R. Higgins, *Problems and Process* (1994), pp. 2–12. <sup>362</sup> *Ibid.*, p. 3.

to general social processes and particular social processes occurring in a sub-system of international law. Within a treaty regime, one possibility of achieving flexibility is through an iterative process of renegotiating a particular treaty or by concluding new and adjusted treaties. However, flexibility is also (and especially) needed if a treaty text remains in force and unchanged for many years.

To enshrine such flexibility is precisely one important function of general clauses,<sup>363</sup> which are, by their open-textured phrasing, exceptionally accessible for a constructive judicial process that considers different social developments.<sup>364</sup> Moreover, in the process of judicial reasoning, a gateway character in this sense appears to be a necessary correspondent to the textual indeterminacy of general clauses. As textual arguments rarely carry persuasive force in the construction of general clauses, other arguments come to the fore and naturally gain importance. Thus, a process of constructive reasoning in relation to general clauses contained in specialised treaty regimes represents a suitable way of establishing systemic relationships between different sub-systems of international law.

## 2 The gateway character of fair and equitable treatment

Fair and equitable treatment depicts such a general clause which is systemically interlinked with general international law and other specialised sub-systems of international law.<sup>365</sup> Thereby, the special connection between fair and equitable treatment and the international legal system as a whole is already demonstrated by the fact that many international investment agreements juxtapose fair and equitable

treatment with a reference to international law.<sup>366</sup> Exactly this textual reference and the associated controversy between the equating and the plain meaning approach are also expressive, at least partly, of the dynamic connection between fair and equitable treatment and international law.<sup>367</sup> For instance, the equating approach clearly emphasises the relationship between fair and equitable treatment and international law, but seeks to restrict this relationship to mere customary international law. The emphasis on the evolutionary character of the customary minimum standard by arbitral tribunals expresses the dynamic element of fair and equitable treatment and the need for adaptation to ongoing social processes. The plain meaning approach similarly highlights this evolution because it recognises that the concept of fair and equitable treatment should be shaped according to the needs of modern investment relationships. Some proponents of the plain meaning approach also acknowledge that the search for the plain meaning of fair and equitable treatment may derive guidance from general international or even national law.<sup>368</sup> Even though the controversy is altogether mistaken, all approaches nevertheless accept at least one aspect of the dynamic concept of fair and equitable treatment, which is systemically interlinked within a fragmented international legal system.

It is therefore suggested that the process of constructing fair and equitable treatment may receive considerable impulses from international law, providing a broader justificatory basis beyond the sole reliance on scant textual or historic arguments. Of course, such a constructive approach may actualise fundamental fears of host states and supporters of the equating approach, since it potentially clears the way for judicial activism and seems to endow arbitrators with considerable discretion, possibly leading to excessively demanding or conflicting arbitral awards.<sup>369</sup> However, such fears misconceive the inevitably constructive function of judicial decision-makers and underestimate

<sup>363</sup> On the functions of general clauses in German private law, see, e.g. G. Teubner, *Standards und Direktiven in Generalklauseln* (1971), especially pp. 116–118; F. Bydlinski, *Juristische Methodenlehre und Rechtsbegriff*, 2nd edn (1991), pp. 582–584; and D. Looschelders and W. Roth, *Juristische Methodik im Prozeß der Rechtsanwendung* (1996), pp. 198–204. Thereby, it is well accepted that the general clauses of statutory private law serve as gateways for the integration of superior constitutional rights: see in detail K. Stern, *Das Staatsrecht der Bundesrepublik Deutschland* (1988), Vol. III/1, pp. 1509 et seq. A difference from general clauses in international law exists insofar as the international legal system is not a hierarchical system, but is rather characterised by its horizontality. However, this does not preclude the present understanding of systemic interaction through general clauses: see also C. McLachlan, 'The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention', *ICLQ* 54 (2005), p. 279 at pp. 282–283.

<sup>364</sup> From the perspective of a systems theory, see G. Teubner, 'Generalklauseln als sozio-normative Modelle', in K. Lüderssen et al. (eds.), *Generalklauseln als Gegenstand der Sozialwissenschaften* (1978), p. 13.

<sup>365</sup> See also van Aaken (above fn. 357), p. 108, speaking of 'windows'.

<sup>366</sup> See the examples provided in Chapter 2, section A, '3(c) Fair and equitable treatment combined with a reference to general international law'.

<sup>367</sup> See also Douglas (above fn. 135), pp. 87–88. <sup>368</sup> See UNCTAD (above fn. 2), p. 12.

<sup>369</sup> These fears are, e.g. expressed by S. D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration', *Fordham L. Rev.* 73 (2005), p. 1521; T.-H. Cheng, 'Power, Authority and International Investment Law', *Am. U. Int'l L. Rev.* 20 (2005), p. 465 at pp. 512–517; and Chung (above fn. 158), pp. 963–966; the issuance of the NAFTA FTC note of interpretation was clearly driven by such fears and represents an outstanding example of how states have been trying to limit the adjudicatory discretion of arbitral tribunals.

the role of a transparent and comprehensive process of justificatory reasoning.

Within this justificatory process, systemic arguments and references to other judicial authorities appear as important means of increasing the persuasive force of arbitral decisions. To such an extent, a comparative analysis of functionally equivalent concepts in other international legal sub-systems or even national legal systems may enrich and give considerable impulse to the doctrinal discussion concerning fair and equitable treatment. Furthermore, such cross-fertilisation is nothing new – for neither arbitral tribunals nor other international dispute resolution mechanisms – and is considered to provide an important tool for increasing legal certainty within a polycentric legal system.<sup>370</sup> Since the system of investment arbitration does not exhibit a hierarchical structure, the quality of judicial reasoning of individual awards in particular stimulates a process of cross-fertilisation. Thereby, judicial cooperation in this sense is not demanded by a formal rule of *stare decisis*, but rather depends on what is sometimes called 'judicial comity'<sup>371</sup> or 'default deference'.<sup>372</sup> This is to say that judicial bodies of different legal backgrounds enter into a dialogue and by a process of iterative connection of legal decisions try to absorb legal uncertainties.<sup>373</sup>

In summary, the recognition of legal processes in other international legal fora is a tool which enriches the doctrinal concept of fair and equitable treatment. By way of improving the quality of arbitral tribunals' legal reasoning, it is also a means of fostering legal certainty and the persuasiveness of arbitral decisions. Moreover, a construction of fair and equitable treatment which takes other spheres of international law into account is necessary when trying to avoid norm conflicts in a relatively fragmented international legal system. The way in which other general clauses have already received such impulses from their international law environment may serve as an example for the interpretation of fair and equitable treatment.

<sup>370</sup> See Fischer-Lescano and Teubner, 'Regime Collisions' (above fn. 339), p. 1039; and A.-M. Slaughter, *A New World Order* (2005), pp. 69–72.

<sup>371</sup> Slaughter (above fn. 370), pp. 86–87.

<sup>372</sup> Fischer-Lescano and Teubner, 'Regime Collisions' (above fn. 339), p. 1039; and Fischer-Lescano and Teubner, *Regime-Kollisionen* (above fn. 339), pp. 111–126.

<sup>373</sup> Fischer-Lescano and Teubner, 'Regime Collisions' (above fn. 339), pp. 1039–1040; see also Thiele (above fn. 339), pp. 29–31, addressing the question of whether international law entails a duty to cooperate among different international judicial bodies.

### 3 Gateway examples

In the following section, only a few prominent cases are recalled in which international courts or tribunals have established systemic linkages between different international legal sub-systems. In these cases, general clauses have been constructed as gateways through which external arguments were integrated into the reasoning of a particular sub-system of international law.

#### (a) Case concerning *Oil Platforms*

A first example is provided by the ICJ judgment in the case concerning *Oil Platforms (Iran v. USA)*.<sup>374</sup> In this case, Iran claimed that the destruction of its oil platforms by American forces during the first Gulf War between Iraq and Iran, as a response to Iranian attacks on neutral shipping in the Gulf, had violated the freedom of commerce as stipulated in the 1955 Iran-US FCN Treaty. The United States in turn invoked Article XX(1)(d) of the Treaty, which allowed the 'application of measures ... necessary to protect [the] essential security interest'<sup>375</sup> of each contracting party. In spite of the fact that the basis of the court's jurisdiction was limited to the interpretation of the bilateral treaty,<sup>376</sup> the court was unable to accept that the treaty 'was intended to operate wholly independently of the relevant rules of international law on the use of force'.<sup>377</sup> Thus, in the process of constructing Article XX(1)(d) of the treaty, the court took into account the relevant rules on the use of force, as contained in the UN Charter and customary international law, and backed this approach by reference to Article 31(3)(c) of the VCLT.<sup>378</sup> Since the destruction of the oil platforms were ultimately qualified as being unlawful under the general international law of the use of force, the court found that the American attacks could not be justified under Article XX(1)(d) of the treaty.<sup>379</sup>

<sup>374</sup> *Oil Platforms (Iran v. USA)*, ICJ (Judgment of 6 November 2003).

<sup>375</sup> Reprinted in *ibid.*, at para. 32.

<sup>376</sup> Article XXI(2) of the treaty (reprinted in *ibid.*, at para. 31); the present case to such an extent differs from the *Nicaragua* case, where the court was also able to base its jurisdiction on an optional clause to the ICJ Statute (Article 36(2) of the Statute) which did not limit the jurisdiction to the treaty provisions: see *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. USA)*, ICJ (Judgment of 27 June 1986), at para. 36.

<sup>377</sup> *Oil Platforms (Iran v. USA)* (above fn. 374), at para. 41. <sup>378</sup> *Ibid.*, at paras. 41–42.

<sup>379</sup> *Ibid.*, at para. 78; for an in-depth discussion, see, e.g. Koskenniemi (above fn. 339), pp. 228–232.

(b) *Mox Plant* dispute

The next example pertains to a dispute which resulted in a series of proceedings in different fora and which thereby lucidly illustrates the proliferation of international courts and tribunals, possessing overlapping and conflicting jurisdictions.<sup>380</sup> This dispute concerns the operation of the British Mox nuclear reprocessing plant at Sellafield, which was challenged by Ireland for environmental reasons. For present purposes, the Irish claim under the 1992 Convention for the Protection of the Marine Environment of the North-East Atlantic (OSPAR Convention) is of particular significance. Thereby, Ireland alleged that the United Kingdom had failed to provide the necessary information according to Article 9(3)(d) of the OSPAR Convention.<sup>381</sup> Ireland argued that the reference to 'applicable international regulations' in Article 9(3) incorporated evolving international law and practice concerning the access to environmental information, such as the 1992 Rio Declaration and the 1998 Aarhus Convention, into the conventional obligation in dispute.<sup>382</sup> While the tribunal agreed with Ireland that the interpretation of the pertinent conventional provisions, according to Article 31(3)(c) of the VCLT, might take other sources of international law and practice into account, it nevertheless found it inadmissible to draw on sources of law that were not applicable or still in *statu nascendi*.<sup>383</sup> However, the tribunal ultimately rejected the claim on other grounds, since it found that the reports sought by Ireland did not fall under Article 9(2)'s category of information.<sup>384</sup>

<sup>380</sup> See *The Mox Plant Case (Ireland v. United Kingdom)*, International Tribunal for the Law of the Sea (Order of 3 December 2001); *Dispute Concerning Access to Information Under Article 9 of the OSPAR Convention (Ireland v. United Kingdom)*, Permanent Court of Arbitration (Award of 2 July 2003); *The Mox Plant Case (Ireland v. United Kingdom)*, Permanent Court of Arbitration (Order of 24 June 2003); and *Commission v. Ireland ('Mox Plant')*, ECJ Case C-459/03 (Judgment of 30 May 2006).

<sup>381</sup> *Dispute Concerning Access to Information Under Article 9 of the OSPAR Convention (Ireland v. United Kingdom)* (above fn. 380); Article 9(3)(d) of the OSPAR Convention is reprinted at para. 6 of the award.

<sup>382</sup> *Ibid.*, at paras. 96–98.

<sup>383</sup> *Ibid.*, at para. 101; see also the dissenting opinion of Arbitrator Griffith, who at least found the Aarhus Convention to be applicable because the Aarhus Convention was in force and, although not ratified, had already been signed by both parties: ILM 42 (2003) at pp. 1162–1163.

<sup>384</sup> *Ibid.*, at para. 182; for further discussion on the other proceedings of the *Mox Plant* dispute, see, e.g. McLachlan (above fn. 363), pp. 299–302.

## (c) European Court of Human Rights

Further examples are provided by three cases decided jointly by the European Court of Human Rights (ECtHR),<sup>385</sup> concerning the question on the relationship between the law of state immunity and the right to a fair trial and access to court, enshrined in Article 6(1) of the 1950 European Convention on Human Rights (ECHR). In each case, the ECtHR had to decide whether a dismissal of a claim against a third state on the ground of that state's immunity constituted an infringement of the right of access to court by the respondent state. Here, the ECtHR found that the right of access to courts is not absolute, but might be subject to limitations if these limitations pursued a legitimate aim and if there was a reasonable relationship of proportionality between the means employed and the aim sought.<sup>386</sup> Within this proportionality test, the ECtHR, with reference to Article 31(3)(c) of the VCLT, held:

The Convention, including Article 6, cannot be interpreted in a vacuum. The Court must be mindful of the Convention's special character as a human rights treaty, and it must also take the relevant rules of international law into account... The Convention should so far as possible be interpreted in harmony with other rules of international law of which it forms part, including those relating to the grant of state immunity.<sup>387</sup>

Therefore, in all three cases, the ECtHR established a systemic connection through a proportionality test and the judicial process of balancing, in which the right of access to court, stipulated in Article 6(1) of the ECHR, was weighed against the doctrine of immunity of states.<sup>388</sup> In the end, the ECtHR did not find an infringement of the right of access to court in any of the three cases.<sup>389</sup>

<sup>385</sup> *Al-Adsani v. United Kingdom [GC]*, ECtHR Application No. 35763/97 (Judgment of 21 November 2001); *McElhinney v. Ireland [GC]*, ECtHR Application No. 31253/96 (Judgment of 21 November 2001); and *Fogarty v. United Kingdom [GC]*, ECtHR Application No. 37112/97 (Judgment of 21 November 2001).

<sup>386</sup> *Al-Adsani v. United Kingdom [GC]* (above fn. 385), at para. 53.

<sup>387</sup> *Ibid.*, at para. 55; this formulation is to be found identically in all three decisions: see also *McElhinney v. Ireland [GC]* (above fn. 385), at para. 36; and *Fogarty v. United Kingdom [GC]* (above fn. 385), at para. 35.

<sup>388</sup> See also McLachlan (above fn. 363), pp. 305–306.

<sup>389</sup> For a critical analysis of the cases, see E. Voyiakis, 'Access to Court v State Immunity', ICLQ 52 (2003), p. 297.



## (d) Article XX of the GATT

The WTO system, especially Article XX of the GATT,<sup>390</sup> providing general exceptions to the obligations of trade liberalisation, contains a series of open-textured terms that are able to serve as gateways for the establishment of systemic linkages.<sup>391</sup> The WTO Appellate Body has repeatedly availed itself of the opportunity to comment on Article XX and has thereby helped to clarify the systemic relationship between WTO law, other specialised legal sub-systems and international law in general.

A well-known example, in which the Appellate Body has developed its integrative approach in the construction of Article XX, is the case of *US-Shrimps*.<sup>392</sup> In this case, the United States were sued under Article XI of the GATT due to an import ban on shrimp and shrimp products which were not harvested according to US standards prescribing the use of 'turtle excluder devices'. In its assessment of whether the import ban could be justified under Article XX(g) of the GATT, the Appellate Body also referred to Article 31(3)(c) of the VCLT. Thereby, the chapeau of Article XX was highlighted as an expression of the principle of good faith, whose language should be interpreted by 'seeking additional interpretative guidance, as appropriate, from the general principles of international law'.<sup>393</sup> The Appellate Body also emphasised the dynamic nature of Article XX by reading the words of this article 'in the light of contemporary concerns of the community of nations about the protection and conservation of the environment'.<sup>394</sup> In applying this approach, the Appellate Body constructed the open-textured terms in Article XX by

<sup>390</sup> Article XX of the GATT provides:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

...  
(b) necessary to protect human, animal or plant life or health;

...

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption...

<sup>391</sup> On the flexible nature of Article XX of the GATT and Article XXI of the GATS, see also G. Marceau, 'WTO Dispute Settlement and Human Rights', *EJIL* 13 (2002), p. 753 at pp. 789-791.

<sup>392</sup> *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Dispute Settlement Body WT/DS58/AB/R (Report of the Appellate Body of 12 October 1998).

<sup>393</sup> *Ibid.*, at para. 158. <sup>394</sup> *Ibid.*, at para. 129.

drawing considerably on general principles of international law and a number of regulations relevant to the protection of endangered species and the environment. Finally, the import ban did not meet the requirements of Article XX because the measure was applied in an arbitrary and unjustifiable manner.<sup>395</sup>

A similar integrative approach based on Article 31(3)(c) of the VCLT has also been used by a number of other WTO panels,<sup>396</sup> leading to an intense discussion regarding the relationship between WTO law and other international legal regimes and the boundaries that may limit the integration of other legal sources.<sup>397</sup> Altogether, the WTO cases and the other examples of systemic integration, although pertaining to a variety of different areas of international law, exhibit considerable parallels as they all take Article 31(3)(c) of the VCLT as a starting point and apply a similar integrative technique. It is therefore submitted that these examples superbly demonstrate how an analogous process of systemic integration and a related integrative reasoning could be adopted in the context of fair and equitable treatment.

### C Systemic integration of international law arguments

Systemic integration based on Article 31(3)(c) of the VCLT<sup>398</sup> was expressly emphasised by the ILC Study Group on Fragmentation as an important means of ensuring coherence in international law by establishing constructive linkages within the international legal system.<sup>399</sup> Surprisingly, although Article 31(3)(c) has somewhat effusively been referred to as a 'master-key' in the international legal

<sup>395</sup> *Ibid.*, at para. 186; for further discussion of the case and the relationship between WTO law and environmental regulations, see also M. Hilf and S. Oeter, *WTO-Recht* (2005), pp. 590-595; and Lowenfeld (above fn. 3), pp. 388-416.

<sup>396</sup> For an overview and discussion of different cases, see J. Neumann, *Die Koordination des WTO-Rechts mit anderen völkerrechtlichen Ordnungen* (2002), pp. 357-365.

<sup>397</sup> See J. Pauwelyn, 'The Role of Public International Law in the WTO', *AJIL* 95 (2001), p. 535; Marceau (above fn. 391); M. Matsushita, 'Governance of International Trade Under World Trade Organization Agreements', *JWT* 38 (2004), p. 185; M. Hilf and S. Hörmann, 'Die WTO - Ein Gefahr für die Verwirklichung von Menschenrechten?', *ArchVR* 43 (2005), p. 397; Koskeniemi (above fn. 339), pp. 223-228; P. Hilpold, 'Human Rights and WTO Law', *ArchVR* 45 (2007), p. 484; and Herdegen (above fn. 167), pp. 182-184.

<sup>398</sup> Article 31(3)(c) of the VCLT provides: 'There shall be taken into account, together with the context: ... (c) any relevant rules of international law applicable in the relations between the parties'.

<sup>399</sup> ILC (above fn. 339), at para. 17.

system,<sup>400</sup> the technique of systemic integration is only beginning to attract attention in the area of international investment law.<sup>401</sup> Arguably, a sincere application of this technique in the construction of fair and equitable treatment represents a possible way of broadening the justificatory basis and integrating arguments that are necessary for a convincing and coherent reasoning in arbitral awards. To this extent, Article 31(3)(c) provides useful guidance on the questions wherefrom justificatory arguments and reasons may be derived and what kind of limitations exist regarding the admissibility of arguments. As the examples mentioned above have shown, an integrative approach in this sense is a widespread phenomenon in a variety of different areas of international law. The examples also indicated which issues in the application of Article 31(3)(c) on fair and equitable treatment need further consideration. These are the determination of the 'relevant rules of international law', their applicability between the parties and the question of inter-temporality.

### 1 Relevant rules of international law

At first, the search for the 'relevant rules of international law' to be taken into account when applying Article 31(3)(c) of the VCLT leads to Article 38(1) of the ICJ Statute, defining the sources of international law: international conventions, international custom and general principles of law. In this sense, it is also quite well accepted in scholarly literature that, in principle, Article 31(3)(c) may refer to all of these sources of law.<sup>402</sup> This is confirmed by the judicial authorities in the above examples, which in their constructions have referred to all three sources of law. Nevertheless, it is also necessary to bear in mind certain limitations.

#### (a) *Lex specialis* rules

In the special context of international investment law, it is crucial to be aware of the fact that one objective of concluding investment agreements was to avoid the deficient rules of customary international law

<sup>400</sup> McLachlan (above fn. 363), pp. 280–281. Others have called the provision a 'clasp' or a 'bridge' for the inter-connection of diverging international legal sub-systems: see Neumann (above fn. 396), p. 357.

<sup>401</sup> See, e.g. McLachlan, Shore and Weininger (above fn. 63), pp. 67 and 222–223.

<sup>402</sup> See, e.g. Jennings and Watts (above fn. 124), p. 1275, especially in fn. 21; Neumann (above fn. 396), p. 366; McLachlan (above fn. 363), p. 290; Koskenniemi (above fn. 339), pp. 214–215; and U. Linderfalk, *On the Interpretation of Treaties* (2007), p. 177.

that initially governed the protection of investors.<sup>403</sup> Constructions of fair and equitable treatment that would revive these customary rules and introduce them 'by the back-door' into the investment treaty regime would foil the attempts of states to create a specialised and tailored conventional regime for the protection of investors.<sup>404</sup> Therefore, investment treaty norms should not be construed in analogy to customary rules if it was the very intention of the concluded treaty to superpose these particular customary rules. In that event, it rather seems that the conventional norm represents a *lex specialis*, which takes precedence over arguments derived from the more general norm.<sup>405</sup> In the construction of fair and equitable treatment, this consideration forms a further argument against the equation of fair and equitable treatment with the classical minimum standard. As the minimum standard belonged to the eschewed customary regime, arguments based on the minimum standard are relevant, only if there are no special arguments taking precedence. However, the establishment of a relation of speciality between certain groups of arguments is also to be based on convincing reasons buttressing the exclusion of more general arguments.

#### (b) The matter of limited jurisdiction

A more far-reaching constraint in the determination of the relevant rules may result from the deliberation that investment tribunals only possess a restricted ambit of jurisdiction. This argument has already been made in other fora. For instance, in his separate opinion in the *Oil Platforms* case, Judge Buergenthal pointed out that the relevant rules under Article 31(3)(c) of the VCLT had to be limited to those rules, with regard to which the jurisdiction of the ICJ had been accepted by the parties.<sup>406</sup> Furthermore, he emphasised that any taking into account of rules beyond the ICJ's scope of jurisdiction 'would conflict with the consensual basis of the court's jurisdiction and would jeopardise the willingness of states to accept the court's jurisdiction for the adjudication of disputes'.<sup>407</sup>

<sup>403</sup> See Z. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration', BYIL 74 (2003), p. 151 at p. 182.

<sup>404</sup> McLachlan, Shore and Weininger (above fn. 63), pp. 17 and 223.

<sup>405</sup> See Koskenniemi (above fn. 339), pp. 30 et seq.

<sup>406</sup> *Oil Platforms (Iran v. USA)* (above fn. 374), p. 1410, at para. 22.

<sup>407</sup> *Ibid.*; on the issue of the ICJ's jurisdiction in the *Oil Platform* case, see also E. Cannizzaro and B. Bonafé, 'Fragmenting International Law through Compromissory Clauses?', EJIL 16 (2005), p. 481.

In international investment law, a similar argumentation was advanced in the judicial review of the *Metalclad* award. Thereby, Justice Tysoe denied that the *Metalclad* tribunal construed Article 1105 of the NAFTA correctly and found that the arbitral tribunal 'misstated the applicable law to include transparency obligations, and it then made its decision on the basis of the concept of transparency'.<sup>408</sup> Justice Tysoe substantiated this by observing that the transparency obligations were contained in NAFTA Chapter 18 and that the right to submit a claim to arbitration was limited to Chapters 11 and 15.<sup>409</sup> He concluded that the tribunal 'decided a matter beyond the scope of the submission to arbitration' and hence set aside the award.<sup>410</sup>

These two examples propose that a construction of a treaty provision, according to Article 31(3)(c) of the VCLT, may not take into account any arguments that are based on norms beyond the scope of jurisdiction conferred to the particular judicial body. However, if the latter is true, what norms of international law are otherwise comprised by Article 31(3)(c) VCLT? Since the 'nearer' context is already part of Article 31(1) and (2), Article 31(3) would be deprived of any practical relevance if it did not relate to such rules of international law that belong to a 'wider' context. Therefore, the narrow understanding of Article 31(3)(c), as maintained by Judge Buergenthal and Justice Tysoe, leads to a construction of treaty provisions that is entirely independent of their normative environment, thereby virtually nullifying the meaning of Article 31(3)(c).<sup>411</sup>

Judge Buergenthal and Justice Tysoe may have overlooked another point as well, which has been spelled out on various occasions in parallel discussions in the WTO context: the distinction between jurisdiction and applicable law.<sup>412</sup> While the jurisdiction of WTO panels and the Appellate Body is of course limited to the WTO agreements,<sup>413</sup> the applicable law that might be taken into account is deemed much wider<sup>414</sup> or even unlimited.<sup>415</sup> Thereby, the limited jurisdiction implies

<sup>408</sup> *Mexico v. Metalclad Corp.* (above fn. 224), at para. 70; for further details of the *Metalclad* case, see Chapter 3, section B, '1(a) The *Metalclad* and S.D. Myers approach'; on the judicial review proceeding, see also Foy and Deane (above fn. 176), pp. 325-329; and Thomas (above fn. 213), pp. 81-90.

<sup>409</sup> *Mexico v. Metalclad Corp.* (above fn. 224), at para. 58. <sup>410</sup> *Ibid.*, at para. 76.

<sup>411</sup> Koskenniemi (above fn. 339), p. 230.

<sup>412</sup> L. Bartels, 'Applicable Law in WTO Dispute Settlement Proceedings', *JWT* 35 (2001), p. 499 at pp. 501-502; Pauwelyn (above fn. 397), pp. 554-565; and Marceau (above fn. 391), pp. 757-779.

<sup>413</sup> See Article 1.1 of the WTO Dispute Settlement Understanding.

<sup>414</sup> Marceau (above fn. 391), pp. 766-767. <sup>415</sup> Pauwelyn (above fn. 397), p. 566.

that non-WTO law may not form the legal basis of a WTO complaint<sup>416</sup> or, more far-reaching, may not be given direct effect in the WTO legal system.<sup>417</sup> However, it is not to be assumed that the WTO members, despite not putting external legal obligations under the control of the WTO enforcement mechanisms, do not want to comply with such external legal obligations. Thus, for the sake of coherence, such external sources of international law may indeed have an indirect effect in the WTO legal system and may be taken into account in the process of judicial reasoning on a specific WTO provision.<sup>418</sup>

A similar approach is widely acknowledged in international investment law. While the jurisdiction of arbitral tribunals in an investor-state dispute is based on a particular international investment agreement, the scope of applicable law may go far beyond the provisions contained in such an investment agreement.<sup>419</sup> In international investment law, the latter is even more obvious than it is in the WTO context, since the applicable substantive law in investment arbitration is heavily controlled by the parties' choice of law and the rules on conflict of laws.<sup>420</sup> The explicit choice of law that has been made in many dispute settlement provisions of investment agreements refers to the particular provisions of the investment agreement, the relevant rules of international law and, sometimes, the domestic law of the host state as well.<sup>421</sup> Even if investment agreements do not contain a choice of law clause, the applicability of other rules of international law in investment arbitration proceedings is not in question.<sup>422</sup>

The broad range of sources of law that are deemed directly applicable in investment disputes suggests that an integrative construction of fair

<sup>416</sup> *Ibid.* <sup>417</sup> Marceau (above fn. 391), pp. 777-778.

<sup>418</sup> Bartels (above fn. 412), p. 510; Marceau (above fn. 391), p. 779; Hilf and Hörmann (above fn. 397), p. 421; and Herdegen (above fn. 167), p. 183.

<sup>419</sup> Thereon, see Douglas (above fn. 403), pp. 194-213; UNCTAD, *International Investment Agreements*, UNCTAD/ITE/IIT/2004/10, Vol. 1 (2004), pp. 365-366; Dolzer and Schreuer (above fn. 54), pp. 265-271; and Newcombe and Paradell (above fn. 3), pp. 75 et seq.

<sup>420</sup> See, e.g. Article 42 of the ICSID Convention and Article 33 of the UNCITRAL Arbitration Rules; on choice of law clauses, see Rubins and Kinsella (above fn. 46), pp. 45-50.

<sup>421</sup> See, e.g. Article 1131(1) of the NAFTA, Article 26 of the ECT, Article 30 of the 2004 US Model BIT and Article 8(3) of the Sri Lanka Model BIT (reprinted in McLachlan, Shore and Weininger (above fn. 63), p. 429).

<sup>422</sup> See Dolzer and Schreuer (above fn. 54), p. 269; Tudor (above fn. 2), p. 13; Newcombe and Paradell (above fn. 3), p. 102; and especially Douglas (above fn. 135), p. 81, emphasising that, 'in arriving at a conception of the investment treaty protection standards, the tribunal must inevitably have recourse to general international law and conventional international law for otherwise it would be interpreting the legal standards in a void'.

and equitable treatment is possible - in a manner that takes into account the normative environment as envisaged by Article 31(3)(c) of the VCLT.<sup>423</sup> What is more, the possibly limited jurisdiction of arbitral tribunals does not provide suitable arguments to restrict the sources of international law that provide reasons for the construction of fair and equitable treatment. Consequently, the findings of Justice Tysoe in the *Metalclad* appeal seem to disregard the distinction that has to be made between jurisdiction and applicable law. Even if Justice Tysoe's observation is admittedly right that the NAFTA parties did not extend the right to arbitration to the transparency obligations in Chapter 18, he misconceived that a particular construction of fair and equitable treatment relying on transparency arguments does not give direct effect to these exact transparency obligations in an investment dispute.

After all, there are no compelling reasons militating against an understanding of Article 31(3)(c) of the VCLT that allow for the consideration of arguments from all other sources of international law, despite the limited jurisdiction of arbitral tribunals.<sup>424</sup> In particular, the integration of arguments from other sources of law into the reasoning on fair and equitable treatment does not mean that these other norms of international law are given direct effect through fair and equitable treatment.<sup>425</sup> Rather, the process of justificatory reasoning on fair and equitable treatment is a more complex one, by means of which the other international law norms only come into effect indirectly. Thereby, the process of judicial reasoning may be compared with a filter which applies to arguments that are systemically integrated from other norms of international law into the concept of fair and equitable treatment. For the construction of such a concept of fair and equitable treatment, it is important to be aware that principally all sources of international law may be of relevance. Thus, the process of reasoning is not narrowed, from the outset, to a particular source of law or to a particular set of arguments.

<sup>423</sup> Caution has to be exercised when trying to integrate arguments derived from national law because it is an important aim of investment agreements to ensure the compliance of domestic law with international law. This aim must not be thwarted. In a conflict between domestic law and international law, it is therefore the latter which usually takes precedence. See Dolzer and Schreuer (above fn. 54), pp. 270-271.

<sup>424</sup> See also *Merrill & Ring Forestry L.P. v. Canada* (above fn. 326), at paras. 184 et seq.

<sup>425</sup> On the distinction between indirect application via Article 31(3)(c) of the VCLT and direct application of international law in investment disputes, see also van Aaken (above fn. 357), p. 100.

## 2 *Applicability between the parties*

Article 31(3)(c) of the VCLT further requires the relevant rules of international law to be 'applicable in the relation between the parties'. While international custom and general principles of law are held to be universally applicable, this requirement is critical if considering other conventional agreements.<sup>426</sup> In the determination of the applicability between the parties, four possible solutions can be discerned:<sup>427</sup> first, all parties to the treaty at issue are also required to be parties to the treaty that provides arguments for the process of judicial reasoning. Second, only the parties in dispute<sup>428</sup> need to be parties to any other treaty relied upon for argumentative purposes. Third, not all parties to the treaty under interpretation are also parties to the other treaty referred to, but the norm provided by it is deemed to be part of customary international law. Fourth, all parties to the treaty under consideration have at least implicitly accepted the other norm, upon which an argument relies.<sup>429</sup>

Arguably, since international investment law mostly comprises BITs, a narrow understanding of the applicability between the parties usually appears appropriate, requiring that the parties to the BIT also feel bound to the other norm that is referred to in the process of judicial reasoning. As multilateral investment agreements are concerned, such an understanding becomes more problematic because it would considerably limit the scope of Article 31(3)(c) of the VCLT. In contrast, it has been argued that the construction of a particular provision should not be dependent on the parties involved in a specific dispute, but should rather be consistent irrelevant of which party is concerned.<sup>430</sup> On this question, however, a clear and easy answer is not yet apparent, but needs to be determined in consideration of the effectiveness of Article

<sup>426</sup> Koskeniemi (above fn. 339), p. 237.

<sup>427</sup> See McLachlan (above fn. 363), p. 314; and Thiele (above fn. 339), p. 26.

<sup>428</sup> In international investment law, the 'parties in dispute' must relate to the home and host states which are parties to the investment agreement out of which the particular investment dispute arises. This additional explanation is due to the idiosyncratic structure of investment disputes which usually emerge in the form of investor-state arbitrations. Thereby, the investor as a private individual or corporation is of course a party neither to the investment treaty itself nor to any other international agreement. Therefore, only the home and host states, but not the investor, are relevant for the determination of the applicability between the parties.

<sup>429</sup> The feasibility of such an interpretational approach is, e.g. indicated by *United States - Import Prohibition of Certain Shrimp and Shrimp Products* (above fn. 392), at para. 130, especially at fn. 110.

<sup>430</sup> McLachlan (above fn. 363), p. 315; and Thiele (above fn. 339), pp. 26-27.

31(3)(c) and the principle of *pacta tertiis nec nocent nec prosunt* as contained in Article 34 of the VCLT.<sup>431</sup> It is yet to be seen what approach investment tribunals take in this respect. Nevertheless, it seems at least that the more the argumentative burden rises, the more controversial the applicability of a particular norm between the parties to an investment agreement becomes.

### 3 Inter-temporality

The issue of inter-temporality relates to the question concerning the relevant moment for the determination of the international law norms that can be taken into account in an integrative process of reasoning, according to Article 31(3)(c) of the VCLT. As has been described, this question has already provoked considerable discussion within the equating approach, which attempts to shape the meaning of fair and equitable treatment in line with the customary minimum standard. Thereby, some wanted to refer to the minimum standard in its classical sense, as it appeared in the 1920s. Others emphasised the evolutionary character of customary law, thus wanting to refer to the minimum standard as it stood when the NAFTA was concluded in 1992 or even to the state of law at the time of the application of the treaty provision.<sup>432</sup>

On the issue of inter-temporality, *Oppenheim's International Law* provides that a 'treaty is to be interpreted in the light of general rules of international law in force at the time of its conclusion'.<sup>433</sup> However, it is also acknowledged that treaty provisions 'cannot be divorced from developments in the law subsequent to its adoption' and that some 'concepts embodied in a treaty may be not static but evolutionary'.<sup>434</sup> The state of the law at the time of the conclusion of the treaty is thus deemed to 'provide at least the starting point for arriving at the proper interpretation of the treaty'.<sup>435</sup> The exact moment at which leaving this

<sup>431</sup> For a narrow understanding of the applicability between the parties, in line with the first and third alternative identified, see *European Communities - Measures Affecting the Approval and Marketing of Biotech Products*, WTO Dispute Settlement Body WT/DS291/R (Report of the Panel of 29 September 2006), at paras. 7.67 et seq.; see also McLachlan (above fn. 363), p. 315; for a slightly broader understanding, see Koskenniemi (above fn. 339), pp. 238-239; and for further differentiation, see Neumann (above fn. 396), pp. 368-387.

<sup>432</sup> See Chapter 3, section B, '3(b) Evolutionary character of the customary minimum standard'.

<sup>433</sup> Jennings and Watts (above fn. 124), p. 1281. <sup>434</sup> *Ibid.*, p. 1282. <sup>435</sup> *Ibid.*

starting point and paying regard to the evolution of law subsequent to the adoption of a treaty appears appropriate is held to be dependent on the parties' intentions, which are deduced from the object and purpose of the relevant treaty provision.<sup>436</sup> Within the recent discussion on the fragmentation of international law, some instances have been identified in which the timely evolution of law shall be relevant in the application of a treaty: this is the use of a term carrying with it an evolving meaning without an idiosyncratic definition or the description of obligations in very general terms.<sup>437</sup>

Both characteristics seem to fit perfectly with a general clause such as fair and equitable treatment. Therefore, it appears hardly controvertible that fair and equitable treatment depicts one of these concepts referred to in *Oppenheim's International Law* which are 'not static but evolutionary'. This may also explain why the idea of the evolutionary character of the minimum standard in the construction of fair and equitable treatment is so widely accepted. To this extent, Article 31(3)(c) of the VCLT provides no reasons to suggest that the line of thought on fair and equitable treatment should be limited to the state of international law at some point in time. Rather, it supports a way of constructing fair and equitable treatment that is considerate of its normative environment as it stands at the time of the application and not as it stood at any earlier time.<sup>438</sup> This understanding is further strengthened when bearing in mind that since the beginning of the BIT movement, fifty years have already elapsed.<sup>439</sup> Moreover, an approach constructing every single fair and equitable treatment clause in a distinctive way, in accordance with its particular normative environment as it stood at a whole range of different stages in time, appears quite awkward. Such an approach would not only threaten a consistent application of international investment law, but would also appear equally ungrounded in arbitral practice.

<sup>436</sup> See R. Higgins, 'Time and the Law', ICLQ 46 (1997), p. 501 at pp. 515-519; and Thiele (above fn. 339), p. 28.

<sup>437</sup> McLachlan (above fn. 363), pp. 316-317; Koskenniemi (above fn. 339), pp. 242-243; in favour of an evolutionary construction, see also Neumann (above fn. 396), p. 367.

<sup>438</sup> In favour of a flexible approach to inter-temporality, see also van Aaken (above fn. 357), pp. 110-111.

<sup>439</sup> The first BIT was signed between Germany and Pakistan on 25 November 1959; on the BIT movement, see Chapter 2, section B, '1(b) The proliferation of international investment agreements'.

### D Conclusion: the integrative construction of fair and equitable treatment

In conclusion, a systemically integrative reasoning in accordance with Article 31(3)(c) of the VCLT appears to be a useful tool by means of which systemic linkages may be established before irreconcilable conflicts of norms arise.<sup>440</sup> Although Article 31(3)(c) of the VCLT applies to all kinds of conventional clauses, vague general clauses are especially amenable to act as gateways for the integration of arguments based on norms of other spheres of the international legal system. Thereby, fair and equitable treatment is a quasi international law archetype of a general clause the dynamics of which and linkage to international law has always (at least partly) been acknowledged, by both the equating and plain meaning approaches. The relatively new discussion pertaining to the fragmentation of international law provides for novel arguments which help to shed light on the complex relationship between fair and equitable treatment and other sub-systems of international law.

Furthermore, a way of constructing fair and equitable treatment that establishes systemic linkages discloses possibilities for increasing the maturity of international investment law. On the one hand, this is because such reasoning does not hinder a growing specialisation of international investment law, which therefore is able to provide for a sophisticated and fitted framework for the international regulation of foreign investment. Without such an idiosyncratic framework, it would hardly be possible to grasp the complex economic system of global capital movements, creating in turn legal uncertainty in a field of enormous economic importance. On the other hand, it seems important that a specialised legal sub-system does not decouple from the general international legal system. To this extent, an integrative construction of fair and equitable treatment guarantees that international investment law maintains contact with other social and legal developments and ensures that arbitral decisions are based on a broader argumentative foundation.

Moreover, systemic integration is not only a general tool to ensure some coherence in a relatively fragmented international legal system, but it also addresses and enlightens a series of questions which are at the core of the discussions surrounding fair and equitable treatment. Thereby, it has been shown that fair and equitable treatment, as a

<sup>440</sup> See also Neumann (above fn. 396), p. 440; and McLachlan (above fn. 363), p. 318.

general clause, is a dynamic concept that may be constructed in light of all different sources of international law, as they stand at the time of the application of the particular fair and equitable treatment clause. This implies the rejection of the equating and plain meaning approaches. Both approaches have for a long time dominated the discourse on fair and equitable treatment, but were ultimately incapable of explaining comprehensively the role of international law in the construction of fair and equitable treatment. In particular, the rejection of the equating and plain meaning approaches entails the refusal of the associated limitations of the reasoning to mainly textual or historic arguments, which by themselves only provide an insufficient justification for arbitral decisions on fair and equitable treatment.

The submitted method for constructing fair and equitable treatment allows for an undisguised view on the different sources of arguments that may be taken into account in the process of justificatory reasoning – without being based on the wrong premise of pegging a high or low level of protection for foreign investors. By considering arguments from any source of international law, tribunals have the opportunity to provide comprehensive reasoning and thereby to manage all social and legal developments influencing a particular investment dispute. However, this does not trigger a direct effect or direct applicability of other norms of international law in a particular investment dispute.<sup>441</sup> Rather, other international law norms only have an indirect effect by delivering arguments for particular constructions of fair and equitable treatment. The latter aspect is especially neglected by critics who object that an integrative approach of constructing fair and equitable treatment appears too far-reaching<sup>442</sup> without differentiating between direct and indirect applicability of other international law sources. Moreover, such criticism appears to be unaware of the discussion on the fragmentation of international law and the important role and function that general clauses have to play in this respect.

The foregoing has attempted to shed light on the questions regarding the sources wherefrom justificatory arguments and reasons may be derived as well as the kind of existing limitations for the admissibility of such arguments. Thereby, it has become clear that fair and equitable

<sup>441</sup> See also Neumann (above fn. 396), p. 388.

<sup>442</sup> However, on a discussion of institutional concerns, see van Aaken (above fn. 357), pp. 124 et seq. For a recent advocacy in favour of a narrow construction of fair and equitable treatment, see, e.g. Orakhelashvili (above fn. 2), p. 104.

treatment mainly serves as a gateway for the systemic integration of other sources of international law. Nevertheless, the specific argumentative patterns to which arbitral tribunals actually refer, in order to justify their decisions on fair and equitable treatment, remain unidentified. These patterns and the pertaining concept of fair and equitable treatment will be analysed in the next part.

## PART II

### The concept of fair and equitable treatment

## 5 Conceptual challenges

### A Conceptual problems in arbitral jurisprudence

This part is devoted to an analysis of the substance of fair and equitable treatment and its underlying conceptual basis. While the previous discussion mainly focused on the question regarding wherefrom justificatory arguments may be derived, the following will delve into the subject matter of these arguments and the specific constructions of fair and equitable treatment built by arbitral tribunals thereupon. In particular, an attempt is made to identify and discuss certain sources of arguments which different strands of arbitral jurisprudence are beginning to display, and to explore the deeper conceptual foundation of these schemes. Arguably, this foundation has to reflect the aforementioned findings that fair and equitable treatment is not equipped with some intrinsic meaning, but is rather of an integrative and dynamic nature enabling the establishment of inter-systemic linkages within the international legal system. Moreover, this part reviews if and in which way such a conceptualisation is able to improve the quality of legal reasoning in relation to fair and equitable treatment.

In the general debate on fair and equitable treatment, it appears that considerations as to the concept of this norm are mainly absent. Rather, it seems that doctrinal discussions reaching beyond the dichotomy between the equating and plain meaning approaches are often avoided by highlighting the fact-specific nature of fair and equitable treatment.<sup>443</sup> Considering that arbitral tribunals have to apply the guarantee of fair and equitable treatment in a specific case, they should indeed take a close look at the contentious facts of this case. However, the fact-driven

<sup>443</sup> See, e.g. *ADC Affiliate Ltd and ADC & ADMC Management Ltd v. Hungary*, ICSID Case No. ARB/03/16 (Award of 2 October 2006), at para. 445; see also Lowe (above fn. 323), p. 73.



approach of arbitral tribunal often goes to such lengths that, in an award, the description of the facts is expatiated in dozens of pages, while the doctrinal concept of fair and equitable treatment is touched, if at all, in very few paragraphs. Excluding some enlightening explanations,<sup>444</sup> arbitrators obviously do not want to go out on a limb in such a shaky and controversial area as the doctrinal concept of fair and equitable treatment. If further guidance is expected from legal scholarship to such an extent, possibly discussing different conceptual schemes or alternative models of reasoning,<sup>445</sup> the result is often equally disappointing. Although scholarly literature on fair and equitable treatment has grown rapidly within recent years,<sup>446</sup> these writings are often satisfied with analysing and categorising existing case law and seldom go beyond that.

### 1 *Topoi in arbitral jurisprudence*

Nevertheless, certain patterns of argumentation on fair and equitable treatment seem to have emerged, gradually filling the concept of this norm with a sense of content. Methodologically, these patterns are based on the augmentation of factual schemes, shorthand definitions and the practice of cross-referencing with decisions rendered by previous tribunals.<sup>447</sup> Tribunals frequently refer to these recurring patterns of argumentation, or *topoi*,<sup>448</sup> as a source of arguments upon which a specific case may be decided. Although arbitral tribunals do not yet employ a fully consistent nomenclature, these *topoi* become increasingly accepted and elaborated in arbitral jurisprudence. Although not completely separable, the following five lines of jurisprudence may be discerned:<sup>449</sup>

<sup>444</sup> See, e.g. the separate opinion of Arbitrator Wälde in *International Thunderbird Gaming Corp. v. Mexico*, UNCITRAL (Separate Opinion by Thomas W. Wälde of 26 January 2006).

<sup>445</sup> On the function of doctrinal scholarship, see, e.g. R. Alexy, *Theorie der juristischen Argumentation*, 1st edn (1978), pp. 326 et seq.; and M. Koskenniemi, 'International Legal Theory and Doctrine', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (Online Publication) (2009).

<sup>446</sup> See the selection provided in Chapter 1.

<sup>447</sup> On the methodological approaches in arbitral jurisprudence, see Chapter 2, section B, '3(a) Methodological approaches to fair and equitable treatment'.

<sup>448</sup> On the role of *topoi* in legal theory, see generally K. Larenz, *Methodenlehre der Rechtswissenschaft*, 6th edn (1991), pp. 145 et seq.

<sup>449</sup> Similar lists are, e.g. provided by the tribunals in *Bewater Gauff Ltd v. Tanzania*, ICSID Case No. ARB/05/22 (Award of 18 July 2008), at para. 602; *Rumeli Telekom SA and Telsim Mobil Telekomikasyon Hizmetleri AS v. Kazakhstan* (above fn. 10), at para. 609; *Waguih Elie George Siag and Clorinda Vecchi v. Egypt*, ICSID Case No. ARB/05/15 (Award of 1 June 2009), at para. 450; and *Bayindir Insaat Turizm Ticaret ve Sanayi AS v. Pakistan* (above fn. 20), at para. 178.

#### (1) *Legitimate expectations*:<sup>450</sup>

Fair and equitable treatment is often said to require the protection of the investors' legitimate expectations. The protection of such expectations covers the abidance to promises and covenants that have been given to the investor and upon which the investor has relied. In this context, arbitral tribunals have also found that the protection of expectations is closely intertwined with a certain level of stability and consistency in the legal framework of the host state.

#### (2) *Non-discrimination*:<sup>451</sup>

Unfair and inequitable treatment may also be found due to state authorities' different forms of discriminatory behaviour towards a foreign investor. Thereby, arbitral tribunals do not only compare the types of treatment accorded to different investors, but also examine whether the state action involves arbitrariness or harassment.

<sup>450</sup> There to, see *Ronald S. Lauder v. Czech Republic*, UNCITRAL (Final Award of 3 September 2001), at paras. 297 et seq.; *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 154; *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at paras. 183–185; *CMS Gas Transmission Co. v. Argentina* (above fn. 102), at paras. 274–279; *Eureko BV v. Poland*, UNCITRAL (Partial Award of 19 August 2005), at paras. 231–235; *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at paras. 147 et seq.; *Saluka Investments BV v. Czech Republic* (above fn. 132), at paras. 301 et seq.; *LG&E Energy Corp and others v. Argentina*, ICSID Case No. ARB/02/1 (Decision on Liability of 3 October 2006), at paras. 124 and 127–131; *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey*, ICSID Case No. ARB/02/5 (Award of 19 January 2007), at paras. 240–241 and 250; *Enron Corp. and Ponderosa Assets LP v. Argentina* (above fn. 302), at paras. 260–265; *MCI Power Group LC, New Turbin Inc v. Ecuador*, ICSID Case No. ARB/03/6 (Award of 31 July 2007), at para. 278; *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at paras. 329 et seq. and 341 et seq.; *BG Group Plc. v. Argentina*, UNCITRAL (Award of 24 December 2007), at para. 310; *Metalpar SA and Buen Aire SA v. Argentina*, ICSID Case No. ARB/03/5 (Award of 6 June 2008), at paras. 182–188; and *Walter Bau AG v. Thailand*, UNCITRAL (Award of 1 July 2009), at para. 12.1.

<sup>451</sup> See *S.D. Myers Inc v. Canada* (above fn. 95), at para. 263; *Ronald S. Lauder v. Czech Republic* (above fn. 450), at paras. 237 et seq. and 293–295; *Nykomb Synergetics Technology Holding AB v. Latvia*, SCC Arbitration Institute (Award of 16 December 2003), at para. 4.3.2; *CMS Gas Transmission Co. v. Argentina* (above fn. 102), at para. 290; *Saluka Investments BV v. Czech Republic* (above fn. 132), at paras. 307 and 460; and *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at paras. 280 and 287 et seq.; on the contrary, it has also been found that non-discrimination is not comprised by Article 1105(1) of NAFTA: see *Methanex Corp. v. United States* (above fn. 275), at part IV, chapter C, paras. 14 et seq.

- (3) *Fair procedure*:<sup>452</sup> Under this heading, fair and equitable treatment demands that judicial and administrative procedures are shaped and exercised in a way that endows the investor with the possibility to bring to bear adequately his rights and interests. Tribunals deal with this aspect of fair and equitable treatment mostly under the categories of due process and/or denial of justice.
- (4) *Transparency*:<sup>453</sup> On various occasions, arbitral tribunals have also identified a lack of transparency as a possible ground for liability of the host state. Transparency in this sense requires the investment-related legal framework and procedures of the host state to be readily apparent for the investor; it must be distinguishable with which regulations and administrative decisions the investor has to conform.
- (5) *Proportionality*:<sup>454</sup> Arbitral tribunals sometimes invoke an element relating to the ideas of proportionality and

reasonableness in the context of fair and equitable treatment. This element presupposes that: any state measure affecting the investment is built upon a reasonable and traceable rationale; the measure strains the investment not more than necessary; and the interests of the state and the foreign investor should be weighed against each other.

## 2 Quality of the concept

The emergence of *topoi* in arbitral jurisprudence marks a further step in the construction of a concept of fair and equitable treatment and endows its vague notions with a degree of substance. It is therefore not astonishing that the analysis and the categorisation of the different *topoi* of fair and equitable treatment - often also referred to as sub-elements or components - have become the main field of activity of legal scholars interested in this provision.<sup>455</sup> Accordingly, the prevalent *modus operandi* is to concretise fair and equitable treatment by defining elements and factual settings in which the standard has been applied.<sup>456</sup> In doing so, the extrapolation of 'factors which may give rise to a breach of the standard'<sup>457</sup> is considered as a common aim of legal scholarship accompanying the proceeding arbitral jurisprudence.<sup>458</sup> Therefore, the legal discussion on fair and equitable treatment seems to focus on the simplification of fair and equitable treatment, in order to split this bulky provision into an easily manageable set of factors, rules and precedents. At the end of such a process of lowering complexity, one might expect a fully differentiated set of criteria, indicating in any possible case whether or not there has been an infringement of fair and equitable treatment.

However, as is also partially admitted by other authors,<sup>459</sup> a complete specification of the concept of fair and equitable treatment appears not

<sup>452</sup> For a selection of arbitral decisions that have dealt with this aspect of fair and equitable treatment, see *Robert Azinian and others v. Mexico* (above fn. 223), at paras. 97-103; *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia* (above fn. 96), at paras. 364 and 371; *Mondev International Ltd v. United States* (above fn. 100), at paras. 126-127 and 154; *Marvin Roy Feldman Karpa v. Mexico*, ICSID Case No. ARB(AF)/99/1 (Award of 16 December 2002), at paras. 138 et seq.; *Loewen Group Inc. and Raymond L. Loewen v. United States* (above fn. 276), at paras. 129 and 153; *Waste Management v. Mexico* (above fn. 102), at paras. 95-99; *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at paras. 197-201; *ADC Affiliate Ltd and ADC & ADMC Management Ltd v. Hungary* (above fn. 443), at paras. 435 and 445; *Compañía de Aguas de Aconquija SA and Vivendi Universal SA v. Argentina*, ICSID Case No. ARB/97/3 (Award of 20 August 2007), at paras. 7.4.10-7.4.12; *Victor Pey Casado and President Allende Foundation v. Chile*, ICSID Case No. ARB/98/2 (Award of 22 April 2008), at paras. 653 et seq.; and *ATA Construction, Industrial and Trading Co. v. Jordan*, ICSID Case No. ARB/08/2 (Award of 18 May 2010), at para. 125.

<sup>453</sup> See, e.g. *Metalclad Corp. v. Mexico* (above fn. 224), at paras. 76 and 99-100; *Emilio Agustín Maffezini v. Spain*, ICSID Case No. ARB/97/7 (Award of 13 November 2000), at para. 83; *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 154; *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at paras. 183 et seq.; and *Champion Trading Co. and Ameritrade International Inc. v. Egypt*, ICSID Case No. ARB/02/9 (Award of 27 October 2006), at paras. 157 et seq.

<sup>454</sup> For examples of arbitral decisions which at least indicate such a proportionality test, see *Pope & Talbot Inc. v. Canada* (above fn. 245), at paras. 123, 125 and 128; *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 109; *Saluka Investments BV v. Czech Republic* (above fn. 132), at paras. 304 et seq., 460 and 499; and *EDF (Services) Ltd v. Romania*, ICSID Case No. ARB/05/13 (Award of 2 October 2009), at para. 293.

<sup>455</sup> See, e.g. Choudhury (above fn. 2), pp. 302-316; C. Schreuer, 'Fair and Equitable Treatment', TDM 2 (2005), issue 5, pp. 373-385; Klein Bronfman (above fn. 2), pp. 637-663; Kreindler (above fn. 2), pp. 9-12; McLachlan, Shore and Weininger (above fn. 63), pp. 226-247; Dolzer and Schreuer (above fn. 54), pp. 133-149; and Tudor (above fn. 2), pp. 154-181.

<sup>456</sup> See also Wälde (above fn. 54), especially pp. 46-47.

<sup>457</sup> McLachlan, Shore and Weininger (above fn. 63), p. 235.

<sup>458</sup> See, e.g. Lowe (above fn. 323), p. 73. <sup>459</sup> Tudor (above fn. 2), pp. 154-155.

to be feasible solely by means of case law. Since new fact situations will always evolve where arbitrators find little or no guidance from pre-existing lines of jurisprudence, the image of a mechanical arbitrator underlying many of these attempts to simplify fair and equitable treatment is misleading. Consequently, precedents always represent past decisions, the force of expression of which is limited when deciding cases with new fact situations or borderline cases in which it is not clear *ab initio* whether they are covered by any precedent. However, it is exactly in these cases – which are the difficult ones<sup>460</sup> – where a mere casuistic approach is unable to provide any criteria that could guide an arbitrator.<sup>461</sup>

If, however, precedents do not furnish the decision-maker with a clear rule, according to which criteria should an arbitrator then decide? Perhaps there are no legal criteria identifying one of the possible solutions as the right one. To such an extent, Austin's old dictum could apply: '[s]o far as the judge's *arbitrium* extends, there is no law at all'.<sup>462</sup> Likewise, one could perceive with Kelsen the decision in favour of or against a possible solution of a case as a problem of legal politics and not of legal theory; the decision would then depend on an act of volition by the arbitrator deciding with full discretion and deriving guidance only from extra-legal concepts.<sup>463</sup> Correspondingly, Hart stated that, where the meaning of law is in doubt, judges have to 'make a choice' by way of weighing and balancing extra-legal interests and moral values.<sup>464</sup>

These prominent proponents of legal positivism<sup>465</sup> suggest that the decision in difficult cases is left open for the free and creative activity of judges or arbitrators, who are relying solely on political and other extra-legal ideas.<sup>466</sup> However, does the concept of fair and equitable treatment really involve such a way of decision-making? When taking into account that fair and equitable treatment was initially a legal expression that

<sup>460</sup> On 'hard cases', see Dworkin (above fn. 116), pp. 81 et seq.

<sup>461</sup> For a similar perception in the context of German private law, see also G. Teubner, '§ 242 BGB', in R. Wassermann (ed.), *Alternativkommentar zum Bürgerlichen Gesetzbuch* (Allgemeines Schuldrecht) (1980), Vol. 2/6, mn. 4.

<sup>462</sup> J. Austin, *Lectures on Jurisprudence or the Philosophy of Positive Law*, 5th edn (1885), Vol. II, p. 664.

<sup>463</sup> H. Kelsen, *Reine Rechtslehre*, 2nd edn (1960), pp. 350–351.

<sup>464</sup> H. L. A. Hart, *The Concept of Law* (1961), pp. 132, 200.

<sup>465</sup> On legal positivism and competing theories in international law, see Shaw only (above fn. 125), pp. 49 et seq.

<sup>466</sup> For further discussion on the problem of objectivity in hard cases, see M. Koskeniemi, *From Apology to Utopia*, Reissue (2005), pp. 41 et seq.

had to be constructed *ab novo* without a precedent, such a positivist approach would not only represent a demanding task,<sup>467</sup> but would also misconstrue the self-conception of arbitrators. As the case law on fair and equitable treatment discloses, arbitrators do not reach a decision because they feel it is politically or morally necessary, but rather because they feel legally bound to decide in a certain way. This self-conception of arbitrators has been uttered by various tribunals, emphasising that fair and equitable treatment does not provide a tribunal with the discretion to decide a dispute *ex aequo et bono*, but rather demands a case to be decided on the basis of law.<sup>468</sup> Thus, tribunals, even when no precedent is applicable for a specific case, are not operating in an extra-legal sphere, but are requested to decide a dispute on fair and equitable treatment according to legal categories. The latter especially includes the delivery of a convincingly reasoned decision.

A doctrinal approach that amounts to nothing more than the categorisation of lines of jurisprudence, in order to simplify fair and equitable treatment by the specification of factors and fact situations possibly indicating a breach of the standard, is unable to guide arbitrators in difficult cases. This is because such a lowering of complexity will never lead to a scheme that is detailed enough so as to cover all difficult cases. Therefore, a comprehensive doctrinal concept needs to go beyond a mere analysis of case law and be capable of indicating, in difficult cases as well, what justificatory arguments are admissible. In particular, a concept of fair and equitable treatment should not hastily strive to lower the complexity of fair and equitable treatment, but should incorporate the identified *topoi* into a greater framework.

## B Conceptual suggestions from legal scholarship

Within the augmenting body of scholarly literature, only a few have presented conceptual suggestions with regard to fair and equitable treatment. Nevertheless, two distinct approaches deserve closer attention and shall be discussed selectively before the conceptual basis of fair and equitable treatment is reviewed in detail against the background of more fundamental theories of international law.

<sup>467</sup> See Dolzer (above fn. 2), p. 105.

<sup>468</sup> See, e.g. *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 284; see also *Mondev International Ltd v. United States* (above fn. 100), at para. 119; and *MCI Power Group LC, New Turbin Inc. v. Ecuador* (above fn. 450), at paras. 369–370.

### 1 Fair and equitable treatment as a 'standard'

In her study, Tudor<sup>469</sup> construes fair and equitable treatment as a 'standard' representing a particular type of norms. Thereby, Tudor views a standard of international law as a tool that allows measuring the conformity of national law with international law.<sup>470</sup> In order to describe the idiosyncrasy of a standard as a type of norms, she emphasises mainly the following elements: a broad and indeterminate concept; a large margin of manoeuvre left to the arbitrator; a very flexible character; a link between society and the law; and a reference point that is the average social conduct.<sup>471</sup> According to these elements, a standard 'has no stable or fixed content'<sup>472</sup> and 'allows a continuous adaptation of the law to the changing social and economic circumstances'.<sup>473</sup> In this process of adaptation, it is for the judges and arbitrators to play a creative role and exert their discretionary power by taking into account 'the average values and behaviours of a society at a given moment in time'.<sup>474</sup>

Accordingly, in the process of applying the 'standard' of fair and equitable treatment, the arbitrator, by taking into account the textual basis and constraints of every investment agreement, has to define a benchmark against which state conduct is to be measured. Thereby, the definition of this standard is said to be dependent on the particular facts of each case, the evolutionary character of fair and equitable treatment and the appreciation of the general situation of the state.<sup>475</sup> According to Tudor, by applying such methodology and building on existent case law, the arbitrator is able to concretise the content and threshold of fair and equitable treatment so as to decide the case at hand.<sup>476</sup>

Tudor's conception of a 'standard' is inspired by early legal theories of different national law traditions in which the standard as a type of norms has attracted attention.<sup>477</sup> Today, notwithstanding the abundant

usage of the notion of standard in different branches of international law,<sup>478</sup> the theoretical concept of standards is primarily discussed in American legal thinking.<sup>479</sup> In contrast to a rule, a standard is thereby often considered as a norm that exhibits a relatively low degree of textual precision and therefore affords the decision-maker a relatively high degree of discretion.<sup>480</sup> In addition, this distinction is said to involve a different way of decision-making, depending on whether a dispute is to be decided on the basis of rules or standards. Rule-like decision-making is described as a classification of fact situations in order to fit them into a preferred category.<sup>481</sup> In contradistinction, standard-like decision-making is characterised by balancing the underlying purposes, background principles or policies at stake and by weighing the competing rights or interests.<sup>482</sup>

In comparison, it seems that the characteristics and functions of a standard, as described by Tudor, reveal considerable similarities with what has been previously described as a 'general clause'.<sup>483</sup> Both standards and general clauses are phrased in relatively broad terms; they possess a flexible character and underline the role of decision-makers, who should be considerate of underlying interests and social processes. A difference exists to the extent that a standard takes the average social conduct of a definable social circle as a reference point: for instance, in the context of national trade law, the diligence of a prudent businessperson or the standard of a fair trade.<sup>484</sup> This is not necessarily the case with general clauses. However, in the context of fair and equitable treatment, Tudor provides no criteria for the determination of an

<sup>478</sup> On standards in international environmental law, see D. Bodansky, 'Rules vs. Standards in International Environmental Law', ASIL Proc. 98 (2004), p. 275.

<sup>479</sup> See, e.g. K. M. Sullivan, 'Foreword: The Justice of Rules and Standards', Harv. L. Rev. 106 (1992), p. 22; L. Kaplow, 'Rules versus Standards', Duke L.J. 42 (1992), p. 557; and C. R. Sunstein, 'Problems with Rules', Cal. L. Rev. 83 (1995), p. 953.

<sup>480</sup> See Sullivan (above fn. 479), pp. 58–59; and Bodansky (above fn. 478), p. 276. This dichotomy between rules and standards is not unanimously accepted: see, e.g. Dworkin (above fn. 116), pp. 22 and 72, who is referring to standards rather as a broad genus that comprises rules, principles and policies; on the relation between standards and principles, see Esser (above fn. 477), pp. 96–98.

<sup>481</sup> Sullivan (above fn. 479), p. 59. <sup>482</sup> With further references, see *ibid.*, pp. 59–61.

<sup>483</sup> See Chapter 2, section C, '(2a) Literal meaning of fair and equitable treatment'. As far as the term 'standard' is used elsewhere in this work, it is, however, not referred to in the technical sense as described by Tudor.

<sup>484</sup> See Pound (above fn. 477), p. 58; Esser (above fn. 477), p. 97; and Teubner (above fn. 363), pp. 45–49.

<sup>469</sup> Tudor (above fn. 2).

<sup>470</sup> *Ibid.*, pp. 114–115; with reference to D. Carreau and P. Juillard, *Droit internationale économique*, 3rd edn (2007), p. 463; and similarly Juillard (above fn. 84), pp. 133–134.

Tudor's understanding of a 'standard' is not to be confused with the growing number of technical standards set, e.g. by the International Organization for Standardization (ISO).

<sup>471</sup> Tudor (above fn. 2), p. 115.

<sup>472</sup> *Ibid.*, p. 133. <sup>473</sup> *Ibid.*, p. 121. <sup>474</sup> *Ibid.* <sup>475</sup> *Ibid.*, pp. 129–132.

<sup>476</sup> *Ibid.*, p. 132; on a methodology for arbitrators, see pp. 144–153.

<sup>477</sup> Re. these early concepts of a standard, see M. O. Stati, *Le Standard Juridique* (1927); A.-A. Al-Sanhoury, *Le Standard Juridique* (1934), Vol. II, pp. 144 et seq.; R. Pound, *An Introduction to the Philosophy of Law*, rev. edn (1954), pp. 55–59; and J. Esser, *Grundsatz und Norm in der richterlichen Fortbildung des Privatrechts*, 2nd edn (1964), pp. 96–98.

average social conduct that could guide the treatment of foreign investors by host states.<sup>485</sup> Building a concept of fair and equitable treatment upon a notion of a standard is therefore only possible if the element of average social conduct as a reference point is omitted.<sup>486</sup> However, it seems that Tudor's category of a standard and her reference to an average social conduct are relatively indeterminate concepts themselves. Moreover, if the application of such a standard is mainly dependent on the arbitrators' circumstances and discretion, Tudor fails to elaborate on the importance and criteria of a convincing process of reasoning as an important means of justifying arbitrators' decisions.

Furthermore, Tudor's assumption, that in the application of fair and equitable treatment a balancing operation may take place exclusively at the compensation and not the liability phase,<sup>487</sup> encounters great difficulties. Her assumption is based on the deliberation that the provisions of investment agreements, by their nature, are only capable of obliging the host state *vis-à-vis* the investor, so that it is only the host state which is required to treat the investor fairly and equitably and not vice versa.<sup>488</sup> In principle, this deliberation deserves assent. Equally true appears the fact that there are factors which are especially accessible for a balancing operation at the compensation phase. However, the categorical refusal of a balancing process at the stage of the determination of a breach of fair and equitable treatment fails to take into account that the concept of a standard, as expressed by Tudor, is closely connected with a method of decision-making by means of balancing and weighing. The same is true in the context of general clauses in which the process of decision-making by means of balancing is also of special importance.<sup>489</sup> Accordingly, if one aims to improve the

<sup>485</sup> A standard of average conduct in this sense could be derived from the classical international minimum standard. In this direction, see ALI, *Restatement of the Law (Second): Foreign Relations Law of the United States* (1965), § 165 lit. d; or K.-H. Strache, *Das Denken in Standards* (1968), p. 15, who, however, also admitted that in this case the determination of the standard of conduct should not be relinquished to the subjectivity of international courts or tribunals. In addition, it has already been demonstrated that the classical minimum standard is not an adequate tool capable of shaping the concept of fair and equitable treatment. Furthermore, terminological confusion could result from the fact that the minimum standard does not demand average, but minimum conduct.

<sup>486</sup> Such tendency has become apparent in some early French writings, thereon critically see Strache (above fn. 485), pp. 13–14.

<sup>487</sup> See Tudor (above fn. 2), p. 205. <sup>488</sup> *Ibid.*, p. 210.

<sup>489</sup> See, e.g. Teubner (above fn. 461), mn. 102.

method of decision-making connected with fair and equitable treatment, one should more closely inspect the process of balancing underlying interests, policies or principles involved in a particular investment dispute.<sup>490</sup> Favouring rule-like decision-making by means of a categorisation of specific fact situations derived from existing precedents, as supposed by Tudor, represents an unsatisfactory way of dealing with fair and equitable treatment. Altogether, Tudor's study emphasises important characteristics of fair and equitable treatment as a vague treaty clause, but misconceives the complexity of fair and equitable treatment and the pivotal importance of justifying arbitral decisions by means of a comprehensive process of reasoning.

## 2 *Fair and equitable treatment as an embodiment of the rule of law*

Another approach employed in order to shape the concept of fair and equitable treatment has been presented by Schill, who considers fair and equitable treatment as an embodiment of the rule of law.<sup>491</sup> Thereby, Schill is guided by the assumption that the *topoi* of fair and equitable treatment exhibit considerable similarities to those of national legal conceptions of the rule of law, *Rechtsstaat* or *état de droit*.<sup>492</sup> Hence, Schill plausibly suggests applying a comparative law methodology so as to identify common features of a concept of the rule of law recognisable in the major domestic systems and also in other international legal regimes.<sup>493</sup> The general patterns, extracted in this vein, may serve as *leitmotiv* for the application of fair and equitable treatment and help to advance the existing system of precedents. According to Schill, a comparative rule of law approach should be able to provide examples concerning the institutional and procedural safeguards offered by a host state to foreign investors, leaving, at the same time, sufficient leeway in order to achieve a just balance between the interests of host states and foreign investors.<sup>494</sup> A normative

<sup>490</sup> Of course this does not mean that the fair and equitable treatment standard obliges the investor to behave in a special manner, simply because a possible outcome of a balancing operation would, at the most, be that the host has not breached a fair and equitable treatment obligation. In contrast, it would never be a possible outcome of a balancing operation that the investor has breached the fair and equitable treatment standard and is therefore obliged to pay compensation.

<sup>491</sup> Schill (above fn. 2); also published as S. W. Schill, 'Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law', TDM 3 (2006), issue 5.

<sup>492</sup> Schill (above fn. 2), p. 40. <sup>493</sup> *Ibid.*, pp. 61–62. <sup>494</sup> *Ibid.*, p. 71.

justification for this approach is given by reference to the object and purpose of investment agreements, aiming at the protection and promotion of foreign investment flows and therefore at the stimulation of economic growth.<sup>495</sup> The close connection between the rule of law and a favourable investment climate producing economic growth is finally substantiated by recourse to institutional economics buttressing such interpretation.<sup>496</sup>

Altogether, Schill's conceptual suggestion provides a valuable attempt providing guidance for the discussion on fair and equitable treatment. The similitude between the *topoi* of fair and equitable treatment and the various elements that are habitually linked to the concept of the rule of law is striking and also acknowledged by others.<sup>497</sup> To such an extent, the rule of law approach invites the carrying out of further comparative research in order to analyse the different concepts of the rule of law and the extent to which these concepts may enrich the quality of legal reasoning in the case of fair and equitable treatment. Schill rightly points out that this research should not be limited to domestic legal conceptions, but should also take into account international legal regimes which already display a sophisticated conception of the rule of law.<sup>498</sup> Although not explicitly emphasised by Schill, looking beyond the international investment law backyard also represents a suitable way of mitigating frictions which might arise out of an increasing fragmentation of international law. As a comparative analysis in this sense is capable of considering legal processes in related sub-systems and of contributing to a desirable cross-fertilisation in the international legal system, Schill's approach appears very much complementary to the ideas discussed earlier in this respect.<sup>499</sup>

<sup>495</sup> *Ibid.*, pp. 63–64. <sup>496</sup> *Ibid.*, pp. 64–69.

<sup>497</sup> See, e.g. P. Behrens, 'Towards the Constitutionalization of International Investment Protection', *ArchVR* 45 (2007), p. 153 at p. 175; McLachlan, Shore and Weininger (above fn. 63), p. 260; on investment rules and the rule of law more generally, see D. Schneiderman, 'Investment Rules and the Rule of Law', *Constellations* 8 (2001), issue 4, p. 521; and S. D. Franck, 'Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law', *Pac. McGeorge Bus. & Dev. L.J.* 19 (2007), p. 337.

<sup>498</sup> Schill (above fn. 2), p. 62; he thereby refers to the jurisprudence of the WTO Appellate Body and the ECtHR and also the principles of European administrative law; on the latter see especially J. Schwarze, *European Administrative Law*, rev. 1st edn (2006).

<sup>499</sup> See Chapter 4, 'The role of international law in the construction of fair and equitable treatment'.

Nevertheless, there are also some difficulties in the application of a comparative rule of law approach. This is not only because the introduction of the concept of the rule of law into the context of fair and equitable treatment requires a well-reasoned justification, but also because it brings with it a raft of different ideas. Arguably, only some of these ideas are suitable for international investment law, while others are inappropriate or contested. However, a legal transplant of the concept of the rule of law, at first, would incorporate all of these ideas and controversies into the investment law context and would thereby create new and unexpected problems.<sup>500</sup> Moreover, the existence of a whole range of different concepts of the rule of law, influenced by the particular domestic law background, involves a laborious search for common elements among the various perceptions.<sup>501</sup> Due to the controversial discussions, also within the domestic legal systems, it seems not without difficulty to deduce common elements that could constitute an international rule of law.<sup>502</sup> Although problems of this kind are increasingly discussed under the broader topic of a global administrative law<sup>503</sup> or a growing international administrative law for foreign investment,<sup>504</sup> the state of research on this point remains in its infancy.<sup>505</sup>

<sup>500</sup> For general criticism on legal transplants, see P. Legrand, 'The Impossibility of Legal Transplants', *Maastricht J. Europ. & Comp. L.* 4 (1997), p. 111.

<sup>501</sup> For a comparative analysis at the European level, see A. von Bogdandy and P. Cruz Villalón (eds.), *Handbuch Ius Publicum Europaeum* (2007), Vol. 1.

<sup>502</sup> This is also admitted by Schill (above fn. 2), p. 41.

<sup>503</sup> On the rapidly growing literature on global administrative law, see, e.g. B. Kingsbury, N. Krisch and R. B. Stewart, 'The Emergence of Global Administrative Law', *Law & Contemp. Probs.* 68 (2005), p. 15; N. Krisch and B. Kingsbury, 'Introduction: Global Governance and Global Administrative Law in the International Legal Order', *EJIL* 17 (2006), p. 1; E. Schmidt-Aßmann, 'Die Herausforderung der Verwaltungsrechtswissenschaft durch die Internationalisierung der Verwaltungsrechtsbeziehungen', *Der Staat* (2006), p. 315; D. C. Esty, 'Good Governance at the Supranational Scale', *Yale L.J.* 115 (2006), p. 1490; and M. Ruffert, 'Perspektiven des Internationalen Verwaltungsrechts', in C. Möllers, A. Voßkuhle and C. Walter (eds.), *Internationales Verwaltungsrecht* (2007); see also G. Van Harten and M. Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law', *EJIL* 17 (2006), p. 121, considering international investment arbitration as the clearest example of global administrative law; for a special focus on the rule of law, see D. Dyzenhaus, 'The Rule of (Administrative) Law in International Law', *Law & Contemp. Probs.* 68 (2005), p. 127; and C. Harlow, 'Global Administrative Law', *EJIL* 17 (2006), p. 187.

<sup>504</sup> See Dolzer (above fn. 73), p. 970.

<sup>505</sup> See also McLachlan, Shore and Weininger (above fn. 63), pp. 205–206.

Further problems result from the practice that a comparative approach draws primarily from legal systems having a strong rule of law tradition – thus mainly ideas originating from European or American legal thinking. Would it, in this case, be legitimate to apply such ideas in a dispute between an investor and a host country of a very different legal background or a weak rule of law tradition? Would it rather be appropriate to base a decision in such a dispute on the perceptions of the legal traditions actually involved? What rule of law perception should ultimately be applied if the home and the host country possess contradicting concepts of the rule of law? Of course, these questions would be dispensable if national rule of law traditions produced universally applicable general principles of law in the sense of Article 38(1)(c) of the ICJ Statute.<sup>506</sup> Then, such general principles of law would be directly applicable in an investment dispute and would not need to be referred to as an argumentative tool for the construction of a norm like fair and equitable treatment.

In summary, it appears that the concept of the rule of law, at least at the international level, is still relatively indeterminate in itself and is therefore incapable of alleviating the burden of arbitral tribunals to provide a comprehensively reasoned justification for their decisions.

<sup>506</sup> Thereon, see Brownlie (above fn. 129), pp. 16–17.

## 6 Fair and equitable treatment and justice

### A Fair and equitable treatment as an embodiment of justice

The following observations endeavour to discuss and evaluate the concept of fair and equitable treatment based on the supposition that fair and equitable treatment is often considered as an embodiment of justice.<sup>507</sup> That is to say that the concept of fair and equitable treatment expresses ideas of justice and moral ethics and that, therefore, the application of the norm aims to establish a just relationship between the host state and the foreign investor. To this end, an attempt is made to disclose the interrelatedness of fair and equitable treatment and different concepts of justice, before turning more generally to the rise of the idea of justice in international law and providing a brief survey of selected theories of justice in international relations.

#### 1 Connections between fair and equitable treatment and justice

A connection between fair and equitable treatment and justice emanates, at first, from the literal sense of the notions of 'fair' and 'equitable', which are frequently circumscribed by terms such as 'impartial', 'just', 'free from bias or prejudice' and 'conformable to principles of justice and right'.<sup>508</sup> Of course, such commonplaces are insufficient for the formulation of a doctrinal concept, but they do give an initial hint at the connectedness between fair and equitable treatment and justice. Due to the choice of treaty-makers in favour of such wording, it may be

<sup>507</sup> Similarly, see, e.g. Frick (above fn. 201), p. 92; and Muchlinski (above fn. 51), pp. 635–636; see also the tribunal's reasoning in *Sempra Energy International v. Argentina* (above fn. 303), considering, at para. 300, fair and equitable treatment as 'a standard which serves the purpose of justice'.

<sup>508</sup> Garner (ed.) (above fn. 134).

presumed that it was intended to relate fair and equitable treatment to ideas of justice in order to integrate these ideas into the investor-state relationship.

Another, much stronger hint in this direction is given by the fact that fair and equitable treatment, on various occasions, has been associated with notions of equity.<sup>509</sup> Thereby, fair and equitable treatment may be considered to be an explicit stipulation of equity, forming then part of fair and equitable treatment as a legal norm.<sup>510</sup> Alongside the controversy on the notion of equity in international law,<sup>511</sup> it appears universally accepted that equity belongs to a wider conception of justice.<sup>512</sup> In the context of fair and equitable treatment, different uses of equity may materialise in a number of ways:<sup>513</sup> first, the frequently emphasised fact-specific nature of fair and equitable treatment and the need to carry out a case-by-case analysis represent forms of individualised justice, adapting the investment regime to the needs of the specific fact situation. Fair and equitable treatment also introduces notions of fairness and reasonableness into the process of legal reasoning, which are expressed by principles such as good faith, estoppel and abuse of rights. Furthermore, fair and equitable treatment makes use of

equity in a sense of distributive justice, since it aims to promote and protect investments so as to create wealth for all parties involved in the investment process.

Among these examples, the principle of good faith has met with wide recognition in the discussion regarding the concept of fair and equitable treatment. In their analysis of a possible breach of fair and equitable treatment, arbitral tribunals frequently highlight good faith as a guiding principle in the relationship between the investor and the host state.<sup>514</sup> Similarly, scholars have adverted to good faith as an underlying scheme that orientates the construction and application of fair and equitable treatment.<sup>515</sup> Thereby, the notion of good faith is referred to in at least two distinct functions:<sup>516</sup> on the one hand, a more subjective function of good faith requires the parties to a treaty to comply with their obligations in a candid and loyal manner. A more objective function of good faith, on the other hand, rather concerns the process of decision-making being committed – while not distinguishable from the concept of equity – to general considerations of justice.<sup>517</sup> In the context

<sup>509</sup> See Schwarzenberger (above fn. 201), p. 221; E. Lauterpacht, *Aspects of the Administration of International Justice* (1991), p. 122; Vasciannie (above fn. 2), pp. 145–147; Schreuer (above fn. 455), p. 365; Klein Bronfman (above fn. 2), pp. 663–664; Lowe (above fn. 323), p. 73; Muchlinski (above fn. 2), pp. 531–532; A. von Walter, 'The Investor's Expectations in International Investment Law', in A. Reinisch and C. Knahr (eds.), *International Investment Law in Context* (2008), p. 175 at pp. 194–195; and F. Francioni, 'Equity in International Law', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (Online Publication) (2009), mn. 21. However, this does not indicate that arbitrators are entitled to decide *ex aequo et bono*. The latter is unanimously accepted: see, e.g. Yannaca-Small (above fn. 2), p. 40; Schreuer (above fn. 455), p. 365; Kreindler (above fn. 2), p. 1; and Dolzer and Schreuer (above fn. 54), p. 148. It has been declared by the ICJ that there exists a distinction between a decision *ex aequo et bono* and one in which equity plays a part in *North Sea Continental Shelf Cases (Federal Republic of Germany v. Denmark; Federal Republic of Germany v. Netherlands)*, ICJ (Judgment of 20 February 1969), at para. 88; see also Franck (above fn. 345), pp. 54–56. On decisions *ex aequo et bono* generally, see Lauterpacht (above fn. 509), pp. 117–152.

<sup>510</sup> See *North Sea Continental Shelf Cases (Federal Republic of Germany v. Denmark; Federal Republic of Germany v. Netherlands)* (above fn. 509), at para. 88; see also Jennings and Watts (above fn. 124), p. 44.

<sup>511</sup> See, e.g. Schachter (above fn. 119), pp. 55–91; and M. W. Janis, 'Equity in International Law', in R. Bernhardt (ed.), *Encyclopedia of Public International Law*, Consolidated Library Edition (1995), Vol. II/V, p. 109 at p. 112.

<sup>512</sup> See already, in the sense of a corrective justice, Aristotle, *Nicomachean Ethics*, Book V, Chapter 14.

<sup>513</sup> On the different uses of equity, see Schachter (above fn. 119), pp. 55–56.

<sup>514</sup> See, e.g. *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 134; *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 153; *Saluka Investments BV v. Czech Republic* (above fn. 132); and *Sempra Energy International v. Argentina* (above fn. 303), stating at para. 291 that fair and equitable treatment 'originates in the obligation of good faith' and at para. 298 that 'the principle of good faith . . . is at the heart of the concept of fair and equitable treatment'.

<sup>515</sup> See Weiler (above fn. 104), pp. 82–84; Dolzer (above fn. 2), p. 91; A. Kolo, 'Investor Protection vs Host State Regulatory Autonomy during Economic Crisis', *JWIT* 8 (2007), p. 457 at p. 502; and von Walter (above fn. 509), pp. 195–197.

<sup>516</sup> On the different functions of good faith, see J. F. O'Connor, *Good Faith in International Law* (1991), pp. 122–124; D. Looschelders and D. Olzen, '§ 242 BGB', in D. Looschelders and M. Martinek (eds.), *J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch* (2005), mn. 1078; and R. Kolb, 'Principles as Sources of International Law', *NILR* 53 (2006), p. 1 at pp. 13 et seq. On good faith in international law, see also B. Cheng, *General Principles of Law* (1953), pp. 105 et seq.; E. Zoller, *La Bonne Foi en Droit International Public* (1977); Verdross and Simma (above fn. 182), pp. 46–48; and T. Cottier and K. N. Schefer, 'Good Faith and the Protection of Legitimate Expectations in the WTO', *New Directions in International Economic Law* (2000), p. 47. In international law, the subjective function of good faith traditionally stands in the foreground, which does not mean that the more objective function is non-existent.

<sup>517</sup> See O'Connor (above fn. 516), pp. 122–123. There exists no uniform understanding of the notions of good faith and equity, neither in international law nor in the different domestic legal traditions. Both notions show considerable functional intersections, especially in what is called here the objective function. For a comparative analysis of good faith in European contract law, see, e.g. J. Stapleton, 'Good Faith in Private Law', *Current Legal Problems* (1999), p. 1; R. Zimmermann and S. Whittaker (eds.), *Good Faith in European Contract Law* (2004); and Looschelders and Olzen (above fn. 516), mn. 1076–1141.



of fair and equitable treatment, the latter function is especially connected with the approach of balancing the interests between host states and foreign investors.

In summary, fair and equitable treatment is indeed closely related to the concepts of equity, good faith and, therefore, justice. This finding may hardly be revealing, for the simple reason that the notions of justice or equity are, by no means, less indeterminate than fair and equitable treatment. Nevertheless, the various connections between fair and equitable treatment and justice underline the idea of justice in the context of international investment law. However, since arbitral tribunals are not entitled to decide *ex aequo et bono*, a construction of fair and equitable treatment, as an embodiment of justice, does not imply that any kind of justice-based argumentation is able to legitimise a particular decision on fair and equitable treatment. Rather, the concept of fair and equitable treatment has to identify particular aspects of the idea of justice which may be of relevance in the application of this norm. This idea of justice has a fickle history in international legal relations.

## 2 The rise of justice in international legal relations

In various ancient and medieval perceptions of international law, the idea of justice was deeply rooted in conceptions of a universal natural or divine order as the fount of moral and legal norms regulating the international relations of that time.<sup>518</sup> This order provided for behavioural standards guiding the actions of sovereigns and states as exemplified by the doctrine of *bellum iustum*<sup>519</sup> – a doctrine that also exposed the shortcomings of such an idea of justice and its susceptibility to political and ideological instrumentalisation. With the dawn of the modern system of nation states, a school of positivist thought emerged that focused on the empirical analysis of the practice of sovereign states, gradually eclipsing the idea of natural justice.<sup>520</sup>

<sup>518</sup> On the history of international law and justice, see, e.g. A. Nussbaum, *A Concise History of the Law of Nations*, rev. edn (1954); Graf Vitzthum (above fn. 129), pp. 43 et seq.; and A. Orakhelashvili, 'Natural Law and Justice', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (Online Publication) (2009); for a comprehensive historical survey of justice-related political thinking in international relations, see T. L. Pangle and P. J. Ahrens Dorf, *Justice Among Nations* (1999).

<sup>519</sup> On this doctrine, see Nussbaum (above fn. 518), especially pp. 36 et seq.; and Pangle and Ahrens Dorf (above fn. 518), pp. 73 et seq.

<sup>520</sup> See Shaw (above fn. 125), pp. 25–26.

The analysis of the behaviour and the will of states became the dominant method in the description of international legal relations. This traditional conception of international law is mainly related to a realist understanding of international politics drawing a sceptical picture of anarchical relations between states struggling for survival and power that leaves little room for ideas of justice at an international level.<sup>521</sup> Such an understanding reduced international law to a legal frame for the coordination of national spheres of activity and interest in order to achieve a peaceful coexistence of nation states based on the guiding principles of sovereignty, equality and reciprocity.<sup>522</sup> According to the latter, the validity of international law was considered to emanate exclusively from the 'free will' of sovereign states, and '[r]estrictions upon the independence of states cannot ... be presumed'.<sup>523</sup> Therefore, this international law of coordination and coexistence served the national interests of each state, rather than expressing more far-reaching aims or interests common to all states or human beings.

Beyond this coordinative function, another layer of international law developed that was concerned with the cooperation of states in addressing common needs and interests primarily through the creation of international institutions.<sup>524</sup> International law in this sense is founded on political insights that the cooperation of interdependent states is capable of optimising parallel state interests and that thereby international welfare effects may be generated.<sup>525</sup> While this understanding of international relations places emphasis on a – functional or general – process of integration, it does not challenge the basic perceptions of

<sup>521</sup> For some of the main representatives of political (neo-)realism, see H. J. Morgenthau, *Politics Among Nations*, 2nd edn (1954); G. Schwarzenberger, *Power Politics*, 3rd edn (1964); and K. N. Waltz, *Theory of International Politics* (1979).

<sup>522</sup> See W. Friedmann, *The Changing Structure of International Law* (1964), p. 60; L. Henkin, *International Law* (1995), p. 100; and M. Nettesheim, 'Das kommunitäre Völkerrecht', JZ (2002), p. 569 at pp. 570–571.

<sup>523</sup> *The Case of the S.S. 'Lotus' (France v. Turkey)*, Permanent Court of International Justice (Judgment of 7 September 1927), at 18.

<sup>524</sup> On the development from coordinative to cooperative international law, see especially Friedmann (above fn. 522), writing at p. 68: '[T]he term "cooperative international law" is tentatively chosen to describe the growing of international legal relationships and organisations which are ... concerned with the regulation of experiments in positive international collaboration. The legal and institutional problems posed by this developing and increasingly important branch of international law are essentially of a different character from those posed by traditional international law.' See also G. Abi-Saab, 'Whither the International Community?', EJIL 9 (1998), p. 248; and C. Tomuschat, 'International Law', RdC 281 (1999), p. 9 at pp. 56 et seq.

<sup>525</sup> See R. O. Keohane and J. S. Nye, *Power and Interdependence* (1977).

traditional international law.<sup>526</sup> In spite of the tremendous augmentation of international law through the formation of manifold international organisations and the pertaining international agreements, the structure of this international law of cooperation remained a voluntaristic system of independent states committed to the traditional values of international law.<sup>527</sup>

A more fundamental change of international law is said to emanate from the increasingly communitarian character of the international legal system.<sup>528</sup> This character is displayed by far-reaching developments in various fields of international law in which a minimum consensus on certain values is deemed to exist, being acknowledged across cultural and political boundaries.<sup>529</sup> It is observed that beneath these developments, which have taken place especially in the fields of human rights protection, environmental law or international economic law, a misty idea of justice is beginning to materialise and is infusing international law with moral elements.<sup>530</sup> However, the extent to which this rise of justice is, in fact, reflected in the current status of international law, or whether it is a mere expression of aspirations and beliefs, is of course open to debate. While to some, this development signifies a shift from traditional paradigms of public international law to a radical vision of Kantian world law ('*Weltrecht*'),<sup>531</sup> others detect profound frictions within the global society and doom to failure any endeavour of finding common values or over-arching rationalities.<sup>532</sup> Such controversies notwithstanding, it appears indeed possible to search for the moral foundations of the

<sup>526</sup> See Nettesheim (above fn. 522), p. 571.

<sup>527</sup> See also Henkin (above fn. 522), pp. 106–107.

<sup>528</sup> On the concept of the international community, see, e.g. R.-J. Dupuy, 'Communauté internationale et disparités de développement', RdC 165 (1979 IV), p. 9; H. Mosler, *The International Society as a Legal Community* (1980); Tomuschat (above fn. 524), pp. 72 et seq.; A. L. Paulus, *Die internationale Gemeinschaft im Völkerrecht* (2001); and C. Warbrick and S. Tierney, 'Towards an "International Legal Community"?' (2006).

<sup>529</sup> See B. Simma and A. L. Paulus, 'The "International Community"', EJIL 9 (1998), p. 266 at pp. 272–276; and especially Nettesheim (above fn. 522), pp. 571 et seq., referring to this layer of international law as 'communitarian international law' ('*kommunitäres Völkerrecht*').

<sup>530</sup> See D. Thürer, 'Modernes Völkerrecht', ZaöRV (2000), p. 557; see also A. Bleckmann, *Grundprobleme und Methoden des Völkerrechts* (1982), pp. 270 et seq., who is already attributing these changes in the understanding of international justice to the layer of cooperative international law.

<sup>531</sup> See the copious study undertaken by A. Emmerich-Fritsche, *Vom Völkerrecht zum Weltrecht* (2007).

<sup>532</sup> See A. Fischer-Lescano and G. Teubner, 'Fragmentierung des Weltrechts', in M. Albert and R. Stichweh (eds.), *Weltstaat und Weltstaatlichkeit* (2007), p. 37; from the perspective

international legal system and to identify at least a minimum of shared values. Before such an attempt is undertaken in the context of fair and equitable treatment, various core elements of international justice theories will be adumbrated below.

### 3 Theories of international justice

'What is Justice?'<sup>533</sup> This is, of course, an extremely far-reaching and fundamental question that is discussed in a series of academic fields and the scope of which is by far not reduced when transposing it to the international level.<sup>534</sup> This is why, in the following, only a very limited survey of theories addressing the question of international justice can be presented. Thereby, a certain emphasis is placed on the ideas of John Rawls, who has especially influenced the discussion on international justice within political philosophy.

#### (a) Cosmopolitanism

As a basic presumption, cosmopolitanism considers all humanity to be part of a global community which is able to share a common idea of morality and justice.<sup>535</sup> A liberal variant of cosmopolitanism endeavours to apply the principles of Rawls' *Theory of Justice*<sup>536</sup> at a global level. In this book, Rawls proposes that, in a fictitious original position, every member of society decides general principles of justice from behind a veil of ignorance, which blinds them inter alia about their place in society, their social status, their religion or the distribution of natural assets and abilities, in order to agree on principles that are fair to all.<sup>537</sup> Rawls argues that this original decision process would yield two principles of justice: first, 'each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others';<sup>538</sup> and second, social and economic inequalities are to be arranged so that (a) offices and positions must be open to everyone under conditions of fair

of critical legal studies, see A. Carty, 'Critical International Law', EJIL 2 (1991), p. 66 at pp. 68–70.

<sup>533</sup> See H. Kelsen, *Was ist Gerechtigkeit?* (1953).

<sup>534</sup> For an overview, see, e.g. A. Tschentscher, *Prozedurale Theorien der Gerechtigkeit* (2000); the essays in K. Ballestrin (ed.), *Internationale Gerechtigkeit* (2001); and T. Pogge and D. Moellendorf (eds.), *Global Justice* (2008).

<sup>535</sup> Most cosmopolitans thereby refer to the idea expressed in the Third Definitive Article of Kant (above fn. 161), stipulating that a law of world citizenship shall exist that is grounded on universal hospitality.

<sup>536</sup> J. Rawls, *A Theory of Justice* (1971). <sup>537</sup> *Ibid.*, pp. 136 et seq. <sup>538</sup> *Ibid.*, p. 60.

equality of opportunity, and (b) they are to be of the greatest benefit to the least-advantaged members of society ('difference principle').<sup>539</sup> In connection with these principles of justice, Rawls also establishes priority relations to ensure that greater equality is not achieved on the account of liberty and that inequalities are only justified if they are to the benefit of the least well off.<sup>540</sup>

While Rawls designed his theory for a society within the relatively closed system of a nation-state, some cosmopolitans question why representatives of countries would not choose the same principles of justice for the global society.<sup>541</sup> Thereby, it is claimed that nationality, like race, gender or social class, is just one further inescapable contingency that cannot be influenced by the individual, and which therefore must be blanked out by a global veil of ignorance.<sup>542</sup> In this vein, the growing interdependence of states and the emergence of other international actors and institutions are conceived to form an open and interdependent system of global cooperation, in which Rawls' principles of justice can and should apply.<sup>543</sup> In particular, the difference principle is attempted to be transposed to the global level, according to which distributive obligations would be established among persons of diverse citizenship analogous to those of citizens of the same state.<sup>544</sup> However, while the point concerning the arbitrariness of nationality has some persuasive clout, it appears hardly possible to imagine global institutions that are actually able to realise such a vision of justice.

Another strand of cosmopolitanism seeks to establish a global order of world citizens through a community of communication in which a free discourse leads to a consensus regarding global rules and institutions.<sup>545</sup> However, it is also acknowledged that the political culture of the world society has not yet developed so far that a global society- and identity-building, in the sense of world internal politics ('Weltinnenpolitik'), appears possible.<sup>546</sup> A cosmopolitan vision of a law of world citizens is thus dependent on international institutions committed to the democratisation

<sup>539</sup> Ibid., p. 302; on the difference principle, see especially pp. 76 et seq.

<sup>540</sup> See ibid., pp. 302-303. <sup>541</sup> See B. Barry, *Theories of Justice* (1989), Vol. 1, p. 189.

<sup>542</sup> T. W. Pogge, *Realizing Rawls* (1989), p. 247.

<sup>543</sup> See C. R. Beitz, *Political Theory and International Relations* (1979), p. 132; and Pogge (above fn. 542), pp. 255 et seq.

<sup>544</sup> Beitz (above fn. 543), p. 128; and Pogge (above fn. 542), pp. 246 et seq.

<sup>545</sup> See K.-O. Apel, 'Diskursethik als Verantwortungsethik', in G. Schönrich and Y. Kato (eds.), *Kant in der Diskussion der Moderne* (1996), p. 326 at pp. 350 et seq.

<sup>546</sup> See J. Habermas, *Die postnationale Konstellation* (1998), p. 163.

of states and the existence of a real global discourse involving a global public and an international civil society.<sup>547</sup> Nevertheless, there exists a growing awareness and discussion about the way in which discourse ethics and the pertaining communicative techniques are able to broaden the legitimacy basis of international relations and institutions.<sup>548</sup>

## (b) Communitarism

Communitarism, in contrast, rejects the cosmopolitan vision of a world of individuals sharing universal principles of justice merely because they belong to a global community of humankind.<sup>549</sup> Rather, communitarism emphasises the embeddedness of the individual in concrete social, ethnic, linguistic, historic and cultural structures, from which the ability to act as a moral agent flows.<sup>550</sup> Therefore, the starting point of Rawlsian cosmopolitanism is already criticised:

[T]he question most likely to arise in the minds of the members of the political community is not, what would rational individuals choose under universalising conditions of such-and-such sort? But rather, what would individuals like us choose, who we are situated as we are, who share a culture and are determined to go on sharing it?<sup>551</sup>

While communitarians accordingly emphasise that the domain of justice remains foremost within a particular community, it is contentious as to what kind of community – from small neighbourhoods, to states, or even transnational networks – is conceived as constitutive for the development of shared principles of justice.<sup>552</sup> Apart from that, at least some proponents of communitarism do not generally deny that moral obligations may exist also at the global level, but they propose different priorities claiming that the moral connections to fellow citizens are usually stronger than those to others.<sup>553</sup> To such an extent, a differentiation between 'thick' and 'thin' justice is proposed.<sup>554</sup>

<sup>547</sup> See Paulus (above fn. 528), p. 138.

<sup>548</sup> See the articles in P. Niesen and B. Herborth (eds.), *Anarchie der kommunikativen Freiheit* (2007); comprehensively on justice and justification processes, see R. Forst, *Das Recht auf Rechtfertigung* (2007).

<sup>549</sup> For a general communitarian critique on the theory of Rawls, see, e.g. M. J. Sandel, *Liberalism and the Limits of Justice* (1982).

<sup>550</sup> See, e.g. A. MacIntyre, *After Virtue* (1981), pp. 6-11.

<sup>551</sup> M. Walzer, *Spheres of Justice* (1983), p. 5. <sup>552</sup> See Paulus (above fn. 528), pp. 36-38.

<sup>553</sup> See M. J. Sandel, *Democracy's Discontent* (1996), p. 343.

<sup>554</sup> See M. Walzer, *Thick and Thin* (1994), especially pp. 63 et seq.

Arguably, communitarians are right in reminding us about the importance and responsibility of domestic communities as main entities regarding the means of achieving justice in reality. Beyond that, however, they tell us very little about international justice, or even about the particular aspects of international justice that could be relevant for the application of international investment norms like fair and equitable treatment. The latter is at least true if communitarians do not want to be understood in the way that international justice is inexistent and that, therefore, economic activities of foreigners should not be protected at all. Anyway, possible considerations as to the non-protection of international economic activities subside if a state has accepted legally binding obligations guaranteeing such rights of foreigners. However, although a growing number of such international legal obligations exists, cosmopolitan one-world visions have also not yet materialised to the extent that any distinction between foreign and domestic investors would be impermissible per se. A theory that presents, to some extent, a compromise between both conflicting views is presented by Rawls' own advancement of his theory at the international level.

### (c) Rawls' *Law of Peoples*

In *The Law of Peoples*,<sup>555</sup> Rawls developed his own notions of international law and justice by applying a methodology similar to, but more general than, the approach he developed in *A Theory of Justice*. Rawls offers a 'realistic utopia'<sup>556</sup> of the international relations in which peoples would convene in an original position (this is a second original position additional to the original position at the domestic level)<sup>557</sup> so as to identify common principles of justice from behind a veil of ignorance. Thereby, he chooses peoples and not states as international actors in order to dissociate his theory from extreme notions of sovereignty granting states unrestricted autonomy, and because peoples in contrast to states possess a moral nature.<sup>558</sup> In order to be realistic, Rawls takes peoples as

<sup>555</sup> J. Rawls, *The Law of Peoples* (1999); for a comprehensive discussion of the theory, see, e.g. R. Martin and D. A. Reidy (eds.), *Rawls's Law of Peoples* (2006).

<sup>556</sup> Rawls (above fn. 555), pp. 11 et seq. <sup>557</sup> See *ibid.*, p. 32.

<sup>558</sup> See *ibid.*, pp. 23 et seq. See, however, H.-J. Cremer, 'John Rawls' "The Law of Peoples"', in H.-J. Cremer et al. (eds.), *Tradition und Weltoffenheit des Rechts* (2002), p. 97 at pp. 121-122, arguing that Rawls could have based his theory just as well on the notion of states if he had taken notice of the changed understanding of sovereignty in international law. On

they are and distinguishes mainly three types of peoples.<sup>559</sup> The first type are 'reasonable liberal peoples' who have adopted, in a first original position, principles of domestic justice like the ones outlined in Rawls' earlier writings. The second type are 'decent hierarchical peoples' who, while not being liberal and democratic, are not aggressive, reveal a common idea of justice and adhere to basic human rights.<sup>560</sup> A third category of non-well-ordered states comprises aggressive 'outlaw states' and 'burdened societies', whose political, social and economic circumstances make their achieving a well-ordered regime, at the very least, difficult.<sup>561</sup>

In an ideal theory, Rawls then enquires which principles of justice reasonable peoples would adopt. He lists the following eight principles as the basic charter of the Law of Peoples: (1) peoples are free and independent; (2) peoples are to observe treaties and undertakings; (3) peoples are equal; (4) peoples are to observe the duty of non-intervention; (5) peoples have the right of self-defence; (6) peoples are to honour human rights; (7) peoples are to observe certain specified restrictions in the conduct of war; and (8) peoples have a duty to assist other peoples living under unfavourable conditions.<sup>562</sup> In a second step, Rawls construes his ideal theory not as a closed club of reasonable peoples, but argues that decent societies, due to their basic structure as rational peoples moved by appropriate reasons, would also agree to the same principles.<sup>563</sup> While the relationship between reasonable and decent societies is characterised by mutual respect and the adherence to the principles of the Law of Peoples, the relationship to outlaw states and burdened societies is discussed in a non-ideal theory describing how to deal with such non-well-ordered peoples.<sup>564</sup>

Altogether, Rawls tries to provide a non-ethnocentric notion of international justice that seeks to establish an overlapping consensus within a pluralistic society of peoples.<sup>565</sup> The international society, as described by Rawls, is a liberal society that leaves room for a number of diverging

the notion of sovereignty, see also Chapter 7, section A, '1(a) Meaning of sovereignty in the context of international investment law'.

<sup>559</sup> See Rawls (above fn. 555), pp. 4 and 63, proposing in total five types of domestic societies.

<sup>560</sup> See *ibid.*, pp. 67 and 88. <sup>561</sup> *Ibid.*, p. 90. <sup>562</sup> *Ibid.*, p. 37. <sup>563</sup> *Ibid.*, p. 63.

<sup>564</sup> *Ibid.*, pp. 89 et seq. This *modus vivendi* with non-well-ordered societies especially includes differentiated criteria for military interventions in order to protect human rights as well as a duty to assist burdened societies.

<sup>565</sup> *Ibid.*, pp. 121 et seq.; see also Paulus (above fn. 528), pp. 157-158.

priorities and values, although they are not themselves liberal and democratic. Therefore, reasonable liberal peoples need to tolerate and respect other well-ordered societies as long as a consensus of overlapping political values exists, upon which the Law of Peoples can be based. Nevertheless, such consensus represents a minimum consensus among peoples and not a community of individuals, and it does not involve a system of distributive justice, as demanded in the domestic context.<sup>566</sup> On the one hand, Rawls accordingly sustains the distinction between international and domestic justice, but, on the other hand, does not deny that a minimum consensus on principles of international justice is possible.<sup>567</sup>

With regard to fair and equitable treatment, the latter reveals that the search for common principles does not imply the streamlining of every domestic legal and economic system, but only the identification of an overlapping consensus. To some extent, such a minimum consensus seems to exist as regards the *topoi* of fair and equitable treatment that are frequently invoked in arbitral decisions. However, what kind of further principles of justice might be of relevance and how all of this affects the application of fair and equitable treatment will be described with reference to another theory of international justice.

## B Franck's theory on fairness in international law

Thomas M. Franck presented a theory on 'Fairness in International Law and Institutions'<sup>568</sup> that is, not only linguistically, apt to describe more deeply the link between fair and equitable treatment and justice.<sup>569</sup> For him, the concept of fairness comprises two aspects – one of which is more procedural, related to 'right process' as a means of achieving legitimacy within a system, the other of which is a more substantive aspect of fairness, especially related to the ideas of distributive justice

<sup>566</sup> Rawls (above fn. 555), pp. 113 et seq.; Rawls thereby expressly rejects the proposals from liberal cosmopolitans which try to achieve distributive justice among the individuals of the world.

<sup>567</sup> In this sense, the first point delineates Rawls' theory from cosmopolitanism, the second point from communitarism.

<sup>568</sup> Franck (above fn. 345); the book is based on a previously held lecture at The Hague Academy of International Law, T. M. Franck, 'Fairness in the International Legal and Institutional System', RdC 240 (1993 III), p. 9.

<sup>569</sup> For an application of Franck's theory on the provision of fair and equitable treatment, see also R. Kläger, 'Fair and Equitable Treatment', JWIT 11 (2010), p. 435.

and equity.<sup>570</sup> These aspects may not always pull in the same direction, because the aspect of legitimacy is deemed to tend towards stability and order within a legal system, while the aspect of equitable justice favours redistributive change within that system.<sup>571</sup> According to Franck, although legitimacy may coincide with justice, 'fairness is the rubric under which this tension is discursively managed'.<sup>572</sup>

### 1 Legitimacy

Turning to legitimacy as one aspect of fairness, Franck emphasises that legitimacy is an attribute of a norm or judgment which conduces to the belief that it is fair, since it was made and is applied in accordance with 'right process', and which therefore promotes voluntary compliance.<sup>573</sup> Franck offers four indicators – determinacy, symbolic validation, coherence and adherence – by means of which the legitimacy of a norm may be assessed.<sup>574</sup> In terms of fair and equitable treatment, questions of legitimacy may arise in two different respects, described in the following.

First, one could question the legitimacy of fair and equitable treatment as a norm and, connected with that, the legitimacy of the whole investment regime in which fair and equitable treatment plays a part. Thereby, a legitimacy crisis of the international investment regime may be attested, due to inequalities in bargaining power at the negotiating stage of an investment treaty and, especially, due to textual indeterminacies and inconsistencies in the application and interpretation of treaty norms.<sup>575</sup> A similar critique attacks fair and equitable treatment itself and denies its legitimacy because of its lack of a clearly defined meaning: '[g]iven the indeterminacy of the standard, it cannot constitute a legitimate norm because it does not provide governments with specific guidance concerning what type of treatment of foreign investors is prohibited'.<sup>576</sup>

In Franck's terminology, these points of criticism relate mainly to the determinacy and coherence of fair and equitable treatment. Thereby, the textual determinacy is considered to display the ability of a text to convey a clear message.<sup>577</sup> To be legitimate, a norm should communicate

<sup>570</sup> Franck (above fn. 345), pp. 7–9. <sup>571</sup> *Ibid.*, p. 7. <sup>572</sup> *Ibid.*

<sup>573</sup> *Ibid.*, p. 26. On legitimacy in international law, see also comprehensively T. M. Franck, *The Power of Legitimacy among Nations* (1990).

<sup>574</sup> *Ibid.*, pp. 25–46. <sup>575</sup> See especially Franck (above fn. 369), pp. 1584–1587.

<sup>576</sup> Porterfield (above fn. 169), p. 113. <sup>577</sup> Franck (above fn. 345), p. 30.

to its addressees what conduct is permitted and what conduct is out of bounds.<sup>578</sup> Coherence, as another indicator of legitimacy, initially demands that, in the application of a norm, similar cases are generally treated alike.<sup>579</sup> Coherence demands furthermore that a norm being part of a legal system is connected and applied consistently in accordance with the general principles of this legal system.<sup>580</sup> Although the critique appears not to be without reason, it is submitted that the legitimacy deficits of fair and equitable treatment are due to the norm's special characteristics as a flexible and dynamic general clause. Problems of textual indeterminacy and incoherence are only to be resolved by a doctrinal concept that constitutes a solid justificatory foundation for the scope and application of the norm in question. This is exactly what the present analysis is attempting to address by reviewing different arguments for the construction of such a concept.

Second, the legitimacy of norms, executive orders or court decisions is also at stake if the host state is exercising sovereign power against the foreign investor. Since legitimacy covers the procedural aspects of fairness, the question as to the legitimacy of the host state's acts also involves these acts being issued and applied in accordance with the right process. Consequently, one important element of fair and equitable treatment relates to the fair procedures and associated requirements with which an act of the host state has to comply in order to be legitimate. In this sense, fair procedure is also recognised by arbitral jurisprudence as one of the *topoi* of fair and equitable treatment.<sup>581</sup> The importance of fair procedures does not, however, entail that 'the principle of fairness should not have substantive content' and that, therefore, the standard of fair and equitable treatment should only provide procedural and not substantive protection to foreign investors.<sup>582</sup> Such understanding would fail to take into account the second component of fairness – equity – that is considered by Franck to cover the substantive aspects of fairness.<sup>583</sup>

## 2 Equity

Equity has already been described above as being closely related to the concept of fair and equitable treatment. Similarly, Franck highlights

<sup>578</sup> Franck (above fn. 573), p. 57. <sup>579</sup> Franck (above fn. 345), p. 38.

<sup>580</sup> *Ibid.*, p. 41. Coherence in this sense overlaps with Dworkin's notion of 'integrity': see R. Dworkin, *Law's Empire* (1986), pp. 176 et seq.

<sup>581</sup> See Chapter 5, section A, '1 *Topoi* in arbitral jurisprudence'.

<sup>582</sup> See, however, Mayeda (above fn. 2), p. 284. <sup>583</sup> Franck (above fn. 345), p. 7.

equity to be more than a licence for the exercise of judicial caprice and perceives equity as law's justice, expressing such important principles as unjust enrichment, good faith or acquiescence, and considering it as a mode of introducing justice into resource allocation.<sup>584</sup> He also points out:

Justice, as an augmentation of law, is also needed to protect those interests not ordinarily recognised by traditional law, such as the well-being of future generations and the 'interests' of the biosphere. Finally, justice has a tempering role to play when the apportionment of goods ... occurs in the context of an almost infinite number of possible geographical, geological, topographical, economic, political, strategic, demographic, and scientific variables. In such cases 'hard and fast' rules of apportionment can be applied only at the risk of achieving results which lead to moral outrage and law's *reductio ad absurdum*. In that sense, fairness discourse which aims to temper the imperative of legitimacy with that of justice serves not to undermine but to redeem the law.<sup>585</sup>

Franck thus insinuates that especially general clauses, in comparison to hard and fast rules, are of a multi-layered complexity that, on the one hand, leaves more room in the application of such a norm, but, on the other hand, allows producing more reasonable and just answers by directly invoking equitable standards.<sup>586</sup> In relation to fair and equitable treatment this means that the norm's determinacy defects do not necessarily lead to its illegitimacy, but rather provide the possibility of introducing notions of justice and fairness into its concept as a norm.<sup>587</sup> The tension between legitimacy and equity appears, therefore, to be an element that is inherent in the very nature of fair and equitable treatment.

Accordingly, it is not only the textual precision of a rule that counts, but also its ability to achieve just results. This flexibility of a norm is of special importance in fields of law that are coined by their high complexity and the intricacy of the interests involved, as is the case with international investment law. However, Franck reminds us, '[t]he power of a court to do justice depends ... on the persuasiveness of the judges' discourse, persuasive in the sense that it reflects not their own, but society's value preferences'.<sup>588</sup> Fair and equitable treatment invites

<sup>584</sup> See *ibid.*, pp. 47 et seq. <sup>585</sup> *Ibid.*, p. 79.

<sup>586</sup> To such an extent Franck also differentiates between 'sophist norms' and 'idiot norms': see Franck (above fn. 573), pp. 74–75.

<sup>587</sup> See also Franck (above fn. 345), p. 33. <sup>588</sup> *Ibid.*, p. 34.

arbitrators 'to do justice', but thereby also discloses the tension that relates to the legitimacy of their decisions. According to Franck, such tension is to be managed within a fairness discourse.

### 3 Fairness discourse

Based on Rawlsian ideas, Franck describes his fairness discourse as a process of reasoning and negotiation that seeks to balance the tension between stability (expressed by the struggle for legitimacy, right process, good order and security) and change (favouring a just redistribution of wealth and resources).<sup>589</sup> Franck establishes two preconditions for any fairness discourse:<sup>590</sup> the first one is the moderate scarcity of the world's resources that are to be distributed. He explains that only when everybody can expect to have a share, but no one can expect to have all that is desired, does the question of fairness in the allocation of this resource arise.<sup>591</sup> The second precondition is the existence of a global community sharing some basic perceptions of what is unconditionally unfair.<sup>592</sup> These preconditions appear to be fulfilled in the case of fair and equitable treatment, since the resources at stake are not inexhaustible, but exist in moderate scarcity. The relevant resources in international investment law are: capital on the one hand and, for example, natural resources, cheap employees and purchasing power on the other. Furthermore, although the existence of a real community remains contentious at the international level, international investment law seems to have developed basic perceptions of what is to be considered as clearly unfair. Such perceptions are reflected, for instance, in the *topoi* as developed by arbitral jurisprudence. Even if these *topoi* merely represent a minimum overlapping consensus, they allow for a meaningful scrutiny of whether or not a certain type of conduct is ultimately fair. Therefore, it appears indeed possible to initiate a fairness discourse on fair and equitable treatment.

Franck furthermore acknowledges that the fairness discourse may take place in different fora, of which international investment law is one where the pull to stability and the push for change is

<sup>589</sup> Ibid., p. 7; on the tension between order and justice in international law, see similarly H. Bull, *The Anarchical Society* (1977), pp. 77 et seq.; and M. Koskeniemi, 'The Police in the Tempel', *EJIL* 6 (1995), p. 325 at pp. 328-330; on stability and change in international law, see also H. Lauterpacht, *The Function of Law in the International Community* (1933), pp. 245 et seq.

<sup>590</sup> Franck (above fn. 345), pp. 9-22. <sup>591</sup> Ibid., p. 10. <sup>592</sup> Ibid., pp. 10-11.

becoming exceptionally apparent.<sup>593</sup> Franck describes important characteristics of such a discourse in international investment law as follows:

The discourse may be dispute-specific or it may be general and normative. In either instance, however, it will be about the tension between change and stability, as also about the extent to which law should reflect political or economic imperatives. It will also be about balancing the social need to induce capital growth against political claims to redistributive justice. However intense the dispute, there is more at stake for the system than the specific interests of the disputing parties. The most important source of development capital for poor countries is the private sector of rich ones. That makes it an essential global priority that a transnational compact between investors and host governments be built – investment agreement by investment agreement, treaty by treaty, and state practice by state practice – and that its perceived fairness in text and in operation give it the elasticity needed to accommodate the inevitable tension between the political pull to change and the economic rationale for stability.<sup>594</sup>

To shape the fairness discourse further, Franck has introduced two 'gatekeepers' of the fairness discourse serving as indicators of what is considered to be unconditionally unfair.<sup>595</sup> The first gatekeeper is described as a 'no-trumping' condition, meaning that no participant of the fairness discourse can make claims which automatically trump the claims made by other participants.<sup>596</sup> This gatekeeper is necessary because any automatic trumping entitlement would vitiate, *a priori*, any attempt to balance the tension between elements of stability and change. The second gatekeeper aims at delineating the broad notion of distributive justice and is called the 'maximin' condition<sup>597</sup> – an adaptation of Rawls' controversial 'difference principle'. This condition means that inequalities in the distribution of goods are only justifiable if the inequality has advantages not only for its beneficiaries, but also for everyone else.<sup>598</sup> While the reach of a possible obligation of maximising wealth and resources is deeply contested among cosmopolitans and communitarians, it must be noted that investment agreements are based on the idea that foreign investments are able to further the just distribution of capital, know-how, labour and natural resources in order

<sup>593</sup> Ibid., pp. 438 et seq. <sup>594</sup> Ibid., p. 441. <sup>595</sup> See *ibid.*, pp. 14 et seq.

<sup>596</sup> Ibid., pp. 16-18. <sup>597</sup> *Thereto* see *ibid.*, pp. 18-22.

<sup>598</sup> Ibid., p. 18. For a critical discussion of Franck's maximin condition, see J. Tasioulas, 'International Law and the Limits of Fairness', *EJIL* 13 (2002), p. 993 at pp. 1014 et seq.

to create welfare effects on all sides.<sup>599</sup> Nevertheless, it seems that welfare considerations in this sense should not hastily be excluded from a fairness discourse, but rather be considered in the pertinent process of balancing.

### C Fairness discourse on fair and equitable treatment

Fair and equitable treatment, with its explicit reference to notions of fairness and equity, may be considered as an invitation by international treaty-makers to proceed by way of a fairness discourse. Such a discursive approach is already inspired by basic Socratic ideas that practical questions should be dealt with within a free discourse, which is deemed crucial for the justification of normative power and the establishment of a just legal system.<sup>600</sup> The following remarks try to identify elements of a model of a fairness discourse on fair and equitable treatment based on the already discussed notions of international justice. Such discourse aims to increase the legitimacy of arbitral decisions on fair and equitable treatment by making them rationally revisable. In this sense, the fairness discourse has to structure the arguments, which are advanced in order to justify particular decisions, and to discover ways that are capable of resolving the tension between differing arguments.

#### 1 Stages of a legal discourse

A differentiation is needed between distinct stages of a fairness discourse. At the very least, a distinction is to be made between a discourse on the establishment of just norms and one on the just application of norms.<sup>601</sup> In this vein, Franck alludes that the discourse may be general and normative, or dispute-specific.<sup>602</sup> This entails that a discourse may take place at the stage of norm-creation, which aims at the establishment of fair norms for the global regulation of international

<sup>599</sup> See, e.g. the preamble of the 2005 Germany Model BIT. To what extent investments agreements are, in fact, able to attract foreign investment flows is contentious: see Chapter 2, section B, '2 The effectiveness of international investment agreements'.

<sup>600</sup> See Habermas (above fn. 116); for an overview and a critical discussion on different discourse theories, see, e.g. A. Engländer, *Diskurs als Rechtsquelle?* (2002); and B. Rütters, *Rechtstheorie*, 3rd edn (2007), pp. 352 et seq.

<sup>601</sup> Thereon, see generally Alexy (above fn. 117), pp. 52–70.

<sup>602</sup> Franck (above fn. 345), p. 441.

investments. Nevertheless, a discourse may also take place at a subsequent stage in which an already established norm is applied to specific fact situations. As fair and equitable treatment is not concerned with the creation of norms, but represents itself a norm that is to be applied, the respective fairness discourse takes place at this subsequent stage. However, as the example of fair and equitable treatment reveals, both stages of a discourse are not fully separable, since, due to the relative indeterminacy of its language, a part of the discourse has been shifted from the first to the second stage.

Franck recognises this second stage of discourse by highlighting 'process determinacy' as a means of overcoming textual indeterminacy through a clarifying process that enlightens the ambiguous meaning of a norm.<sup>603</sup> This clarifying process must be governed by a court or other authority which is recognised as legitimate by the addressees of the norm and which applies coherent argumentative principles.<sup>604</sup> However, as the legitimacy of the decision-maker is ultimately dependent on the quality of the issued decisions, the legal discourse at the application stage of a norm also affects the decision-maker itself.<sup>605</sup>

The discourse on the application of a norm is, above all, an analysis of the rationality of the judicial decisions that have applied this norm. The rationality of a judicial decision presupposes that the arguments, upon which the decision is built, are true, correct and acceptable and that the particular decision may be deduced from these arguments.<sup>606</sup> Therefore, to make a decision revisable on a rational basis, it is necessary that the decision unfolds all relevant arguments and the relevant reasons why some arguments are allocated more weight than others. Thus, the discourse has to provide convincing reasons that justify a particular decision. This is unproblematic if the discourse at the norm-creation stage has already generated a simple structured rule that features a clear-cut literal meaning. Usually, however, and especially when considering general clauses like fair and equitable treatment, the literal

<sup>603</sup> Franck (above fn. 573), pp. 61 et seq. <sup>604</sup> *Ibid.*, pp. 61 and 64.

<sup>605</sup> On the rationality of review, see also Chapter 7, section C, '3 Rationality deficits'.

<sup>606</sup> See R. Alexy, 'Die logische Analyse juristischer Entscheidungen', in R. Alexy et al. (eds.), *Elemente einer juristischen Begründungslehre* (2003), p. 9 at p. 12. Moreover, Alexy distinguishes between an internal justification, concerning the logical deduction from the premises, and an external justification, concerning the truthness of the premises. The discourse on the rationality of a decision mainly concerns the external justification. On internal and external justification, see also J. Wróblewski, 'Legal Decision and its Justification', in H. Hubien (ed.), *Legal Reasoning* (1971), p. 409 at p. 414; and Alexy (above fn. 445), pp. 273 et seq.



meaning of a norm is not absolutely clear in this sense, but reveals a 'penumbra of uncertainty' giving a certain leeway to the decision-maker.<sup>607</sup> In that case, the legal discourse at the stage of the application of this norm has to search for other second-order arguments that sustain a certain decision. Arguably, such discourse delivers manifold arguments that are to be considered in deciding a case, but which do not always point in the same direction. In the sense of a fairness discourse, the arguments may be attributed to one of the conflicting poles of stability and change, and the tension resulting therefrom has to be balanced in the individual case. To be able to carry out such a balancing operation, it must first be determined which elements of fair and equitable treatment stand for stability and which stand for change.

## 2 Aspects of stability and change

Arguments that can be introduced into the discourse on fair and equitable treatment may be of different kinds. The forms of arguments may especially relate to the relevant text of an investment agreement, to precedents and doctrine, as well as to certain legal objectives.<sup>608</sup> However, as a consequence of the gateway character of fair and equitable treatment within the relatively fragmented international legal system, these arguments are not necessarily limited to the text of the particular investment agreement in dispute. Rather, systemic arguments may also derive from other legal texts or objectives of other sub-systems of international law if they can be systemically integrated into the concept of fair and equitable treatment.<sup>609</sup> In the present discussion on fair and equitable treatment, alongside the interpretation of a specific investment treaty text, arguments relating to precedents have played a dominant role. To such an extent, the *topoi*, as identified by arbitral tribunals, are apt to provide valuable arguments for the discourse. However, the *topoi* do not describe merely a conglomeration of past cases, but are also representative of a deeper 'overlapping consensus' on objectives that are commonly pursued by all parties to investment agreements.

<sup>607</sup> See Hart (above fn. 464), p. 12; in the context of European law, see also Nettesheim (above fn. 118), mnn. 64 et seq.

<sup>608</sup> Thereon, see Alexy (above fn. 445), pp. 285 et seq.; see also Nettesheim (above fn. 118), mn. 63.

<sup>609</sup> Thereon, see Chapter 4, 'The role of international law in the construction of fair and equitable treatment'.

However, these objectives are not the only relevant sources of arguments in international investment law, but they compete against other objectives of the international legal system. In particular, they also compete against the traditional objective of sovereignty of states that is inherent in the international legal system and against other already established or emerging objectives of other sub-systems, such as international human rights or international environmental law. Further arguments could be extracted from the idea that fair and equitable treatment represents an embodiment of the rule of law or from the discussion on the emergence of a global administrative law.<sup>610</sup> Similarly, arguments could emanate from the identification of principles of international economic law in general,<sup>611</sup> which would also have an impact on the application of fair and equitable treatment. In order to be legitimate, a decision on fair and equitable treatment needs to establish a certain level of coherence between the arguments deriving from all of these competing principles or objectives if they are to be relevant for the particular case.

The model of a fairness discourse helps to describe the tension between these arguments and enables a certain structuring by assigning each objective to one of the two above-mentioned aspects of fairness. The meaning of these aspects – stability and change – in international investment law is once again recounted by Franck.<sup>612</sup> He assumes that a global capital market exists that is essential for the development and growth of national economies, but which does not benefit rich and poor equally. Thereby, this capital market is operating within a national political system that presumably tries to mitigate the gap between rich and poor or to attenuate other negative impacts of foreign capital by state intervention. However, such intervention may clash with the investor's expectations and his reliance on the stability of the political parameters. Nevertheless, the change in the legal framework may not be considered illegitimate per se if the change is conducted in accordance with a right and publicly known process. To such an extent, a fairness discourse on fair and equitable treatment

<sup>610</sup> See also Chapter 5, section B, '2 Fair and equitable treatment as an embodiment of the rule of law'.

<sup>611</sup> On principles of international economic law, see, e.g. G. Schwarzenberger, 'The Principles and Standards of International Economic Law', RdC 117 (1966 I), p. 1; Weiler (above fn. 105); and Weiler (above fn. 104).

<sup>612</sup> See Franck (above fn. 345), pp. 438–441.

needs to 'accommodate the inevitable tension between the political pull to change and the economic rationale for stability'.<sup>613</sup>

Arguments that call for stability or the legitimacy of state action are therefore to be found mainly in the lines of jurisprudence of arbitral tribunals, such as fair procedure, non-discrimination, the protection of the investor's legitimate expectations and transparency. Arguments that call for redistributive change are often not explicitly mentioned, but mostly may be subsumed under the notion of state sovereignty, entitling a state to pursue different tax, currency, labour, social or other policies. Further arguments for change may derive from social or ecological considerations and may be embraced by the label of sustainable development. Although these examples certainly do not depict an exhaustive list,<sup>614</sup> each of these elements represents one aspect of either stability or change and may therefore provide for valuable arguments that may be introduced into the fairness discourse. In summary, six easily identifiable elements of stability and change have to play a role in the fairness discourse: fair procedure, non-discrimination, transparency and the protection of the investor's legitimate expectations, on the stability side; sovereignty and sustainable development, on the change side. In contrast to these objectives, proportionality is considered to be an element to structure further the arguments derived from the mentioned objectives.

While it is not precluded to introduce further elements into the fairness discourse, the following remarks will be limited to these elements for reasons of convenience. For the present purposes, it also appears unnecessary to discuss whether these aspects should be referred to as 'topoi', 'objectives' or 'principles', since all of these legal concepts are able to act as sources of arguments that are capable of justifying a particular decision. Nevertheless, the notion of principles will be preferred in the following, since it has already been employed by others<sup>615</sup>

<sup>613</sup> Ibid., p. 441.

<sup>614</sup> For instance, further arguments could be derived from human rights obligations: see van Aaken (above fn. 357), pp. 117 et seq. In the dichotomy of stability and change, however, human rights arguments reveal a certain ambivalence because property-related rights would stand for stability while, e.g. social rights could stand for change. Therefore, human rights arguments, insofar as they stand for change, are deemed here to be embraced by the principles of sovereignty and sustainable development. Insofar as they stand for stability, they are considered to be contained in the other principles of fair and equitable treatment.

<sup>615</sup> See, e.g. Schill (above fn. 2), p. 41; and more generally Douglas (above fn. 135), pp. 85 et seq. Others refer to fair and equitable treatment itself as a principle; however, this

and because it is a bone of contention in describing the general structure of law that will be discussed at a later stage.

### 3 *The imperative of balancing*

After the identification of the aspects of stability and change, the discourse at the application stage of fair and equitable treatment has to solve the tension that exists between those elements. Accordingly, if in a specific fact situation some arguments favour stability while others strive for change, it is to be decided which ones will ultimately prevail. Thereby, it has already been alluded to that the process of decision-making, connected with a general clause like fair and equitable treatment, is characterised by a process of balancing and weighing.<sup>616</sup> The importance of balancing is also acknowledged by some investment tribunals stating, for example, that '[t]he determination of a breach of [fair and equitable treatment] therefore requires a weighing of the claimant's legitimate and reasonable expectations on the one hand and the respondent's legitimate regulatory interests on the other'.<sup>617</sup>

The process of balancing represents an integral part of the fairness discourse.<sup>618</sup> As an important prerequisite of a balancing of aspects of stability and change, especially Franck's 'no-trumping' condition comes into play, assuring that no argument derived from any particular aspect of the discourse automatically trumps another or even all other arguments at stake.<sup>619</sup> In this sense, a fairness discourse demands that arguments related to the sovereignty of states, to the stability of investor-state relations or to any of the other principles of fair and equitable

parlance is not adopted here because it may lead to confusion in the description of the position of fair and equitable treatment in the system of international law sources – thereon see Chapter 8, 'Fair and equitable treatment in the system of international law sources'.

<sup>616</sup> See Chapter 5, section B, '1 Fair and equitable treatment as a "standard"'.  
<sup>617</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 306; see also *International Thunderbird Gaming Corp. v. Mexico* (above fn. 444), at paras. 30 and 102; on the balance between investment protection and host state regulatory freedom, see, e.g. F. O. Vicuña, 'Regulatory Authority and Legitimate Expectations', *International Law Forum* 5 (2003), p. 188; M. Krajewski and J. Ceyssens, 'Internationaler Investitionsschutz und innerstaatliche Regulierung', *ArchVR* 45 (2007), p. 180; T. Grierson-Weiler and I. A. Laird, 'Standards of Treatment', in P. Muchlinski et al. (eds.), *The Oxford Handbook of International Investment Law* (2008), p. 259 at pp. 299–301; and on the balancing in public international law generally, see P. Hector, *Das völkerrechtliche Abwägungsgebot* (1992), pp. 173 et seq.

<sup>618</sup> See, however, Tudor (above fn. 2), p. 205, denying the possibility of a balancing operation at the liability phase.  
<sup>619</sup> See Franck (above fn. 345), p. 16.

treatment do not automatically precede other arguments. Accordingly, the principles underlying fair and equitable treatment and the arguments derived therefrom are not absolute but relative, and the relations of precedence between these arguments are not predetermined, but vary in accordance with the circumstances of the specific case.

Which particular argument or principle prevails in the discourse is ultimately a question that relates to the 'dimension of weight'<sup>620</sup> of each principle. Similar to the identification of the relevant *topoi* or principles that influence the application of fair and equitable treatment, the relative weight of the pertaining arguments is also to be based on an overlapping consensus established in a discursive way. To such an extent, arbitral tribunals need to justify their particular weight allocation by explaining why, according to the facts of the particular case, one argument outweighs another. In addition to the facts of a case, such justification has to correspond to preference relations already established in the texts of relevant agreements and precedents as well as by a comparative law methodology.<sup>621</sup> In most cases, the weight of a particular argument will not demand that another principle is pushed aside as a whole, but will only claim validity to a certain extent that is determined by the specific weight allocation in the particular case.<sup>622</sup> This means that arbitrators should attempt to achieve a reconciliation of all conflicting principles in a way that each principle, in accordance with its relative weight, is brought to bear as far as possible.<sup>623</sup>

Arguably, a decision that achieves such a balance between conflicting principles and arguments has to be considered as fair because it favours stability and change at the same time. Nevertheless, in light of the considerable disparities among domestic legal traditions and the (still) quite different attitudes towards foreign investment, it is also to be conceded that the identified principles hardly represent more than a minimum consensus at a relatively high level of generality. To such an

<sup>620</sup> Dworkin (above fn. 116), p. 26; see also R. Alexy, *A Theory of Constitutional Rights* (trans. Julian Rivers) (2002), p. 50.

<sup>621</sup> In the context of European law, see, e.g. Nettesheim (above fn. 118), mnn. 87 et seq.

<sup>622</sup> See the 'law of balancing' as proposed by Alexy (above fn. 620), p. 102, stipulating: '[t]he greater the degree of non-satisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other'.

<sup>623</sup> This approach is well known in German constitutional law under the notion of 'praktische Konkordanz', which was coined by K. Hesse, *Grundzüge des Verfassungsrechts der Bundesrepublik Deutschland*, 20th edn (1995), p. 28.

extent, the acceptance of such overlapping consensus does not mark the end of a discourse, but rather the beginning of a fairness discourse on the reasonable concretisation and application of these principles in the context of fair and equitable treatment.<sup>624</sup> This discourse on the right balance between stability and change is, of course, not free from arbitrators' personal assessments, especially in the process of determining the specific weight of each principle at stake. Thereby, it also appears possible that a variety of particular weight allocations remain which may reasonably be taken. Arbitrators then have to choose a particular decision and justify this by providing reasons. The criteria according to which arbitrators then decide - by applying the maxim of *in dubio mitius*,<sup>625</sup> defining areas of judicial self-restraint or favouring a dynamic pro-investor approach - are again to be justified by an adequate process of reasoning.

In conclusion, the foregoing has attempted to show that fair and equitable treatment may be considered as an embodiment of justice within the system of international investment law. This search for justice arises from the increasing breadth and complexity of international investment law that is almost naturally accompanied by growing concerns about the fairness of that legal system.<sup>626</sup> Only if international investment law is generally perceived as fair and if it demonstrates an ability to produce fair results even in critical situations, will it meet with the sustained acceptance of its actors. Perceived fairness of a legal system depends on its capacity to unite claims to the redistribution of wealth and resources, and those to order and legitimacy. It is thus submitted that the described concept of fair and equitable treatment, as a concept of balancing arguments related to stability and change, represents a step in the direction of an increased quality of legal reasoning and decision-making.

<sup>624</sup> The need to concretise further the overlapping consensus on certain principles of justice is also acknowledged by Rawls (above fn. 555), p. 37.

<sup>625</sup> Thereto see Jennings and Watts (above fn. 124), pp. 1278-1279; on the limited relevance of this maxim, see Tomuschat (above fn. 524), pp. 170-171.

<sup>626</sup> See also Franck (above fn. 345), p. 6.

## 7 Principles of fair and equitable treatment

### A Substantive principles

The following remarks endeavour to analyse further the principles of fair and equitable treatment and the way in which arbitral tribunals concretise and balance these principles. Within this analysis, a general distinction is made between principles addressing rather substantive issues and those mainly related to procedural aspects of a host state's legal system.<sup>627</sup> In addition, the manner is discussed in which arbitral tribunals structure their argumentation on fair and equitable treatment and the extent to which it is capable of increasing the overall rationality of the argumentation. In the ensuing sections, the following points are addressed in relation to each of the principles of fair and equitable treatment: a general and comparative survey of the principle; the principle's appearance in arbitral jurisprudence; and its relative weight in the balancing process.

#### 1 Sovereignty

Sovereignty constitutes a meta-principle of public international law<sup>628</sup> that enshrines the independence and autonomy of states. Due to the importance of sovereignty in traditional international law and the fact that most other principles of fair and equitable treatment typically conflict first and foremost with state sovereignty, this principle is chosen to commence the present discussion. Thereby, it is not intended to

<sup>627</sup> The present distinction between substantive and procedural principles of fair and equitable treatment is only to arrange the different principles more clearly and is irrespective of the attribution of procedural aspects to the category of legitimacy and substantive aspects to the category of equity which T. Franck suggests for his fairness discourse.

<sup>628</sup> See Article 2 No. 1 of the UN Charter, referring expressly to the principle of the sovereign equality of all states.

give a comprehensive description on the concept of sovereignty: this section will illustrate only those aspects that might be of relevance for the understanding of the principle as part of the discourse on fair and equitable treatment.

#### (a) Meaning of sovereignty in the context of international investment law

The multi-faceted notion of sovereignty cannot be understood without being aware of its fickle history. The notion of sovereignty is intimately connected with the name of Jean Bodin,<sup>629</sup> who – based on the bellicose chaos in Europe in the sixteenth century – proclaimed the absolute sovereignty of a ruler within a state.<sup>630</sup> Absolute sovereignty in this sense was an internal sovereignty, meaning that the ruler was not legally responsible for his exercise of power to any superior authority to whom his acts might be appealed.<sup>631</sup> The idea of sovereignty assumed an external dimension through the Peace of Westphalia (1648), which is generally considered as the dawn of the era of territorial states, the coexistence of which is characterised by the principles of independence and equality.<sup>632</sup> However, this external sovereignty was not considered as an absolute sovereignty in the radical Hobbesian sense,<sup>633</sup> considering states to be warring against each other in a 'state of nature' without being bound by any superior legal order.<sup>634</sup> Excluding certain excessive perceptions of state sovereignty in the nineteenth and early twentieth century, absolute sovereignty in its classical meaning represented an internal concept, entitling a ruler to exercise supreme authority within its borders, rather than an external concept that would have exonerated states from commitments to which they had consented under international law.<sup>635</sup>

<sup>629</sup> J. Bodin, *Les six livres de la république* (1576).

<sup>630</sup> On Bodin's notion of sovereignty and international law, see generally H. Quaritsch, 'Bodins Souveränität und das Völkerrecht', ArchVR 17 (1977/1978), p. 257.

<sup>631</sup> H. Steinberger, 'Sovereignty', in R. Bernhardt (ed.), *Encyclopedia of Public International Law* (1987), Vol. 10/12, p. 397 at p. 402.

<sup>632</sup> See, e.g. S. Oeter, 'Souveränität – ein überholtes Konzept?', in H.-J. Cremer et al. (eds.), *Tradition und Weltoffenheit des Rechts* (2002), p. 259 at p. 264; and J. Kokott, 'States, Sovereign Equality', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (Online Publication) (2009), mn. 6.

<sup>633</sup> From the works of Thomas Hobbes, see especially T. Hobbes, *Leviathan* (1651).

<sup>634</sup> See Steinberger (above fn. 631), pp. 402–403. A similar theory of absolute sovereignty degrading public international law to a mere external law of the state was enunciated by G. W. F. Hegel, *Grundlinien der Philosophie des Rechts* (1821), §§ 330 et seq.

<sup>635</sup> See Verdross and Simma (above fn. 182), pp. 26–27; Steinberger (above fn. 631), pp. 403–407; and Oeter (above fn. 632), pp. 272–274.

In modern international law, it is generally accepted that sovereignty describes a legal status of a state within but not above international law; it denotes the states' direct subjectivity to international law and protects their territorial integrity, exclusive personal and territorial jurisdiction, cultural identity and freedom of self-determination over political and socio-economic affairs.<sup>636</sup> To such an extent, the sovereignty or independence of states today represents a relative concept<sup>637</sup> or a 'question of degree'<sup>638</sup> that encompasses the freedom of states to submit to an international order which is dependent on their own consent. Moreover, far-reaching developments, for instance, in the fields of human rights law, international environmental law and international criminal law, show that the requirement of state consent in international law has been increasingly on the retreat.<sup>639</sup> The various qualifications of external sovereignty also affect the initially absolute internal sovereignty of states, leading to a progressive internationalisation of internal law and a diminishing of what is commonly called the *domaine réservé* of states.<sup>640</sup> These trends, frequently associated with the buzzword of globalisation, have certainly caused a deep - sometimes bemoaned and sometimes acclaimed - transformation of the concept of sovereignty,<sup>641</sup> raising sweeping questions as to whether the era of the nation state or the concept of sovereignty is coming to an end.<sup>642</sup>

<sup>636</sup> See, e.g. Steinberger (above fn. 631), pp. 408 and 410; Jennings and Watts (above fn. 124), pp. 382-384; Graf Vitzthum (above fn. 129), p. 25; T. Stein and C. von Buttlar, *Völkerrecht*, 12th edn (2009), p. 178; and comprehensively W. von Simson, *Die Souveränität im rechtlichen Verständnis der Gegenwart* (1965).

<sup>637</sup> See I. Seidl-Hohenveldern, *International Economic Law*, 3rd edn (1999), pp. 19-20; and G. Dahm, J. Delbrück and R. Wolfrum, *Völkerrecht*, 2nd edn (1989), Vol. I/1, pp. 215-216.

<sup>638</sup> Jennings and Watts (above fn. 124), p. 391.

<sup>639</sup> See, e.g. Kokott (above fn. 632), mn. 31; and Stein and von Buttlar (above fn. 636), pp. 179-180.

<sup>640</sup> See E. Klein, 'Die Internationalen und die Supranationalen Organisationen', in W. Graf Vitzthum (ed.), *Völkerrecht*, 4th edn (2007), p. 265 at p. 355; and Kokott (above fn. 632), at mnn. 32-33. See also Dahm, Delbrück and Wolfrum (above fn. 637), pp. 217-222.

<sup>641</sup> Thereon see N. Shrivjer, 'The Changing Nature of State Sovereignty', *BYIL* 70 (1999), p. 65; K. Jayasuriya, 'Globalization, Law, and the Transformation of Sovereignty', *Ind. J. Global Legal Stud.* 6 (1999), p. 425; C. D. Wallace, *The Multinational Enterprise and Legal Control*, 2nd edn (2002), pp. 60 et seq.; and A. Coleman and J. Maogoto, 'After the Party, is there a Cure for the Hangover?', *Legal Issues of Economic Integration* 20 (2003), p. 35. See also Franck (above fn. 345), p. 3, commencing his study on fairness in international law with the observation, '[s]overeignty has historically been a factor greatly overrated in international relations'.

<sup>642</sup> See, e.g. C. Schreuer, 'The Waning of the Sovereign State', *EJIL* 4 (1993), p. 447; Oeter (above fn. 632); and M. Herdegen, *Völkerrecht*, 7th edn (2008), p. 197.

It is possible to observe the transformation of the notion of sovereignty in international investment law and also more generally in international economic law. Thereby, international economic law has always been a field of strong interdependence between different national markets, creating strong incentives for international economic cooperation.<sup>643</sup> However, since decolonisation, many developing countries have understandably guarded their sovereignty very closely and therefore tried to protect their newly achieved independence against external interference. In order to pursue the nationalisation of their economies and diminish their dependency on foreign enterprises, these countries proclaimed the concept of 'permanent sovereignty over natural resources', which found its most conspicuous restatement in Article 2(1) of the 1974 Charter of Economic Rights and Duties of States.<sup>644</sup> The legal character of this conception, and especially whether it constituted a return to a dated notion of absolute sovereignty contravening already established international investment agreements or the perception of a customary minimum standard, remained highly controversial.<sup>645</sup> However, since the Charter stipulates the avowal of states to fulfil international obligations in good faith,<sup>646</sup> it is generally assumed that the sovereignty over natural resources conveys a matter of course without abandoning the notion of relative sovereignty in the field of international investment law.<sup>647</sup> The latter is confirmed by the fact that, subsequent to the proclamation of permanent sovereignty over natural resources, as an expression of their very own sovereignty, states have concluded hundreds of binding international investment arrangements and thereby consented to the restriction of their own sovereignty in matters of investment regulation.<sup>648</sup>

<sup>643</sup> See Schwarzenberger (above fn. 611), p. 27.

<sup>644</sup> Article 2(1) of the Charter provides:

Every state has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

<sup>645</sup> See, e.g. Schachter (above fn. 119), pp. 301-305; and Seidl-Hohenveldern (above fn. 637), pp. 23-27.

<sup>646</sup> See Chapter 1 lit. j of the UN General Assembly resolution 3281 (XXIX) of 12 December 1974 (Charter of Economic Rights and Duties of States).

<sup>647</sup> See Verdross and Simma (above fn. 182), pp. 813-815; Schachter (above fn. 119), pp. 304-305; Seidl-Hohenveldern (above fn. 637), pp. 27; and Sornarajah (above fn. 3), pp. 90-92.

<sup>648</sup> On the proliferation of BITs, see Chapter 2, section B, '1(b) The proliferation of international investment agreements'.

However, the appraisal that the international regulation of investment by means of an international treaty regime is not contrary but rather corresponds to the states' sovereignty<sup>649</sup> does not mean that sovereignty would be irrelevant in the application of these treaties. Indeed, as the review of various principles of fair and equitable treatment has shown, the application of investment treaties seriously affects the host states' freedom of action in a number of ways.<sup>650</sup> In particular, the intrusion into the sovereignty of host states is not restricted to a small part of government activity, but may interfere with all branches – legislature, executive and judiciary – of a state's sovereign jurisdiction. However, as the investment treaty regime that imposes such restrictions has been established by the mutual agreement of states, the continuance of the regime is, *e contrario*, dependent on the persistent acceptance of the participating states.<sup>651</sup> Accordingly, fair and equitable treatment and the other obligations contained in international investment treaties are not to be interpreted separately from the sovereignty of states, but by taking into account the independence of states.

The latter is buttressed by the generally accepted connection between state sovereignty and the freedom of self-determination.<sup>652</sup> Within the boundaries of international law, sovereignty entails, *inter alia*, the right of states to choose freely their political, social, cultural and economic

<sup>649</sup> To such an extent, the 'paradox that [states], to remain sovereign, they have to cooperate' (as noticed by H. G. Schermers and N. M. Blokker, *International Institutional Law*, 4th edn (2003), p. 1204) also applies in the field of international investment law, since developing countries by concluding BITs are seeking to increase their development possibilities. The international regulation of investment is, to some extent, also a response to global capital flows as an economic actuality: thereon see R. Dolzer, 'Wirtschaftliche Souveränität im Zeitalter der Globalisierung', in H.-J. Cremer *et al.* (eds.), *Tradition und Weltoffenheit des Rechts* (2002), p. 137 at p. 139.

<sup>650</sup> See also Dolzer (above fn. 73), p. 964, observing that 'the principle of fair and equitable treatment may, in practice, have wide-ranging repercussions for the sovereignty of the host state to determine and apply its administrative law ... Depending upon how it is interpreted and applied by the tribunals, the principle has the potential to reach further into the traditional *domaine réservé* of the host state than any one of the other rules of the treaties.' On regulatory freedom and international investment law, see also Sornarajah (above fn. 3), pp. 265–266; Krajewski and Ceysens (above fn. 617); and Kolo (above fn. 515).

<sup>651</sup> Acceptance in this sense means the general acceptance of the investment treaty regime as such. Hence, the repudiation by a state of particular awards of investment tribunals, which order the state to pay damages to private investors, is not to be considered as an encroachment on that state's sovereignty because the risk of disadvantageous awards has been assumed through the conclusion of the pertinent investment treaty.

<sup>652</sup> See Steinberger (above fn. 631), p. 412; and Kokott (above fn. 632), mn. 51.

system.<sup>653</sup> It is obvious that states, by concluding international investment treaties, are unwilling to deprive themselves of their basic freedom to pursue public policies in this respect. To such an extent, a certain degree of regulatory flexibility, as often advocated through slogans like the 'right to regulate' or 'policy space',<sup>654</sup> appears undoubtedly necessary in order to guarantee such basic freedom of states. However, these conceptions are also not absolute but relative, and are subject to certain qualifications by international investment treaties that are binding upon states. Hence, in the case of fair and equitable treatment, the flexibility of states as embodied in the broad notion of sovereignty conflicts with other principles favouring foreign investors' interests. The resulting tensions between sovereignty and investment protection are to be eased by arbitral tribunals in consideration of the facts of a particular case.

#### (b) Sovereignty in arbitral jurisprudence

Sovereignty does not appear as a sub-element of fair and equitable treatment that is expressly recognised as such within the lines of argumentation in arbitral jurisprudence. Nevertheless, the sovereignty of states to regulate freely their internal affairs and install pertinent administrative and judicial procedures represents a subject which, in investment disputes, is continuously acting as a counterbalance against the interests of foreign investors. Accordingly, sovereignty also provides arguments for the construction of the concept of fair and equitable treatment and is, therefore, at least implicitly, accepted as a relevant principle in this context. To such an extent, all cases reviewed in the following and under the heading of other principles could also be considered to be descriptions of the principle of sovereignty. It is for this reason that only a few distinctive cases dealing with sovereignty will be examined at the present stage.

An interesting example in this respect is provided by the case of *Pope & Talbot Inc. v. Canada*, in which Canada enacted a complex regulatory regime for the implementation of the Softwood Lumber Agreement (SLA)

<sup>653</sup> See lit. e of the principle of sovereign equality as stipulated in the 1970 Friendly Relations Declaration; see also *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. USA)* (above fn. 376), at para. 205; Krajewski (above fn. 203), p. 261; Herdegen (above fn. 167), pp. 84–85; and in the context of WTO law, see also Hilf and Oeter (above fn. 395), pp. 119–120.

<sup>654</sup> On the importance of policy space in international investment law, see UNCTAD, *FDI Policies for Development*, World Investment Report (2003), pp. 145 *et seq.*

between Canada and the United States.<sup>655</sup> The foreign investor attacked the Canadian regulations at a number of points that were negatively affecting the investor's business. However, the tribunal could not find that any of the regulations amounted to a violation of fair and equitable treatment because the regulations corresponded to the international specifications by the SLA, did not discriminate against foreign investors, tried to mitigate adverse effects of the legal changes and thus constituted a 'reasonable response' to the legal and economic circumstances.<sup>656</sup> Moreover, the tribunal acknowledged the discretion and flexibility of the Canadian Government in the search for suitable regulatory mechanisms for the just implementation of the SLA.<sup>657</sup> Nevertheless, the tribunal found a breach of fair and equitable treatment due to the treatment accorded to the investor in an audit after the investment dispute had arisen.<sup>658</sup> The tribunal argued that the uncooperative manner in which the competent Canadian authority was conducting the audit imposed a substantial and disruptive burden on the investor which could not be justified by reasonable legal concerns.<sup>659</sup>

*International Thunderbird Gaming Corp. v. Mexico* addressed the role of sovereignty in the context of the Mexican gaming industry.<sup>660</sup> The case concerned the lawfulness of certain gaming facilities under domestic law. Similar to many other statements in arbitral jurisprudence discussed below,<sup>661</sup> the tribunal acknowledged the host state's sovereignty in judicial matters by declaring: 'It is not the tribunal's function to act as a court of appeal or review in relation to the Mexican judicial system regarding the subject matter of the present claims.'<sup>662</sup> Furthermore, the tribunal highlighted the regulatory flexibility of the host state in the gambling industry and explained the following:

The role of Chapter Eleven in this case is therefore to measure the conduct of Mexico towards Thunderbird against the international law standards set up by Chapter Eleven of the NAFTA. Mexico has in this context a wide regulatory 'space' for regulation; in the regulation of the gambling industry, governments have a particularly wide scope of regulation reflecting national views on

<sup>655</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245); for a more detailed description of the facts and further discussion on the case, see Chapter 3, section B, '1(b) The *Pope & Talbot* final merits award'.

<sup>656</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245), at paras. 119 et seq.

<sup>657</sup> See *ibid.*, at para. 155. <sup>658</sup> *Ibid.*, at para. 181. <sup>659</sup> See *ibid.*, at paras. 172-173 and 181.

<sup>660</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275).

<sup>661</sup> See the cases reviewed below (Chapter 7, section B, '1(b)(i) Denial of justice').

<sup>662</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at para. 125.

public morals. Mexico can permit or prohibit any forms of gambling as far as the NAFTA is concerned. It can change its regulatory policy and it has a wide discretion with respect to how it carries out such policies by regulation and administrative conduct. The international law disciplines of Articles 1102, 1105 and 1110 in particular only assess whether Mexican regulatory and administrative conduct breach these specific disciplines. The perspective is of an international law obligation examining national conduct as a 'fact'.<sup>663</sup>

A similar emphasis on the host state's freedom can be found in the separate opinion of arbitrator Wälde, although he - in contrast to the tribunal's majority opinion - would have found an infringement of fair and equitable treatment by means of a frustration of the investor's legitimate expectations.<sup>664</sup> Wälde, for instance, explained that within the concept of fair and equitable treatment 'a balancing process takes place between the strength of legitimate expectations ... and the very legitimate goal for retaining "policy space" and governmental flexibility'.<sup>665</sup>

The developmental aspect of state sovereignty is pointed out in the case of *Saluka Investments BV v. Czech Republic*, relating to a governmental assistance programme in the Czech banking sector.<sup>666</sup> In the interpretation of the fair and equitable treatment obligation, the tribunal referred to the preamble of the Netherlands-Czech Republic BIT, which it found established a linkage between fair and equitable treatment, the stimulation of foreign investments and the economic development of the contracting parties.<sup>667</sup> Hence, the tribunal observed:

The protection of foreign investments is not the sole aim of the treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties' economic relations. That in turn calls for a balanced approach to the interpretation of the treaty's substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host states from admitting foreign investments and so undermine the

<sup>663</sup> *Ibid.*, at para. 127. A similar statement can be found in *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 263, emphasising 'the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders'.

<sup>664</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at paras. 109-110.

<sup>665</sup> *Ibid.*, at para. 102.

<sup>666</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132); see also Chapter 3, section C, '1(c) *Saluka Investments BV v. Czech Republic*'.

<sup>667</sup> See *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 298; the preamble of the BIT is reprinted at para. 299 of the award.

overall aim of extending and intensifying the parties' mutual economic relations.<sup>668</sup>

The balanced approach favoured by the tribunal was further specified by stressing that alongside the foreign investor's interests and expectations, 'the host state's legitimate right . . . to regulate domestic matters in the public interest must be taken into consideration as well'.<sup>669</sup> Such avowal notwithstanding, the tribunal confirmed the relative character of the states' right to regulate by finding that the discriminatory application of the governmental assistance programme violated the standard of fair and equitable treatment.<sup>670</sup>

The relative character of the right to regulate is similarly affirmed in the case of *ADC Affiliate Ltd and others v. Hungary*.<sup>671</sup> This case related to regulatory measures depriving the foreign investor of its revenues in connection with the construction of Hungary's principal airport. While the tribunal recognised the host state's right to regulate, it also elaborated on the limitations of that right and, in the present case, rejected the host state's arguments as being of a pretextual nature:

It is the tribunal's understanding of the basic international law principles that while a sovereign state possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. As rightly pointed out by the claimants, the rule of law, which includes treaty obligations, provides such boundaries. Therefore, when a state enters into a bilateral investment treaty like the one in this case, it becomes bound by it and the investment-protection obligations it undertook therein must be honoured rather than be ignored by a later argument of the state's right to regulate.<sup>672</sup>

Regarding the risk assumed by the investor in relation to regulatory changes of the host state's legal framework, the tribunal argued:

The related point made by the respondent that by investing in a host state, the investor assumes the 'risk' associated with the state's regulatory regime is equally unacceptable to the tribunal. It is one thing to say that an investor shall conduct its business in compliance with the host state's domestic laws and regulations. It is quite another to imply that the investor must also be ready

<sup>668</sup> *Ibid.*, at para. 300. <sup>669</sup> *Ibid.*, at para. 305.

<sup>670</sup> Thereon, see the assessment of the *Saluka* case in Chapter 7, section A, '3(b) Non-discrimination in arbitral jurisprudence'.

<sup>671</sup> *ADC Affiliate Ltd and ADC & ADMC Management Ltd v. Hungary* (above fn. 443); on the facts, see paras. 79 et seq.

<sup>672</sup> *Ibid.*, at para. 423. The tribunal referred to the right to regulate in the context of the expropriation claim, but found that this approach would equally apply to fair and equitable treatment: see para. 445.

to accept whatever the host state decides to do to it. In the present case, had the claimants ever envisaged the risk of any possible depriving measures, the tribunal believes that they took that risk with the legitimate and reasonable expectation that they would receive fair treatment and just compensation and not otherwise.<sup>673</sup>

In summary, the ADC tribunal clearly distinguished between the legitimate regulatory flexibility of a host state and unacceptable contentions as to a presumably unrestricted right to regulate justifying almost any unfair treatment of foreign investors. Additionally, the tribunal could not accept the view that a foreign investor, while of course being obliged to comply with the host state's domestic law, would be beholden to bear the costs of any unfair or inequitable regulatory measure.

### (c) The relative weight of sovereignty

These few cases suffice to evince that the sovereignty of states is, of course, an important factor in the determination of whether a breach of fair and equitable treatment has occurred. Yet, the cases have equally made clear that the regulatory space of states is not unrestricted, but is subject to those limitations to which states have consented in international investment treaties. Such consent includes the progressive development of international investment law and especially the dynamics that are intrinsically tied with the concept of general clauses like fair and equitable treatment. In contradiction to some excessive political rhetoric, external and internal economic sovereignty of states depicts a relative concept, which is not only qualified by the factual interdependence of national economies around the globe, but also by the growing body of international legal instruments as created by states.

A relative understanding of sovereignty is pivotal for the present approach towards fair and equitable treatment and the balancing of principles. This is because understanding sovereignty in terms of absolutes would trump any argument in favour of foreign investment protection and would therefore elude any form of balancing state and investor interests. Hence, construing the concept of sovereignty as a principle of fair and equitable treatment, in accordance with Franck's 'no-trumping' condition, corresponds to the general understanding of states' independence as a 'question of degree'<sup>674</sup> and allows the weighing of this principle against other principles of investment protection. However, this approach is not so much a restriction of state sovereignty,

<sup>673</sup> *Ibid.*, at para. 424. <sup>674</sup> Jennings and Watts (above fn. 124), p. 391.



but rather seeks to reconcile competing state and investor interests. To such an extent, a balancing approach towards fair and equitable treatment respects the sovereignty of states by ensuring that not only the interests of foreign investors, but also the public policy concerns of states, are adequately taken into account.

The allocation of the specific weight of sovereignty in relation to the other principles may certainly involve a difficult balancing act by arbitral tribunals in the particular case, which appears even more difficult if complex regulatory measures are at stake. Therefore, it is important to make this balancing act rationally comprehensible by ensuring that arbitral tribunals display the criteria for their specific weight allocation in the most transparent way possible. To such an extent, it is also necessary for tribunals expressly to recognise sovereignty as a principle of fair and equitable treatment. This requires lines of jurisprudence on sovereignty to be developed, just as is increasingly the case with other principles indicating certain weight allocations in particular fact patterns. In so doing, an improved quality of legal reasoning in investment disputes would be achieved. Additionally, this approach could contribute towards mitigating criticism with regard to the lopsidedness of international investment law, since principles of investment protection and sovereignty would then equally be taken into account in the determination of a possible violation of fair and equitable treatment.

The question as to what extent, in fact, arbitral tribunals value the principle of sovereignty by balancing – explicitly or implicitly – the principles of investment protection against the host states' regulatory freedom pervades the subsequent chapters. For the time being, it may be observed that arbitral tribunals are generally attesting a regulatory discretion to host states. However, tribunals do not accept arguments regarding sovereignty of a mere pretextual nature. Tribunals are also trying to ensure that state policies or measures in the domestic public interest are not implemented in a way that would be unfair or inequitable to foreign investors. Accordingly, a host state in exercising its sovereignty has to respect the other principles of fair and equitable treatment that are outlined in the following.

## 2 Legitimate expectations

An important and controversial principle of fair and equitable treatment is the protection of a foreign investor's legitimate expectations. Generally, these expectations may be based on: the presumed stability of the overall legal framework; any representations made explicitly or

implicitly by the host state; and commitments resulting from the contractual relationship with the host state.<sup>675</sup> Since the idea of protecting the investor's expectations originates in domestic legal concepts,<sup>676</sup> an attempt is made to catch a glimpse of these legitimate expectations concepts.

### (a) The relevance of expectations in general

Many legal systems acknowledge, at least to some extent, that certain expectations of individuals in relation to a state's behaviour should be protected. Although these domestic concepts of legitimate expectations display considerable variability in structure and labelling, they nevertheless seem to have certain basic elements in common emanating from some understanding of fairness as an underlying rationale.<sup>677</sup>

The protection of legitimate expectations or comparable concepts<sup>678</sup> is increasingly recognised, at least in most of the European states and at the level of the European Community.<sup>679</sup> These concepts are primarily related to the idea that private persons need to know if they can rely on statements or decisions notified to them by officials or public agencies.<sup>680</sup> To such an extent, different situations are discussed in which the expectations of an individual may restrict public authorities' freedom of action.<sup>681</sup> These situations mainly deal with the revocation of administrative decisions in which, for example, an authority makes a

<sup>675</sup> See also Dolzer and Schreuer (above fn. 54), pp. 134 and 140.

<sup>676</sup> See Vicuña (above fn. 617), pp. 192–193; and Fietta (above fn. 305), p. 376; see also *International Thunderbird Gaming Corp. v. Mexico* (above fn. 444), at paras. 27 et seq.

<sup>677</sup> See, e.g. Rawls (above fn. 536), pp. 235–236; S. J. Schønberg, *Legitimate Expectations in Administrative Law* (2000), pp. 7–8 and 29–30; and H. Woolf, J. Jowell and A. Le Sueur, *De Smith's Judicial Review*, 6th edn (2007), p. 609. Even though usually derived from the concept of the rule of law and legal certainty, the German principle of legitimate expectations (*Vertrauensschutz*) is also not decoupled from notions of good faith and equity: see H. Maurer, *Allgemeines Verwaltungsrecht*, 16th edn (2006), p. 292. On further justifications for the protection of legitimate expectations, see also Schønberg (*ibid.*), pp. 9 et seq.; and P. Craig, *EU Administrative Law* (2006), pp. 612–613.

<sup>678</sup> In legal systems with a common law tradition, the protection of legitimate expectations partly overlaps with the doctrine of estoppel: see Schwarze (above fn. 498), pp. 903–904; and A. W. Bradley and K. D. Ewing, *Constitutional and Administrative Law*, 13th edn (2003), p. 726.

<sup>679</sup> For a detailed study, see Schwarze (above fn. 498), Chapter 6; for a comparative analysis beyond the European level, see Woolf, Jowell and Le Sueur (above fn. 677), pp. 644–650; for the recognition of different aspects of legitimate expectations in public international law, see J. P. Müller, *Vertrauensschutz im Völkerrecht* (1971).

<sup>680</sup> Bradley and Ewing (above fn. 678), p. 722.

<sup>681</sup> On different categories, see Schønberg (above fn. 677), pp. 8–9; Bradley and Ewing (above fn. 678), p. 723; and Craig (above fn. 677), p. 611.

formal decision about a person, or a limited group, and later seeks to revoke that decision due to certain reasons. Other situations concern an authority's representation that they will follow or have been following certain procedures or policies, but the authority subsequently makes a decision that is inconsistent with that representation, wants to revoke its general policy choice or depart from it in a particular case. In all of these situations, a multitude of different criteria exists so as to determine whether the public interest or the private persons' expectations ultimately prevail. For instance, relevant factors for such an analysis are whether: the expectations were really legitimate and sufficiently concrete; the representation made was lawful or unlawful; it granted rights or was just declaratory; the revocation or policy change applied *ex nunc* or *ex tunc*; certain deadlines have been met; and a balancing of the private and public interests has taken place.<sup>682</sup>

While the mentioned situations concern the revocation of decisions or the change of or departure from administrative procedures or policies, another, but more limited, aspect of the protection of legitimate expectations is affecting the activity of the legislative branch. This aspect pertains to the retroactivity of norms, according to which it is limited in a number of legal systems to introduce and apply laws and regulations to events which have already been concluded.<sup>683</sup> Beyond that, however, the presented concept of legitimate expectations does not usually impose any restrictions that would delimit the legislator's ability to pursue or change certain economy-related laws or policies.

In addition, there is another domestic legal concept emanating from US constitutional law - the doctrine of investment-backed expectations<sup>684</sup> - which could also be of relevance for fair and equitable treatment.<sup>685</sup> According to this doctrine, a landowner's reasonable investment-backed expectations are relevant considerations in the determination of

<sup>682</sup> See only the summary in Schwarze (above fn. 498), pp. 1154-1159.

<sup>683</sup> Thereon see *ibid.*, pp. 1168-1170.

<sup>684</sup> See the fundamental article by F. I. Michelman, 'Property, Utility, and Fairness', *Harv. L. Rev.* 80 (1967), p. 1165, especially at p. 1233.

<sup>685</sup> See also Fietta (above fn. 305), p. 378. However, Fietta is relating the doctrine of investment-backed expectations associated with the protection of property rights more to expropriation claims in international investment law. Nevertheless, it appears still unsettled whether the recurrence to the investor's expectations in expropriation claims is of a different nature than in fair and equitable treatment claims: see von Walter (above fn. 509), p. 193.

whether a regulatory taking has occurred.<sup>686</sup> Thereby, investment-backed expectations relate to an investor's general expectations when entering into an investment, based upon all of the circumstances of the investment.<sup>687</sup> However, especially the determination of the reasonableness of these expectations appears to be not without difficulty and is dependent on a number of factors, such as the existence of a prior notice of a restrictive regulatory regime, possible delays in making use of the investment, the historical use and government representations.<sup>688</sup> Overall, because the reasonable expectations analysis is deemed to be rooted in fairness, it therefore requires a careful examination and weighing-up of all relevant circumstances.<sup>689</sup>

A further concept that aims for the stability of the contractual relationship between the foreign investor and the host state is called *pacta sunt servanda*, and is well known not only in national but also in international law.<sup>690</sup> Thereby, *pacta sunt servanda* is recognised as a general principle of international law and an expression of good faith,<sup>691</sup> ensuring the binding force of a treaty to the parties and their duty to perform the treaty obligations in good faith.<sup>692</sup> However, the sanctity of contracts in contractual relationships between states seems quite undisputed in such a general form; the applicability of this principle to contracts between foreign investors as private persons and host states (state contracts) causes more difficulties by far. These difficulties emanate from an intense and persistent contention surrounding the legal nature of state contracts as international, quasi-international and domestic law contracts, or as being contracts *sui generis*.<sup>693</sup>

<sup>686</sup> *Penn Central Transportation Co. v. City of New York*, US Supreme Court (Judgment of 26 June 1978), at p. 124.

<sup>687</sup> Fietta (above fn. 305), p. 378.

<sup>688</sup> See J. D. Breemer, 'Playing the Expectations Game', *Urb. Law.* 38 (2006), p. 81.

<sup>689</sup> *Ibid.*, p. 108.

<sup>690</sup> On the historic and philosophical foundations of *pacta sunt servanda*, see H. Wehberg, 'Pacta Sunt Servanda', *AJIL* 53 (1959), p. 775, noting at p. 786 that '[n]o economic relations between states and foreign corporations can exist without the principle *pacta sunt servanda*'.

<sup>691</sup> See Cheng (above fn. 516), pp. 112-114; Brownlie (above fn. 129), p. 620; and critically Sornarajah (above fn. 3), p. 426.

<sup>692</sup> Article 26 of the VCLT.

<sup>693</sup> For an overview and further references, see E. Schanze, *Investitionsverträge im internationalen Wirtschaftsrecht* (1986), pp. 95-137; J. A. Westberg and B. P. Marchais, 'General Principles Governing Foreign Investment as Articulated in Recent International Tribunal Awards and Writing of Publicists', *ICSID Rev. - FILJ* 7 (1992), p. 453 at pp. 462-467; Sornarajah (above fn. 3), pp. 416-434; and Bishop, Crawford and Reisman (eds.) (above fn. 53), pp. 662-689.

It is neither intended nor necessary to comment on the controversial nature of state contracts here. This is because the sanctity of contracts, in the present context, is only considered as an element of the principle of protection of legitimate expectations that is to be balanced against other principles within fair and equitable treatment, irrespective of its direct applicability to state contracts. However, if *pacta sunt servanda* is deemed itself to be a principle of fair and equitable treatment, or part of one, this means that it is not applicable in an all-or-nothing fashion,<sup>694</sup> but may be subject to qualification dependent on its specific weight in a particular case. To such an extent, one argument in the debate on the nature of state contracts will be mentioned nevertheless, since it draws a comparison with domestic legal concepts of administrative contracts. This argument suggests that state contracts should be perceived as administrative contracts, which may be terminated or changed unilaterally if the public interest so requires.<sup>695</sup> However, despite the fact that the concept of administrative contracts is often controversial and the loosening of these contracts' binding force in domestic law is usually construed in a narrow sense, the analogy to administrative contracts is also divisive at the international level.<sup>696</sup> In any case, the different domestic concepts of administrative contracts only facilitate the cancellation and renegotiation of the contract itself, but they are unable to justify infringements of the contractual commitments by reference to the public interest, nor can they reveal anything about the state's capability to alter the legal framework upon which the contract is based.<sup>697</sup> Moreover, even if an administrative contract contravenes domestic law due to an alteration of the legal framework or other reasons, it appears possible that the contract need not be considered void per se, but may persist because of considerations, similar to

<sup>694</sup> See also Seidl-Hohenveldern (above fn. 637), p. 146, stating that the security of *pacta sunt servanda* cannot be absolute.

<sup>695</sup> See Westberg and Marchais (above fn. 693), p. 463. Thereby, the French model of administrative contract is particularly invoked. A, to some extent, comparable model of administrative contracts is also provided by German administrative law, which allows (against compensation) for a cancellation or an adaptation of the contract in case of severe detriment to the public interest or in accordance with the principle of *clausula rebus sic stantibus*, § 60 of the VwVfG (German Code of Administrative Procedure). Thereto, see Maurer (above fn. 677), p. 402.

<sup>696</sup> See, e.g. pro: Franck (above fn. 345), pp. 444-445; and Sornarajah (above fn. 3), pp. 422-423; contra: Arbitrator Dupuy in *Texaco Overseas Petroleum Co. v. Libya*, International Arbitral Tribunal (Award on the Merits of 19 January 1977), at para. 57; and U. Kischel, *State Contracts* (1992), pp. 347-348.

<sup>697</sup> See H. Merkt, *Investitionsschutz durch Stabilisierungsklauseln* (1990), pp. 242-246.

the situation of revocation of administrative decisions as stated above, requiring the protection of the private person's legitimate expectations.<sup>698</sup>

This survey has attempted to sketch a few legal concepts which concede a certain relevance to private persons' expectations in the stability and consistency of public administration. Thereby, the creation of expectations that ought not to be frustrated especially comes into question if public authorities have made representations or covenants suggesting a consistent behaviour in relation to the individual. However, an attempt is always made to achieve a balance between private persons' expectations and the necessary space for legislators and public authorities to implement suitable and effective laws and policies.<sup>699</sup> In the following, it will be assessed how arbitral tribunals in investment disputes address the issue of investors' expectations.

## (b) Investors' expectations in arbitral jurisprudence

### (i) Stability of the overall legal framework

A first example concerning the stability of the overall legal framework is presented by *Occidental Exploration & Production Co. (OPEC) v. Ecuador*.<sup>700</sup> As described above, this case relates to the interpretation of Ecuadorian tax laws and the granting and subsequent revocation of value-added tax (VAT) refunds to OPEC by the domestic tax authorities.<sup>701</sup> With reference to a common formulation in the preamble of the BIT, stipulating the desirability 'to maintain a stable framework for the investment', the tribunal found the stability of the legal and business framework to be an essential element of fair and equitable treatment.<sup>702</sup>

<sup>698</sup> This is at least the case in certain situations in German administrative law in which § 59(2) of the VwVfG applies. The latter provision, again, tries to establish a balance between the strict legality of administrative actions and the protection of private persons' legitimate expectations: see H. J. Bonk, '§ 59', in P. Stelkens et al. (eds.), *Verwaltungsverfahrensgesetz*, 7th edn (2008), mn. 5.

<sup>699</sup> See, e.g. Schwarze (above fn. 498), p. cxlvii, diagnosing that the ECJ has ultimately negated a violation of the legitimate expectations in the vast majority of cases.

<sup>700</sup> *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289).

<sup>701</sup> For a more detailed description of the facts, see Chapter 3, section C, '1(a) *Occidental Exploration & Production Co. (OPEC) v. Ecuador*'.

<sup>702</sup> *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 183. The tribunal thereby referred to prior awards in other cases in which the stability and predictability of the overall investment framework have also been emphasised, namely *Metalclad Corp. v. Mexico* (above fn. 224), at para. 99; and *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 154.

Subsequently, the tribunal noted, 'the framework under which the investment was made and operate[d] has been changed in an important manner ... without providing any clarity about its meaning and extent and the practice and regulations were also inconsistent with such changes'.<sup>703</sup> The changes in the Ecuadorian tax laws, which occurred after OEPC had made its investment, related to the expansion of VAT charges and altered the procedure and conditions for receiving VAT refunds.<sup>704</sup> These alterations of the legal framework created uncertainty as to whether or not OEPC was entitled to such refunds, and OEPC accordingly attempted to clarify the legal situation. However, the conduct of the tax authority after the clarification request was ambiguous, since the authority initially granted reimbursements of VAT refunds, but later annulled that decision and ordered OEPC to return the reimbursements.<sup>705</sup>

In its analysis on fair and equitable treatment, the tribunal did not differentiate between the legislative changes in the tax laws and the administrative conduct of the tax authority, although both issues showed considerable differences in their breadth. Due to the sweeping explanation that 'there is certainly an obligation not to alter the legal and business environment in which the investment has been made',<sup>706</sup> the tribunal had no difficulty in finding a breach of the fair and equitable treatment obligation.<sup>707</sup> Whether the regulatory changes alone, without the ambiguous conduct of the tax authority, would have sufficed for a breach of fair and equitable treatment remained unanswered by the tribunal.

The case of *GAMI Investments Inc. v. Mexico*<sup>708</sup> also addressed aspects of the legal framework's stability. This case arose in the context of the highly regulated Mexican sugarcane industry. It concerned the alleged maladministration in the implementation and enforcement of a complex regulatory programme, pertaining to reference prices, export requirements and production controls, which was based on the participation of various actors, such as farmers, mill owners and public authorities.<sup>709</sup>

In its assessment of a potential breach of fair and equitable treatment, the tribunal made clear that 'NAFTA arbitrators have no mandate to

<sup>703</sup> *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 183.

<sup>704</sup> *Ibid.*, at paras. 119 et seq.; see also Franck (above fn. 289), fn. 22.

<sup>705</sup> *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 32.

<sup>706</sup> *Ibid.*, at para. 191. <sup>707</sup> *Ibid.*, at paras. 186-187.

<sup>708</sup> *GAMI Investments Inc. v. Mexico* (above fn. 276).

<sup>709</sup> See *ibid.*, especially at paras. 44 et seq.

evaluate laws and regulations that predate the decision of a foreigner to invest'.<sup>710</sup> It was held that the tribunal's duty is rather to appraise how pre-existing laws and regulations are applied to the foreign investor.<sup>711</sup> Furthermore, the 'failure to satisfy requirements of national law' or '[t]he failure to fulfil the objectives of administrative regulations without more does not necessarily rise to a breach of international law'.<sup>712</sup> Since, to such an extent, not every shortcoming under national law was considered capable of amounting to an infringement of fair and equitable treatment, the tribunal had to determine the 'more' of maladministration necessary for a breach of international law. It stated: 'A claim of maladministration would likely violate Article 1105 if it amounted to an "outright and unjustified repudiation" of the relevant regulations.'<sup>713</sup> Since GAMI could not demonstrate anything approaching such a type of maladministration, the tribunal eventually denied a violation of fair and equitable treatment.

A further case, tackling the stability of the legal investment environment, is the case of *CMS Gas Transmission Co. v. Argentina*,<sup>714</sup> in which Argentina altered the legal framework by enacting far-reaching emergency laws in order to counteract the severe economic crisis that affected the country. Similar to the reasoning in the *Occidental* case, the tribunal found fair and equitable treatment to entail a duty to maintain a stable legal and business framework for investments, which was held to be disregarded by the Argentine Government through the freezing of tariff adjustments and devaluation of the Argentine peso.<sup>715</sup> However, the tribunal more cautiously formulated: 'It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made.'<sup>716</sup> To such an extent, the tribunal acknowledged the possibility of the legal framework to develop, but due to the frustration of guarantees given under the legal framework crucial for the

<sup>710</sup> *Ibid.*, at para. 93. <sup>711</sup> *Ibid.*, at para. 94.

<sup>712</sup> *Ibid.*, at para. 97; with reference to *Waste Management v. Mexico* (above fn. 102), at paras. 89 et seq.

<sup>713</sup> *GAMI Investments Inc. v. Mexico* (above fn. 276), at para. 103; again with reference to *Waste Management v. Mexico* (above fn. 102), at para. 115.

<sup>714</sup> *CMS Gas Transmission Co. v. Argentina* (above fn. 102); thereon, see also Chapter 3, section C, '1(b) *CMS Gas Transmission Co. v. Argentina*'.

<sup>715</sup> *Ibid.*, at paras. 274-276. <sup>716</sup> *Ibid.*, at para. 277.

investment decision, an infringement of fair and equitable treatment was found.

Subsequent cases with similar fact situations in the Argentine gas sector, at large, foster such a conception of the investor's legitimate expectations towards the stability of the overall legal framework. For example, the tribunal in *LG&E Energy Corp. v. Argentina* determined a violation of fair and equitable treatment because of a complete 'dismantling of the very legal framework constructed to attract investors',<sup>717</sup> and described the characteristics of the investor's legitimate expectations as follows:

[The expectations] are based on the conditions offered by the host state at the time of the investment; they may not be established unilaterally by one of the parties; they must exist and be enforceable by law; in the event of infringement by the host state, a duty to compensate the investor for damages arises except for those caused in the event of state of necessity; however, the investor's fair expectations cannot fail to consider parameters such as business risk or industry's regular patterns.<sup>718</sup>

A similar reasoning was adopted in the cases of *Enron Corp. and others v. Argentina*<sup>719</sup> and *Sempra Energy International v. Argentina*,<sup>720</sup> summarising the situation in the following way:

The measures in question in this case have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented. Argentina in the early 1990s constructed a regulatory framework for the gas sector containing specific guarantees to attract foreign capital to an economy historically unstable and volatile. As part of this regulatory framework, Argentina guaranteed that tariffs would be calculated in US dollars, converted into pesos for billing purposes, adjusted semi-annually in accordance with the US PPI and sufficient to cover costs and a reasonable rate of return. It further guaranteed that tariffs would not be subject to freezing or price controls without compensation. Foreign investors were specifically targeted to invest in the privatization of public utilities in the gas sector. Substantial foreign investment was undertaken on the strength of such guarantees.<sup>721</sup>

<sup>717</sup> *LG&E Energy Corp. and others v. Argentina* (above fn. 450), at paras. 132–139. For a discussion of the case and the tribunal's analysis of matter of state necessity, see S. W. Schill, 'International Investment Law and the Host State's Power to Handle Economic Crises', *Journal of International Arbitration* 24 (2007), p. 265.

<sup>718</sup> *LG&E Energy Corp. and others v. Argentina* (above fn. 450), at para. 130.

<sup>719</sup> *Enron Corp. and Ponderosa Assets LP v. Argentina* (above fn. 302).

<sup>720</sup> *Sempra Energy International v. Argentina* (above fn. 303).

<sup>721</sup> *Enron Corp. and Ponderosa Assets LP v. Argentina* (above fn. 302), at para. 264.

The *Enron* tribunal found that these considerable changes of the business framework turned certainty and stability for investors into doubt and ambiguity and that the long-term business outlook, enabled by the tariff regime, had been transformed into a day-to-day discussion about what comes next.<sup>722</sup> Although unrelated to the Argentine crisis, another tribunal in *PSEG Global Inc. and others v. Turkey* similarly maintained that the 'roller-coaster effect' of continuing legislative changes violated fair and equitable treatment and that '[s]tability cannot exist in a situation where the law kept changing continuously and endlessly'.<sup>723</sup> Hence, especially in cases related to the Argentine gas sector, but also elsewhere, the substantial changes to the regulatory framework were deemed to constitute an infringement of fair and equitable treatment because the regulatory guarantees were specifically tailored to attract foreign investors.<sup>724</sup>

The legitimate expectations principle has also played a central role in the case of *Parkerings-Compagniet AS v. Lithuania*, in which a Norwegian investor entered into a contract with the city of Vilnius pertaining to the construction of a parking lot system in order to control the traffic in the city's historic old town.<sup>725</sup> The contract encompassed the creation, development, maintenance and enforcement of the public parking system and entitled the investor to revenues through the collection of parking fees, which were shared between the parties. However, later changes in Lithuanian law disallowed the type of fee-sharing as foreseen in the contract, leading ultimately to the termination of the contract by the city of Vilnius. The investor claimed that the host state's conduct destroyed the legal integrity of the contract upon which the investment was based, and alleged, inter alia, a violation of fair and equitable treatment.

<sup>722</sup> *Ibid.*, at para. 266; almost identically in *Sempra Energy International v. Argentina* (above fn. 303), at para. 303.

<sup>723</sup> *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey* (above fn. 450), at paras. 250 and 254.

<sup>724</sup> See also *BG Group Plc. v. Argentina* (above fn. 450), at para. 310; *National Grid Plc. v. Argentina* (above fn. 133), at para. 179. However, in another award related to the Argentinean crisis and the subsequent pesification, the tribunal denied the existence of legitimate expectations and accordingly a violation of fair and equitable treatment because, in that case, neither were any direct representations made to the investor, nor did there exist any licences, permits or contracts between the host state and the investor: see *Metalpar SA and Buen Aire SA v. Argentina* (above fn. 450), at paras. 185–186.

<sup>725</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138); the facts are described at paras. 51 et seq.

In the assessment of whether the investor had legitimate expectations that the investment conditions would remain unchanged, the tribunal made the following instructive explanation relating to the legitimacy of the investor's expectations:

The expectation is legitimate if the investor received an explicit promise or guarantee from the host state, or if implicitly, the host state made assurances or representation that the investor took into account in making the investment. Finally, in the situation where the host state made no assurance or representation, the circumstances surrounding the conclusion of the agreement are decisive to determine if the expectations of the investor are legitimate. In order to determine the legitimate expectation of an investor, it is also necessary to analyse the conduct of the state at the time of the investment.

It is each state's undeniable right and privilege to exercise its sovereign legislative power. A state has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a *stabilisation* clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a state to act unfairly, unreasonably or inequitably in the exercise of its legislative power.

In principle, an investor has a right to a certain stability and predictability of the legal environment of the investment. The investor will have a right of protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in light of the circumstances. Consequently, an investor must anticipate that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of legal environment.<sup>726</sup>

After developing this perception of legitimacy, the tribunal denied the existence of any such expectations because the host state did not give any explicit or implicit promise that the legal framework would remain unchanged.<sup>727</sup> The tribunal further opined that the political circumstances in Lithuania as a country in transition could not justify the creation of legitimate expectations as regards the stability of the investment's legal environment.<sup>728</sup> Rather, the investor was considered to have taken the business risk to invest notwithstanding the possible legal and political instability at that time.<sup>729</sup>

<sup>726</sup> Ibid., at paras. 331-333; similarly, see *EDF (Services) Ltd v. Romania* (above fn. 454), at paras. 216-219.

<sup>727</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at para. 334.

<sup>728</sup> Ibid., at para. 335. <sup>729</sup> Ibid., at para. 336.

As in the above-mentioned cases, the *Parkerings-Compagniet* tribunal acknowledged the investor's interest in stability and predictability in principle; but it furthermore suggested certain criteria in order to assess whether the investor's expectations relating to the stability of the legal framework were legitimate. These criteria are, at first, explicit or implicit promises of the host state and, if such promises are absent, the circumstances surrounding the investment determined by the host state's conduct and political situation and the investor's due diligence.

(ii) *Stability in the administrative conduct*

More closely connected to the national legal concepts of legitimate expectations is the protection of the investor's expectations in relation to the stability in the administrative conduct of the host state. A first case where this issue was addressed is *Metalclad Corp. v. Mexico*, concerning representations by government officials with regard to permits for the construction of a hazardous waste landfill.<sup>730</sup> Thereby, Metalclad was granted various federal and state permits for the construction of the landfill, but could not obtain a necessary permit from the municipality, although federal officials asserted that the municipality would have no legal basis for denying the permit.<sup>731</sup> The tribunal found that the denial of the municipal construction permit, coupled with procedural and substantial deficiencies of the denial, was improper<sup>732</sup> and hence concluded:

Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.<sup>733</sup>

A next and important example for the recognition of the protection of the investor's legitimate expectations is provided by the case of *Técnicas Medioambientales, TECMED SA v. Mexico*.<sup>734</sup> In this case, a TECMED subsidiary purchased a landfill of hazardous industrial waste in a public auction and transferred the landfill to Cytrar, a company organised by

<sup>730</sup> *Metalclad Corp. v. Mexico* (above fn. 224); for a more detailed description of the facts, see Chapter 3, section B, '1(a) The *Metalclad* and *S.D. Myers* approach'.

<sup>731</sup> See *ibid.*, at paras. 85-94. <sup>732</sup> *Ibid.*, at para. 97. <sup>733</sup> *Ibid.*, at para. 99.

<sup>734</sup> *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98). For a discussion of the case, see, e.g. S. W. Schill, 'Völkerrechtlicher Investitions- und Eigentumsschutz in der ICSID-Entscheidung *TECMED*', *RIW* (2005), p. 330.

TECMED to run the landfill operations.<sup>735</sup> The landfill originally had an operating licence granted by federal authorities for an indefinite period of time, but the licence granted to Cytrar was valid for only one year with the possibility to renew every year. After the licence was renewed once, a further renewal was denied because of alleged deficiencies of Cytrar to operate the landfill properly.<sup>736</sup> However, the tribunal found that the denial was rather due to political circumstances, since the landfill was subject to criticism by a citizen's movement demanding closure of the landfill.<sup>737</sup> Although Cytrar thereupon agreed to relocate the landfill, the application for the renewal of the licence was rejected and a programme for closure of the landfill was requested.<sup>738</sup>

In its analysis on fair and equitable treatment, the tribunal elaborated on the characteristics of the investor's expectations and stated:

[Fair and equitable treatment] requires the contracting parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations . . . The foreign investor also expects the host state to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the state to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation.<sup>739</sup>

This standard, developed by the *TECMED* tribunal, is widely criticised for being excessively demanding and for being 'rather a description of perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain'.<sup>740</sup> The tribunal nevertheless found that on the basis of existing relocation agreements Cytrar might have understood in good faith that the operation of the landfill would continue for a reasonable time until the

<sup>735</sup> On the facts, see *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at paras. 35 et seq.

<sup>736</sup> See *ibid.*, at para. 99. <sup>737</sup> *Ibid.*, at paras. 106 et seq. and 127.

<sup>738</sup> *Ibid.*, at paras. 110-112. <sup>739</sup> *Ibid.*, at para. 154. <sup>740</sup> Douglas (above fn. 289), p. 28.

effective relocation.<sup>741</sup> The refusal to renew the permit was therefore considered by the tribunal to have been 'actually used to permanently close down a site whose operation has become a nuisance due to political reason relating to the community's opposition expressed in a variety of forms, regardless of the company in charge of the operation and regardless of whether or not it was being properly operated'.<sup>742</sup> Such behaviour and the fact that Cytrar was initially only granted a limited permit, which according to the tribunal had been made with the intention to circumvent a more difficult revocation of an unrestricted permit,<sup>743</sup> therefore resulted in a breach of fair and equitable treatment.

Following the far-reaching *TECMED* award, the tribunal in the case of *MTD Equity Sdn. Bhd. and others v. Chile*<sup>744</sup> also addressed the issue of administrative consistency. In this case, a Malaysian investor wanted to develop a real estate project consisting of the construction of a 600-hectare satellite city to the south of the capital of Santiago.<sup>745</sup> Thereby, MTD was aware of the existing zoning of the chosen area for agricultural use, but believed that the land could easily be re-zoned. After the Chilean Foreign Investment Commission approved the planned investment, MTD initiated the proceedings for the necessary zoning changes. However, the negotiations on the re-zoning failed and the necessary changes for the project were eventually rejected by other authorities because they conflicted with the government's urban development policy.

In its considerations on an alleged breach of fair and equitable treatment, the tribunal detected fair and equitable treatment to be framed as a 'pro-active statement', requiring 'treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment'.<sup>746</sup> Furthermore, the tribunal found that the approval of the project in a certain location by the Foreign Investment Commission 'would give *prima facie* to an investor the expectation that the project

<sup>741</sup> *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 160.

<sup>742</sup> *Ibid.*, at para. 164. <sup>743</sup> *Ibid.*, at para. 170.

<sup>744</sup> *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97); in the subsequent decision on annulment, the annulment committee criticised the tribunal's reliance on the *TECMED* analysis, but could not find a manifest transgression of the tribunal's power: see *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile*, ICSID Case No. ARB/01/7 (Decision on Annulment of 21 March 2007), at paras. 67-71.

<sup>745</sup> For further facts, see *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at paras. 39 et seq.

<sup>746</sup> *Ibid.*, at para. 113.

is feasible in that location from a regulatory point of view'.<sup>747</sup> Hence, the fact that the approval of the project was in opposition to the government's urban development policy satisfied the tribunal for the finding of a breach of fair and equitable treatment.<sup>748</sup> To such an extent, the tribunal from an international law perspective treated the different organs and authorities as a unit and placed a considerable burden on the host state to act coherently and consistently.<sup>749</sup>

An intense discussion of the concept of the investor's legitimate expectations as regards administrative stability has taken place in the case of *International Thunderbird Gaming Corp. v. Mexico*.<sup>750</sup> In this case, the foreign investor was engaged in the business of operating gaming facilities and requested an official opinion from the relevant Mexican Government authority concerning the legality of the opening and operation of its planned gaming facilities in Mexico.<sup>751</sup> In the request, Thunderbird described its video game machines as being designed for 'games of skills and ability' in which 'chance and wagering or betting is not involved'.<sup>752</sup> The Mexican authority in its formal response expressly alluded to the *Ley Federal de Juegos y Sorteos* prohibiting 'all gambling and luck related games', but declared, 'if the machines ... operate in the form and conditions stated by you, this governmental entity is not able to prohibit its use'.<sup>753</sup> Thereupon, Thunderbird opened a number of gaming facilities which were subsequently closed down by the authorities due to an administrative decision that was issued after a change of government had occurred in Mexico.

In its assessment, the tribunal's majority opinion described the concept of the investor's legitimate expectations in the following way:

<sup>747</sup> *Ibid.*, at para. 163. At the same time, however, the tribunal also stated: 'This is not to say that approval of a project in a particular location entitles the investor to develop that site without further governmental approval.'

<sup>748</sup> *Ibid.*, at para. 166. However, the tribunal also found the investor to have acted without due diligence and that BITs are not an insurance against business risk (at paras. 168-178). The tribunal therefore reduced the amount of apportioned compensation by 50 per cent (at para. 246).

<sup>749</sup> See *ibid.*, at para. 165.

<sup>750</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275). For a discussion of the case, see, e.g. S. Fietta, 'International Thunderbird Gaming Corporation v. The United Mexican States: An Indication of the Limits of the "Legitimate Expectation" Basis of Claim under Article 1105 of NAFTA?', TDM 3 (2006), issue 2.

<sup>751</sup> On the facts, see *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at paras. 41 et seq.

<sup>752</sup> See *ibid.*, at para. 50. <sup>753</sup> See *ibid.*, at para. 55.

Having considered recent investment case law and the good faith principle of international customary law, the concept of 'legitimate expectations' relates ... 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 ... to honour those expectations could cause the investor (or investment) to suffer damages.<sup>754</sup>

The majority opinion subsequently concluded that the formal response by the Mexican authorities, because of two principal factors, did not create legitimate expectations upon which Thunderbird could reasonably rely.<sup>755</sup> First, the information presented by Thunderbird in the request was deemed incomplete and partly inaccurate because the gambling machines indeed involved a certain degree of luck, required the insertion of dollar bills and the winning tickets were redeemable for cash. Second, it was found that Thunderbird had to be aware of the potential risk of its investment, since it knew that gambling was an illegal activity under Mexican law, and that the response by the authorities did no more than point to the existing legislation and convey a message based on sparse information.

A broader understanding of the investor's legitimate expectations has been expressed in the separate opinion by Thomas W. Wälde,<sup>756</sup> providing a detailed and comprehensive examination of that concept under Article 1105 of the NAFTA. Wälde rejected the majority opinion on this point and accorded more weight to the principle of legitimate expectations, by allocating the risk of ambiguity of a governmental assurance rather to the government than to the investor, for the sake of achieving effective protection of foreign investors.<sup>757</sup> Accordingly, he determined a governmental duty to clarify proactively any misunderstanding or confusion caused by official communications and thus found that the formal response of the Mexican authority created legitimate expectations, which had been subsequently frustrated by the closure of the gaming facilities.<sup>758</sup> However, even if Wälde, due to a different weight allocation, would have found a breach of Article 1105 of the NAFTA, he

<sup>754</sup> *Ibid.*, at para. 147. The tribunal dealt with the concept of legitimate expectations in the way of a general preface before turning to the specific investment protection standards. Accordingly, the tribunal appeared to be of the opinion that the principle of legitimate expectations may be of relevance for all of those standards.

<sup>755</sup> *Ibid.*, at paras. 148 et seq.

<sup>756</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 444). <sup>757</sup> *Ibid.*, at para. 4.

<sup>758</sup> See *ibid.*, at paras. 95 and 102 et seq. Wälde's reasoning was especially influenced by the analysis in the MTD award, which he considered the most relevant authoritative precedent: see para. 54.



also acknowledged at various points the need for governmental flexibility and to balance the investor's expectations against legitimate state interests.<sup>759</sup>

(iii) *Stability in the contractual relationship*

A third, but certainly not less important, stage at which the investor's expectations may be of relevance is the contractual relationship between the foreign investor and the host state. This dimension was addressed in the cases of *Ronald S. Lauder v. Czech Republic*<sup>760</sup> and *CME Czech Republic BV v. Czech Republic*,<sup>761</sup> which also constitute excellent examples of the possible contradictions arising from the diversification of international tribunals.<sup>762</sup> In these cases, Ronald Lauder, through its majority interest in CME and further subsidiaries, tried to break into the new market of television broadcasting which was privatised by the Czech Republic during the early 1990s.<sup>763</sup> In this privatisation process, the Czech Media Council issued a broadcasting licence to the small Czech company CET 21 which was to operate the first private broadcasting station 'TV NOVA' in coordination with a CME subsidiary, providing for the necessary expertise and funding. Since a direct interest of a foreign investor in CET 21 was politically objectionable, an operating company (CNTS) was installed with the approval of the Media Council, as an exclusive service provider, in which CET 21 and CME participated. Due to changes in the Czech Media Law and the interference by the Media Council by commencing administrative proceedings against CNTS, the exclusive basis upon which CNTS operated the broadcasting licence was successively undermined.<sup>764</sup> Moreover, the Media Council

<sup>759</sup> See especially *ibid.*, at para. 102. Furthermore, Wälde would have only awarded a trickle of the claimed compensation: see at paras. 119 et seq.

<sup>760</sup> *Ronald S. Lauder v. Czech Republic* (above fn. 450).

<sup>761</sup> *CME Czech Republic BV v. Czech Republic*, UNCITRAL (Partial Award of 13 September 2001); and *CME Czech Republic BV v. Czech Republic*, UNCITRAL (Final Award of 14 March 2003). The Czech Republic challenged the arbitral award in the *CME* case, but the Svea Court of Appeals refused to set aside the award: see *Czech Republic v. CME Czech Republic BV*, Svea Court of Appeals (Judgment of 15 May 2003).

<sup>762</sup> On the latter, see Chapter 4, section A, 'Fragmentation and international investment law'.

<sup>763</sup> On the facts, see *Ronald S. Lauder v. Czech Republic* (above fn. 450), at paras. 43 et seq.; for a summary of the facts and further discussion of the cases, see, e.g. B. Bezdek, 'Czech Republic: Broadcasting - Treaties and Laws', *Ent. L.R.* 13 (2002), pp. N25-29; and W. Kühn and U. Gantenberg, 'Die CME Saga - Ein internationaler Investitionsstreit', *SchiedsVZ* (2004), p. 1.

<sup>764</sup> Initially, the providing of services by CNTS to CET 21 on an exclusive basis was a condition made by the Media Council for the issuance of the licence to CET 21 as

expressed its belief that the exclusive relationship between CET 21 and CNTS was legally impermissible. Due to the forced adaptations in the company agreement of CNTS, CET 21 was ultimately able to operate the licence on its own and later terminated the service contract with CNTS, which was meanwhile fully owned by CME.

The awards rendered by the different tribunals were largely contradictory. The *Lauder* tribunal, on the one hand, could not find any inconsistent conduct attributable to the Media Council that would have thwarted the contractual relationship between CET 21 and CME. Accordingly, the tribunal denied all claims for damages under the US BIT and rejected, in particular, any alleged infringement of fair and equitable treatment, including *pacta sunt servanda*.<sup>765</sup> The *CME* tribunal, on the other hand, was convinced that the Media Council's political interference constituted a breach of fair and equitable treatment under the Dutch BIT because the initial approval of the contractual structure in operating the broadcasting licence was considered to create legitimate expectations, upon which the investment was built.<sup>766</sup> Although this dispute did not involve a state contract, but rather related to a contractual relationship between two private parties, it nevertheless gives a first impression that the stability of the contractual relationship as such is of relevance within the concept of fair and equitable treatment. Nevertheless, the inconsistencies and contradictions revealed by the two awards in the same case are capable of seriously undermining the legitimacy of such decisions on fair and equitable treatment.

Also in some other cases, the question of contractual stability and the abidance to promises given in state contracts was addressed. The tribunals in these cases mainly adopted sweeping formulations suggesting that fair and equitable treatment would comprehensively protect the contractual rights of foreign investors without making any serious reservations.<sup>767</sup> One such example is presented by the case of *Eureko*

formal licence holder. However, due to the changes of the Czech Media Law the licence holders were entitled to request a waiver of all licence conditions. Subsequently, such a waiver as regards the mentioned condition was granted on CET 21's request.

<sup>765</sup> See *Ronald S. Lauder v. Czech Republic* (above fn. 450), especially at paras. 209, 174 and 295-304.

<sup>766</sup> *CME Czech Republic BV v. Czech Republic* (above fn. 761), especially at paras. 457, 520 and 611.

<sup>767</sup> See, e.g. *Noble Ventures Inc v. Romania*, ICSID Case No. ARB/01/11 (Award of 12 October 2005), at para. 182; see also *Mondev International Ltd v. United States* (above fn. 100), at para. 134, stating that 'a governmental prerogative to violate investment contracts would appear to be inconsistent with the principles embodied in Article 1105 [NAFTA]

*BV v. Poland*,<sup>768</sup> in which a Dutch investor during a privatisation process had acquired 20 per cent of PZU's shares, the leading insurance group in Poland. Under the share purchase agreement between Eureko and the State Treasury of Poland, the investor alleged the right to acquire additional shares in a public offering in order to attain majority control of PZU. However, due to a politically motivated change in the privatisation strategy, the timetable foreseen in the share purchase agreement had been protracted considerably and the public offering never took place.

The tribunal found it 'abundantly clear' that Eureko had been treated unfairly and inequitably.<sup>769</sup> The tribunal was of the opinion that Poland had breached the basic obligations of Eureko by not complying with its contractual obligation for political and nationalistic reasons to hold a public offering in which the investor would have obtained majority control of PZU.<sup>770</sup> To such an extent, the tribunal determined a violation of fair and equitable treatment due to a breach of a contractual right. Remarkably, this breach did not involve any interference with Eureko's existing shareholding in PZU, but related only to the contractual expectation with regard to the possible enlargement of the investment. While, in this case, the political motivation obviously increased the weight of the investor's arguments, the tribunal's reasoning is questionable due to its sweeping and undifferentiated requirement of contractual stability.

This impression is confirmed by the reasoning of other tribunals that are more reluctant to find a violation of the obligation to treat foreign investors fairly and equitably. In this respect, an example is presented by the case of *Waste Management v. Mexico*,<sup>771</sup> concerning a concession agreement for the provision of waste disposal and street cleaning services on an exclusive basis in the tourist and beachfront area of the city of Acapulco. Under the concession agreement, Waste Management was entitled to charge a monthly fee for the services it provided. However, the city had problems enforcing an ordinance that should ensure the exclusivity of the investor's services and failed to pay the vast majority of the invoices presented to it, even though the city was equipped with a guarantee issued by the Mexican public development bank.

and with contemporary standards of national and international law concerning governmental liability for contractual performance'.

<sup>768</sup> *Eureko BV v. Poland* (above fn. 450); on the factual background, see paras. 34 et seq.

<sup>769</sup> *Ibid.*, at para. 231.

<sup>770</sup> *Ibid.*, at paras. 232–233. Thereon critically see Douglas (above fn. 289), pp. 41–42.

<sup>771</sup> *Waste Management v. Mexico* (above fn. 102), re. the facts, see paras. 40 et seq.

In the tribunal's eyes, although it was clear that the city had failed in a number of respects to fulfil its contractual obligations under the concession agreement, such conduct was not deemed an infringement of the host state's fair and equitable treatment obligation.<sup>772</sup> The tribunal stated that NAFTA Chapter 11 should be treated neither as a forum for the resolution of contractual disputes nor as an insurance policy against bad business judgments.<sup>773</sup> Moreover, it noted:

[E]ven the persistent non-payment of debts by a municipality is not to be equated with a violation of 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. In the present case, the failure to pay can be explained, albeit not excused, by the financial crisis, which meant that at key points the City could hardly pay its own payroll. There is no evidence that it was motivated by sectoral or local prejudice.<sup>774</sup>

Another caveat has been expressed by the tribunal in the case of *Impregilo SpA v. Pakistan*,<sup>775</sup> arising out of a contractual relationship between a joint venture headed by Impregilo and a Pakistani authority that pertained to the construction of hydroelectric power facilities. Thereby, Impregilo claimed a violation of fair and equitable treatment due to alleged contractual shortcomings by the Pakistani authorities in causing obstacles and delays in the course of the project and denying requests for extensions to the contractual deadlines and for the compensation of additional costs. As regards the interrelationship between contract claims and the asserted breaches of the investment treaty, the tribunal stated:

In order that the alleged breach of contract may constitute a violation of the BIT, it must be the result of behaviour going beyond that which an ordinary contracting party could adopt. Only the state in the exercise of its sovereign authority ('*puissance publique*'), and not as a contracting party, may breach the obligations assumed under the BIT.<sup>776</sup>

Accordingly, in its assessment of a potential breach of fair and equitable treatment, the tribunal found the threshold to establish that a breach of the contracts constitutes a breach of the investment treaty to be a

<sup>772</sup> *Ibid.*, at paras. 109–117. <sup>773</sup> *Ibid.*, at para. 114. <sup>774</sup> *Ibid.*, at para. 115.

<sup>775</sup> *Impregilo SpA v. Pakistan*, ICSID Case No. ARB/03/3 (Decision on Jurisdiction of 22 April 2005); on the facts and the submissions of the parties, see paras. 8 et seq.

<sup>776</sup> *Ibid.*, at para. 260, referring to S. M. Schwebel, 'On Whether the Breach by a State of a Contract With an Alien is a Breach of International Law', in S. M. Schwebel (ed.), *Justice in International Law* (1994), p. 425 at pp. 431–432 and 435.

high one.<sup>777</sup> The tribunal concluded by excluding parts of the complaints of unfair and inequitable treatment from its jurisdiction and retained the remaining claims for its award on the merits.<sup>778</sup>

Hence, the *Impregilo* decision may be seen as a proposition to introduce the distinction between *acta iure imperii* and *acta iure gestionis* into the question of whether or not a breach of contract amounts to a breach of fair and equitable treatment. Similar propositions can be found in several other arbitral decisions. For instance, in the case of *Consortium RFCC v. Morocco*, concerning failures of the Moroccan state to make payments under contract for the construction of a motorway, the tribunal held that only the state's use of its sovereign prerogatives was subject to scrutiny under the BIT and that only such activities could possibly amount to a violation of fair and equitable treatment.<sup>779</sup>

A further aspect that is possibly able to hinder the finding of a violation of fair and equitable treatment in case of an alleged breach of contract has been expressed in the above-described case of *Parkerings-Compagniet AS v. Lithuania*, concerning the unilateral termination of a contract due to prior changes of the legal environment of that agreement.<sup>780</sup> Thereby, the tribunal acknowledged that, under certain limited circumstances, a substantial breach of contract could constitute a violation of an investment treaty, but that case law has offered very few illustrations thus far.<sup>781</sup> In the present case, the tribunal denied a breach of fair and equitable treatment because the investor did not

<sup>777</sup> *Ibid.*, at para. 267. <sup>778</sup> See *ibid.*, at paras. 268-271.

<sup>779</sup> *Consortium RFCC v. Morocco*, ICSID Case No. ARB/00/6 (Award of 22 December 2003), at para. 51, stating the following:

L'Etat, ou son émanation, peuvent s'être comportés comme des cocontractants ordinaires ayant une divergence d'approche, en fait ou en droit, avec l'investisseur. Pour que la violation alléguée du contrat constitue un traitement injuste ou inéquitable au sens de l'Accord bilatéral, il faut qu'elle résulte d'un comportement exorbitant de celui qu'un contractant ordinaire pourrait adopter. Seul l'Etat, en tant que puissance publique, et non comme contractant, a assumé des obligations au titre de l'Accord bilatéral.

Similarly, see *Joy Mining Machinery Ltd v. Egypt*, ICSID Case No. ARB/03/11 (Award on Jurisdiction of 6 August 2004), at paras. 78-79; and *Duke Energy Electroquil Partners and Electroquil SA v. Ecuador* (above fn. 326), at para. 345. On the distinction between *acts iure imperii* and *iure gestionis* in the context of an expropriation claim, see *Siemens AG v. Argentina*, ICSID Case No. ARB/02/8 (Award of 6 February 2007), at paras. 246 et seq.

<sup>780</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138); see also Chapter 7, section A, '2(b)(i) Stability of the overall legal framework'.

<sup>781</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at para. 316.

search for any remedies before the local courts.<sup>782</sup> The tribunal observed:

[I]f the contracting party is denied access to domestic courts, and thus denied opportunity to obtain redress of the injury and to complain about those contractual breaches, then an arbitral tribunal is in position, on the basis of the BIT, to decide whether this lack of remedies had consequences on the investment and thus whether a violation of international law occurred. In other words, as a general rule, a tribunal whose jurisdiction is based solely on a BIT will decide over the 'treatment' that the alleged breach of contract has received in the domestic context, rather than over the existence of a breach as such.<sup>783</sup>

Accordingly, the tribunal stipulated the exhaustion of local remedies as a prerequisite for the finding that, in fact, an *ultra vires* act under national law had occurred, which could possibly amount to a violation of fair and equitable treatment in the case of an alleged breach of contract.<sup>784</sup>

To sum up, the presented cases suggest that fair and equitable treatment generally protects contractual stability. This element of fair and equitable treatment not only applies to state contracts, but may also be of relevance in cases in which a state interferes by other means with the contractual framework that relates to a foreign investment. However, the degree to which the principle of contractual stability is protected under fair and equitable treatment has not yet become very clear. While some cases contain rather broad and general stipulations of a duty to observe contractual obligations as regards the investor, others seem to favour a more differentiated approach, emphasising the distinction between a state's commercial and sovereign activities or the exhaustion of remedies. In principle, a more reluctant approach concords with the general international law on state responsibility to the extent that a breach of contract with an alien is not considered to be a breach of international law per se and that hence something further is required.<sup>785</sup> Whether *puissance publique* or the exhaustion of remedies<sup>786</sup> will emerge as suitable criteria for the finding of something more is not yet certain and partly contested. For instance, the criterion of *puissance*

<sup>782</sup> *Ibid.*, at para. 320. <sup>783</sup> *Ibid.*, at para. 317. <sup>784</sup> See *ibid.*, at para. 319.

<sup>785</sup> See, e.g. C. F. Amerasinghe, 'State Breaches of Contracts with Aliens and International Law', *AJIL* 58 (1964), p. 881 at p. 912; Schwebel (above fn. 776), p. 426; and Crawford (above fn. 185), pp. 86 and 96.

<sup>786</sup> The exhaustion of domestic remedies receives further discussion in relation to the concept of denial of justice as a principle of fair and equitable treatment: see Chapter 7, section B, '1(b)(i) Denial of justice'.

*publique* has been criticised for being indeterminate itself, since even in a primarily commercial relationship certain considerations of a government may still be governmental and not commercial.<sup>787</sup> The delineation between commercial and sovereign activities is further complicated by the fact that international investment law exceedingly defies the classical dichotomy between private and public law, which underlies this delineation.

### (c) The relative weight of investors' expectations

The previous case analysis has shown that the protection of the investor's expectations as regards the stability of the host state's conduct is, in general, quite well established at all three levels just described. However, problems arise in the determination of the legitimacy or reasonableness of these expectations, since of course no subjective expectation is deemed to be protected by fair and equitable treatment. Whether or not an arbitral tribunal ultimately finds an investor to have legitimate expectations is the result of a balancing operation of the different interests at stake undertaken explicitly or implicitly by the tribunal.<sup>788</sup> Recent arbitral decisions suggest that this weighing should take into account all circumstances, including the political, socio-economic, cultural and historic conditions prevailing in the host state.<sup>789</sup> The balancing operation may certainly arrive at different results in different cases. However, inconsistent decisions in the same case, like the ones rendered by the *Lauder* and *CME* tribunal, are threatening the legitimacy of fair and equitable treatment, especially if such inconsistencies are combined with sweeping propositions that are not thoroughly justified by convincing reasoning.

However, despite this uncertainty, relative agreement exists insofar as the law at the time of the investment represents the basis and limitation of the investor's legitimate expectations.<sup>790</sup> This means that the investor has to take the law of the host state as he finds it and may expect that this state of the law exhibits stability to a certain extent without depriving the host state of its ability to advance reasonably and

adapt its laws and administrative policies. Furthermore, taking the state of the law at the time of the investment as a reference point for the investor's expectations entails that, on the one hand, the investor has to procure the means to become aware of the domestic legal framework, while on the other hand, he may expect that the laws principally be carried out within their terms. However, since the wrongfulness of an act under national law as such is no benchmark for finding a breach of international law,<sup>791</sup> the tribunals search for something more that justifies a decision that the fair and equitable treatment obligation has been violated, such as a complete alteration of the investment environment or some form of political hostility.

Moreover, expectations may be created by any representations or commitments by the host state after the investment has been made. Thereby and generally, the weight of the investor's expectations increases the more concrete and individualised these representations are.<sup>792</sup> However, arbitral tribunals have not yet established more detailed criteria concerning the weight allocation in the balancing of the conflicting arguments. While the lack of such criteria leaves considerable uncertainty in the application of this important principle of fair and equitable treatment, it is to be expected that criteria will be developed over time by the tribunals in analogy to the national legitimate expectations concepts.

### 3 Non-discrimination

The principle of non-discrimination denotes another essential element that is inherent in the concept of fair and equitable treatment. While arbitral tribunals, in this context, also refer to other notions such as arbitrariness or harassment, all of these notions shall be subsumed under one principle of non-discrimination that is construed comprehensively here. The principle of non-discrimination is also insinuated in cases reviewed in relation to other principles of fair and equitable treatment. In the present context, an attempt is made nevertheless to describe the foundation and application of the concept of

<sup>787</sup> Dolzer and Schreuer (above fn. 54), p. 142.

<sup>788</sup> See also *Saluka Investments BV v. Czech Republic* (above fn. 132), at paras. 305–306.

<sup>789</sup> See *Duke Energy Electroquil Partners and Electroquil SA v. Ecuador* (above fn. 326), at para. 340; and *Bayindir Insaat Turizm Ticaret ve Sanayi A Ş v. Pakistan* (above fn. 20), at paras. 192 et seq.

<sup>790</sup> See *Bayindir Insaat Turizm Ticaret ve Sanayi A Ş v. Pakistan* (above fn. 20), at para. 190; and Dolzer (above fn. 73), pp. 968–969.

<sup>791</sup> See only Crawford (above fn. 185), p. 86.

<sup>792</sup> See also W. M. Reisman and M. H. Arsanjani, 'The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes', in P.-M. Dupuy *et al.* (eds.), *Völkerrecht als Wertordnung* (2006), p. 409 at p. 422, suggesting that even nationally unlawful statements or declarations by the host state may create legitimate expectations if these statements are concrete enough and the host state is acting with the intention to create such expectations.

non-discrimination as an idiosyncratic principle of fair and equitable treatment.

#### (a) General meaning of non-discrimination

The meaning of non-discrimination is controversial in international law and has therefore already generated some discussion. As a starting point, dictionary items may reveal the linguistic affinity between non-discrimination and the obligation of fair and equitable treatment, but they are hardly able to enlighten the meaning of non-discrimination. For instance, 'discrimination' is described as a '[d]ifferential treatment; esp., a failure to treat all persons equally when no reasonable distinction can be found'<sup>793</sup> or as '[t]reating a person less favourably than others on grounds unrelated to merit', possibly including harassment.<sup>794</sup> Related to that, 'arbitrary' is characterised as '[d]epending on individual discretion; ... founded on prejudice or preference rather than on reason or fact'.<sup>795</sup> To such an extent, the ordinary meaning of discrimination is ambiguous. While the word can be employed neutrally to mean mere differentiation, it can also be understood as having a negative connotation, meaning an unfair, arbitrary or unreasonable distinction;<sup>796</sup> the latter meaning predominates in international law.<sup>797</sup>

Beyond international investment law, the principle of non-discrimination is also appreciated in other areas of international law. In international trade law, for example, non-discrimination is embodied in the conventional standards of national treatment and most-favoured-nation treatment obliging a state not to treat products or services from another country less favourably than national or third-party products or services.<sup>798</sup> While the latter standards provide quite a specific regime of rules and exceptions, the quest within other fields of international law, concerning for example the protection of property rights and standards banning racial, sexual and other discriminations,

<sup>793</sup> Garner (ed.) (above fn. 134).

<sup>794</sup> E. A. Martin and J. Law (eds.), *Oxford Dictionary of Law*, 6th edn (2006).

<sup>795</sup> Garner (ed.) (above fn. 134).

<sup>796</sup> See also W. A. McKean, 'The Meaning of Discrimination in International and Municipal Law', *BYIL* 44 (1970), p. 177 at pp. 177-178.

<sup>797</sup> See *ibid.*, pp. 185-186; W. Kewenig, *Der Grundsatz der Nichtdiskriminierung im Völkerrecht der internationalen Handelsbeziehungen* (1972), Vol. 1, p. 27; E. W. Vierdag, *The Concept of Discrimination in International Law* (1973), pp. 48-49, 60; R. Dolzer, 'Generalklauseln in Investitionsschutzverträgen', in J. A. Frowein (ed.), *Verhandeln für den Frieden* (2003), p. 291 at pp. 296-297; and Brownlie (above fn. 129), p. 573.

<sup>798</sup> See, e.g. Hilf and Oeter (above fn. 395), pp. 116-117.

is rather to distinguish reasonable differentiations from arbitrary, invidious or otherwise unjustifiable discriminations.<sup>799</sup> To such an extent, if not otherwise specified, non-discrimination does not inhibit any differential treatment, but only such differentiations that lack a reasonable basis.<sup>800</sup> It is of course difficult to compile a set of factors and indicators for determining whether permissible grounds for any such differentiation exist.<sup>801</sup> However, it seems that any determination regarding whether there is a reasonable basis for a particular differentiation has to take into account not only the value primarily at stake, but also the varying features of the context in which the differentiation is made.<sup>802</sup>

The following review endeavours to identify how arbitral tribunals apply the principle of non-discrimination within the concept of fair and equitable treatment to international investment disputes. Thereby, there is an emergence of intersections with other investment standards related to non-discrimination, such as national and most-favoured-nation treatment as well as the duty to refrain from arbitrary and discriminatory treatment. However, for the time being and due to reasons of clarity, these questions will be postponed to a later stage.<sup>803</sup>

#### (b) Non-discrimination in arbitral jurisprudence

The principle of non-discrimination as part of fair and equitable treatment has been acknowledged in the controversial first partial award in *S.D. Myers Inc. v. Canada*.<sup>804</sup> That case pertained to an export ban of certain highly toxic chemical compounds (PCBs) by the Canadian Government in order to protect the fledgling Canadian disposal industry. In its reasoning, the tribunal noted that a violation of fair and equitable treatment occurs '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

<sup>799</sup> On discrimination in human rights law, see McDougal, Lasswell and Chen (above fn. 184), pp. 737 et seq.

<sup>800</sup> See ALI, *Restatement of the Law (Third): Foreign Relations Law of the United States* (1986), § 711 lit. f and g; for manifold references to international jurisprudence, see also A. F. M. Maniruzzaman, 'Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment', *J. Transnat'l L. & Pol'y* 8 (1998), p. 57 at pp. 61 et seq.; and Brownlie (above fn. 129), p. 573.

<sup>801</sup> See Dolzer (above fn. 797), p. 303, observing that there exists no consensus at all in relation to the purpose, ambit or application of conventional non-discrimination provisions in international law.

<sup>802</sup> See Maniruzzaman (above fn. 800), p. 65.

<sup>803</sup> See Chapter 9, section A, 'Interplay with other standards of investment protection'.

<sup>804</sup> *S.D. Myers Inc v. Canada* (above fn. 95); for a detailed description of the facts and further discussion, see Chapter 3, section B, '1(a) The *Metalclad* and *S.D. Myers* approach'.

unacceptable from the international perspective'.<sup>805</sup> Then, the tribunal affirmed a contravention of fair and equitable treatment due to the same reasons which it found established a breach of the previously considered national treatment obligation.<sup>806</sup> In relation to the latter, the tribunal took into account whether the state measure, prima facie, differentiated between nationals and non-nationals and whether it had the practical effect of creating a disproportionate benefit for nationals over non-nationals.<sup>807</sup> Furthermore, it found discriminatory intent to be an important factor, but not necessarily decisive unto itself.<sup>808</sup> Ultimately, the tribunal determined that the intention to protect the domestic industry in order to maintain the ability to dispose of the chemicals within Canada in the future constituted, in principle, a legitimate goal, but that there existed other means of achieving that goal which were less intrusive to the investor than the export ban.<sup>809</sup> Hence, the tribunal decided that a legitimate aim could justify a differential treatment,<sup>810</sup> but that in the realisation of that aim the effects of the investor's measure are also to be taken into account.

A violation of fair and equitable treatment through discriminatory treatment was furthermore alleged in the dispute relating to Ronald Lauder's engagement in the Czech television broadcasting sector.<sup>811</sup> Thereby, the tribunal in the case of *CME Czech Republic BV v. Czech Republic* determined that the Media Council's interference with the exclusive contractual framework of the investment discriminated against the investor and constituted a violation of the fair and equitable treatment provision.<sup>812</sup> The *CME* tribunal stated:

On the face of it, the Media Council's actions and inactions ... were unreasonable as the clear intention ... was to deprive the foreign investor of the exclusive use of the licence ... and the clear intention ... was to collude with the foreign investor's Czech business partner to deprive the foreign investor of its investment. The behaviour of the Media Council also smacks of discrimination against the foreign investor.<sup>813</sup>

<sup>805</sup> *S.D. Myers Inc v. Canada* (above fn. 95), at para. 263. <sup>806</sup> *Ibid.*, at para. 266.

<sup>807</sup> *Ibid.*, at para. 252. <sup>808</sup> *Ibid.*, at para. 254. <sup>809</sup> *Ibid.*, at para. 255.

<sup>810</sup> Similarly, e.g. *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia* (above fn. 96), at para. 363.

<sup>811</sup> On this case, see also Chapter 7, section A, '2(b)(iii) Stability in the contractual relationship'.

<sup>812</sup> *CME Czech Republic BV v. Czech Republic* (Partial Award of 13 September 2001), especially para. 611.

<sup>813</sup> *Ibid.*, at para. 612.

Consequently, against the opinion of the tribunal in the *Lauder* case,<sup>814</sup> the *CME* tribunal decided that the overall conduct of the Media Council arbitrarily pressured the foreign investor in a way which could not be justified by any legitimate purpose. However, a mere 'smack of discrimination' without explaining through which facts such presumption materialised is a questionable basis for establishing a breach of fair and equitable treatment, which at the most may buttress other, more solid arguments in this direction.

As a reaction to the NAFTA FTC note of interpretation<sup>815</sup> and in contrast to the rather wide interpretation in the *S.D. Myers* case, the tribunal in the case of *Methanex Corp. v. United States*<sup>816</sup> adopted a narrow approach in relation to fair and equitable treatment and non-discrimination. The case related to Methanex, a Canadian investor and the world's largest producer of methanol. Methanol is used as a feedstock of MTBE, a source of octane and an oxygenate in gasoline.<sup>817</sup> Due to environmental concerns and scientific studies that gasoline containing MTBE leaked into and contaminated California's ground water, California issued an executive order for the phasing-out of MTBE as an oxygenate of gasoline.<sup>818</sup> Methanex did not produce MTBE itself. However, it complained that the MTBE ban was rather due to protectionist motives than to environmental reasons. The latter was because US ethanol producers as the beneficiaries of the ban - ethanol is another oxygenate that is interchangeable with methanol - had started a lobbying campaign against methanol and allegedly provided political and financial inducements (but not bribes) to the state government.<sup>819</sup> Methanex therefore submitted that the US measures were intended to discriminate against foreign investors and that intentional discrimination was, by definition, inequitable in the sense of Article 1105(1) of the NAFTA.<sup>820</sup>

The *Methanex* tribunal first denied a violation of the national treatment obligation enshrined in Article 1102 of the NAFTA because the

<sup>814</sup> The *Lauder* tribunal could not find any breach of fair and equitable treatment or any discrimination in that dispute: see *Ronald S. Lauder v. Czech Republic* (above fn. 450), especially at paras. 294-295.

<sup>815</sup> Thereon, see Chapter 3, section B, '2 FTC note of interpretation on Article 1105(1) of the NAFTA'.

<sup>816</sup> *Methanex Corp. v. United States* (above fn. 275). For a concise summary of the facts, see, e.g. Kirkman (above fn. 244), pp. 360-362; and S.E. Gaines, 'Methanex Corp. v. United States', *AJIL* 100 (2006), p. 683 at pp. 683-685.

<sup>817</sup> *Methanex Corp. v. United States* (above fn. 275), part II, chapter D, paras. 2-3.

<sup>818</sup> *Ibid.*, at part II, chapter D, paras. 7 et seq. <sup>819</sup> *Ibid.*, at part II, chapter D, para. 25.

<sup>820</sup> *Ibid.*, at part IV, chapter C, para. 2.

MTBE ban, on the face of it, did not differentiate between foreign and domestic MTBE producers,<sup>821</sup> and then turned to fair and equitable treatment. However, since the tribunal found that non-discrimination was not an element of fair and equitable treatment, it also rejected the investor's view on Article 1105 of the NAFTA.<sup>822</sup> It declared:

[E]ven assuming that Methanex had established discrimination under Article 1102, (which the tribunal has found it did not) and ignoring, for the moment, the FTC's interpretation – the plain and natural meaning of the text of Article 1105 does not support the contention that the 'minimum standard of treatment' precludes governmental differentiations as between nationals and aliens.<sup>823</sup>

Based on a textual argumentation, the tribunal further opined that the parties did not want to include non-discrimination in the concept of fair and equitable treatment, since they had already included it in other provisions of the agreement.<sup>824</sup> Eventually, the tribunal also negated that a customary rule of non-discrimination existed that could have been taken into account in the interpretation of fair and equitable treatment.<sup>825</sup>

The narrow approach in the *Methanex* award excluding discriminatory elements from fair and equitable treatment appears very restrictive indeed.<sup>826</sup> A number of prominent instances which affirm that non-discrimination has its role to play within fair and equitable treatment thus disapprove the *Methanex* approach. In addition to the cases cited above, Stephen M. Schwebel, a witness in the above-mentioned *MTD* case, for example, attested that fair and equitable treatment is 'a broad and widely-accepted standard encompassing such fundamental standards as good faith, due process, non-discrimination, and proportionality'.<sup>827</sup> Similarly, in the *Eureka* award, a breach of fair and equitable treatment has been determined due to actions 'not for cause but for purely arbitrary reasons linked to the interplay of ... politics and nationalistic

<sup>821</sup> See *ibid.*, at part IV, chapter B, para. 38. <sup>822</sup> *Ibid.*, at part IV, chapter C, para. 13.

<sup>823</sup> *Ibid.*, at part IV, chapter C, para. 14. <sup>824</sup> *Ibid.*, at part IV, chapter C, para. 16.

<sup>825</sup> *Ibid.*, at part IV, chapter C, para. 15. Thereon differentiating, see Kewenig (above fn. 797), pp. 32 et seq. and 41 et seq.

<sup>826</sup> With reference to *Waste Management v. Mexico* (above fn. 102), at para. 98, the *Methanex* tribunal also admitted that sectional and racial prejudice might be of relevance in relation to fair and equitable treatment, but found it unnecessary to further comment on this issue: see *Methanex Corp. v. United States* (above fn. 275), at part IV, chapter C, para. 26.

<sup>827</sup> See *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 109; on this case, see also Chapter 7, section A, '2(b)(ii) Stability in the administrative conduct'.

reasons of a discriminatory character'.<sup>828</sup> The tribunal in the *Parkerings-Compagniet* case similarly ascertained: 'Discrimination is a significant element in determining whether the standard of fair and equitable treatment has been breached.'<sup>829</sup> In relation to the legitimate expectations principle, Thomas W. Wälde stated in his separate opinion in the *Thunderbird* case:

'Discriminatory elements' may *per se* not amount to a breach of Article 1102 of the NAFTA (and I concur that breach of one NAFTA Chapter XI duty does not necessarily indicate the breach of another one), but in particular in the context of fair and equitable treatment (Article 1105 of the NAFTA) discriminatory elements have to play a role in the process of determining if problematic conduct has risen to the required threshold of intensity required under Article 1105.<sup>830</sup>

Through these few examples, the impression emerges that the *Methanex* tribunal misconstrued the principle of non-discrimination to the extent that it equated the principle with a national treatment obligation.<sup>831</sup> However, the examples also show that fair and equitable treatment does not oblige a host state to treat national and foreign investors equally, as the standard national treatment would demand. Fair and equitable treatment rather requests that, if a distinction is made between foreign investors and others, these distinctions have to be made without arbitrariness and based upon a rational foundation. The protection of the environment, as pleaded in the *Methanex* case, may have represented such a rational basis that is capable of outweighing the less favourable treatment accorded to methanol producers than to ethanol producers.

The award in the case of *Saluka Investments BV v. Czech Republic*,<sup>832</sup> concerning the privatisation of the struggling Czech banking sector, fortifies such understanding of non-discrimination. In that case, three still mainly state-owned banks benefited from a governmental assistance programme, while the IPB bank that had already been fully privatised could not obtain such assistance and subsequently collapsed.

<sup>828</sup> *Eureka BV v. Poland* (above fn. 450), at para. 233.

<sup>829</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at para. 280; similarly *Victor Pey Casado and Président Allende Foundation v. Chile* (above fn. 452), at paras. 671–674.

<sup>830</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 444), at para. 103.

<sup>831</sup> Generally, on the relation between fair and equitable treatment and national treatment, see Chapter 9, section A, '1 National treatment'.

<sup>832</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132); for a more detailed description of the facts and further discussion, see Chapter 3, section C, '1(c) *Saluka Investments BV v. Czech Republic*'.

In its comprehensive reasoning on the principle of non-discrimination within the concept of fair and equitable treatment, the tribunal specified the meaning of fair and equitable treatment and non-discrimination as follows:

A foreign investor protected by the treaty may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment.<sup>833</sup>

Furthermore, the tribunal developed a test for the determination of discriminatory conduct which was considered to have occurred 'if (i) similar cases are (ii) treated differently (iii) and without reasonable justification'.<sup>834</sup> In the application of this test, the tribunal approved that all four banks were in a comparable situation because they all had problems with large non-performing loan portfolios and the banks were of similar significance for the Czech economy at large.<sup>835</sup> The tribunal also found that the banks had been treated differently because the IPB bank was excluded from the assistance programme after the foreign investor had acquired the bank's shares and could not benefit from the programme until it was put under forced administration (after its collapse).<sup>836</sup> Eventually, the tribunal could not find a reasonable justification for the differential treatment, since it deemed the Czech Republic, as the regulator of the banking sector, to be responsible for somehow resolving the bad debt problem as a whole in an even-handed way.<sup>837</sup>

Moreover, a lack of even-handedness was determined by the tribunal due to the failure of the Czech authorities to examine the investor's proposals to solve the financial problems of the IPB bank in an unbiased way, rather than to prefer unreasonably the transfer of IPB's business to another state-owned bank.<sup>838</sup> Being thus convinced that the foreign investor had been treated in a discriminatory manner, the tribunal went on to bolster this finding by assessing other principles of fair and equitable treatment that were of importance for the process of

<sup>833</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 307.

<sup>834</sup> *Ibid.*, at para. 313. <sup>835</sup> *Ibid.*, at para. 322. <sup>836</sup> *Ibid.*, at para. 326.

<sup>837</sup> *Ibid.*, especially at para. 335. <sup>838</sup> *Ibid.*, at paras. 408 et seq.

weighing as applied by the tribunal.<sup>839</sup> Thereby, the tribunal further found that the host state failed to act consistently<sup>840</sup> and transparently<sup>841</sup> and breached the investor's legitimate expectations.<sup>842</sup> The totality of arguments sufficed the arbitral tribunal to conclude that a breach of fair and equitable treatment had occurred because the foreign investor's interests outweighed the host state's flexibility to pursue a privatisation policy according to its idiosyncratic needs and interests.<sup>843</sup>

### (c) The relative weight of non-discrimination

The case review shows that, in general, non-discrimination is strongly supported by arbitral tribunals as an element of fair and equitable treatment. The differing approach applied by the *Methanex* tribunal must be considered as a rather isolated view within arbitral jurisprudence that seems to be due to the peculiarities of the NAFTA FTC note of interpretation. The latter impression is confirmed by scholarly writings which from the outset have considered non-discrimination to be an integral part of the concept of fair and equitable treatment.<sup>844</sup> However, that is not to say that fair and equitable treatment would oblige a host state to treat foreign and national investors equally in any case.<sup>845</sup> This is because it is accepted that international law does not impose a general precept of equality on states as long as they have not agreed to such a duty in the form of a national or most-favoured-nation treatment obligation in an international treaty.<sup>846</sup> Nevertheless, we have seen that it is well established in arbitral jurisprudence that discriminatory elements play a role in the determination of a breach of fair and equitable treatment. However, the resultant flexibility does not depict a paradox, but is rather due to a general perception of fairness and the character of non-discrimination as a principle of fair and equitable treatment.<sup>847</sup>

As is best revealed by the *Saluka* award, non-discrimination is part of an operation of balancing and weighing which ultimately may establish

<sup>839</sup> On the tribunal's weighing methodology, see *ibid.*, at paras. 306-308.

<sup>840</sup> *Ibid.*, at para. 417. <sup>841</sup> *Ibid.*, at para. 420. <sup>842</sup> *Ibid.*, at para. 348.

<sup>843</sup> See *ibid.*, at paras. 497-502.

<sup>844</sup> See, e.g. Schwarzenberger (above fn. 201), p. 221; Vasciannie (above fn. 2), p. 131; Choudhury (above fn. 2), pp. 311-314; and Schill (above fn. 491), p. 19.

<sup>845</sup> See also Schachter (above fn. 119), pp. 315-316.

<sup>846</sup> See Dolzer and Stevens (above fn. 5), p. 58.

<sup>847</sup> On the principle character of non-discrimination in German constitutional law, see L. Michael, 'Gleichheitsrechte als grundrechtliche Prinzipien', in J.-R. Sieckmann (ed.), *Die Prinzipientheorie der Grundrechte* (2007), p. 123.



a breach of fair and equitable treatment. Thereby, discriminatory elements may give further weight to other principles such as the protection of the investor's legitimate expectations or compliance with fair procedures. However, an arbitrary conduct may also, in itself or supported by inconsistent or non-transparent behaviour as in the *Saluka* award, be able to constitute a violation of fair and equitable treatment if it outweighs competing principles.

As regards the content of non-discrimination, the most illuminating explanation is probably also provided by the *Saluka* tribunal which requested, for the establishment of discrimination, that similar cases be treated differently without reasonable justification. It is not at all surprising that the *Saluka* tribunal thereby restricted the comparison to similar cases only, since any comparison by necessity presupposes the comparability of the objects that are to be compared.<sup>848</sup> Therefore, the question as to the identification of the criteria according to which the comparability of investments is to assess appears more interesting. In the context of fair and equitable treatment, such criteria are not yet apparent.<sup>849</sup>

However, due to the broad construction of non-discrimination within the concept of fair and equitable treatment, the latter question also seems to be of limited relevance in arbitral jurisprudence. This is because arbitral tribunals are not distinguishing between the notions of non-discrimination, non-arbitrariness and reasonableness. They therefore seem to derive from the broad principle of non-discrimination a general precept of non-arbitrariness which is mostly described as a duty to act reasonably without any precondition of a differential treatment.<sup>850</sup> Accordingly, the usage of the terms 'discrimination' or 'arbitrariness' is often dependent on whether or not a comparable investment existed that could have been treated as distinct from the investment affected. Hence, the core issue of the non-discrimination principle is always represented by the search for the reasonableness of any measure impairing the foreign investment.<sup>851</sup> While a differentiation

<sup>848</sup> See Krajewski and Ceysens (above fn. 617), p. 197.

<sup>849</sup> On certain criteria applied by arbitral tribunals in relation to national treatment obligations, see Chapter 9, section A, '1 National treatment'.

<sup>850</sup> A similar example is provided by German constitutional law, in which the duty not to act arbitrarily is also derived from the general rule of equality: see H. D. Jarass, 'Article 3', in H. D. Jarass and B. Pieroth (eds.), *Grundgesetz für die Bundesrepublik Deutschland*, 8th edn (2006), mn. 26.

<sup>851</sup> Thereon, see also Schachter (above fn. 119), pp. 316-320.

has been deemed reasonable in arbitral jurisprudence if it corresponded to exigencies of the public interest or the protection of the environment, the finding of reasonableness appears unlikely if the differentiation is borne by a clearly protectionist intent or the legitimate aim could be achieved by less intrusive means. Thus, the reasonableness of a measure again depends on a balancing of the principles at stake and is inherently connected to the proportionality rule discussed below.<sup>852</sup>

#### 4 Sustainable development

Fair and equitable treatment is not only governed by arguments pertaining to the sphere of international investment law, but also by other arguments which may be systemically integrated into the concept of fair and equitable treatment and which contribute to an overall coherence of the international legal system.<sup>853</sup> An example of one of these principles, or rather a conglomeration of several principles, is provided by the concept of sustainable development. Thereby, the legal discussion on sustainable development could be of relevance in the sense that it may deliver arguments derived from emerging principles within sustainable development that enrich the process of balancing under fair and equitable treatment. Additionally, the conceptual construction of sustainable development may reveal similarities to fair and equitable treatment with regard to the process of integration and balancing of competing normative arguments, which also deserves closer attention.<sup>854</sup>

##### (a) Emergence and meaning of sustainable development

Sustainable development is often associated with the desire as expressed in the 1987 Brundtland Report to meet 'the needs of the present without compromising the ability of future generations to meet their own needs'.<sup>855</sup> While the term sustainable development, at first, might only have been a slogan to grasp the policy objective of environmental protection, it has increasingly displayed other development perspectives. At least since the 2002 World Summit for

<sup>852</sup> See Chapter 7, section C, '1 Proportionality as structural element'.

<sup>853</sup> On fragmentation and systemic integration in the context of fair and equitable treatment, see Chapter 4, 'The role of international law in the construction of fair and equitable treatment'.

<sup>854</sup> See also R. Kläger, 'Fair and Equitable Treatment and Sustainable Development', in M. W. Gehring et al. (eds.), *Sustainable Development in World Investment Law* (2011), p. 237.

<sup>855</sup> See para. 2 of the 1987 Report of the World Commission on Environment and Development, UN Doc. A/RES/42/187.

Sustainable Development this notion has been employed as a collective term in its broadest sense also to include ideas of economic and social development.<sup>856</sup> The broad umbrella of sustainable development therefore aims to address environmental, economic and social problems at the same time and seeks to establish a process of development that is mutually reinforced by all three pillars of that concept. Beyond the appealing policy objective of the sustainable development movement,<sup>857</sup> this concept has developed a legal dimension that requires a differential examination.

The umbrella of sustainable development covers various fields of international law comprising a broad range of different legal instruments. For instance, the global environmental movement alone has generated a whole flood of different treaties dealing with the environment, as well as a series of institutions acting in this field.<sup>858</sup> These treaties and institutions have established a rapidly growing sub-system of international law that operates according to its own legal principles.<sup>859</sup> As regards the social aspect of sustainable development, human rights law as another sub-system of international law is of crucial importance; especially the 1948 UN Universal Declaration of Human Rights as well as the 1966 International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights stipulate various principles that are of relevance in the context of sustainable development.<sup>860</sup> Additionally, regimes of regional protection of human rights<sup>861</sup> or other specialised bodies, such as the International Labour Organization (ILO),<sup>862</sup> provide a number of legal instruments that are linked to the concept of sustainable development. With regard to the aspect of economic development, the legal regimes of world trade law and international investment law

<sup>856</sup> For a recognition of these three pillars of sustainable development, see UN, *Johannesburg Declaration on Sustainable Development*, UN Doc. A/CONF.199/20 (2002), para. 5. As far as cultural issues are relevant for the present purposes, they will be subsumed under the notion of social development.

<sup>857</sup> For a comprehensive description of the development of the sustainable development movement, see, e.g. M.-C. Cordonier Segger and A. Khalfan, *Sustainable Development Law* (2004), pp. 15 et seq.

<sup>858</sup> For a compilation of environmental treaties, see Lowenfeld (above fn. 3), p. 378; see also Shaw (above fn. 125), pp. 844 et seq.

<sup>859</sup> See only P. Sands, *Principles of International Environmental Law*, 2nd edn [reprint] (2005).

<sup>860</sup> On these guarantees, see, e.g. Hailbronner (above fn. 169), pp. 230–233.

<sup>861</sup> For an overview, see *ibid.*, pp. 234 et seq.

<sup>862</sup> Thereon, see Shaw (above fn. 125), pp. 338–341.

especially come into play. While it is often pointed out that the promotion of trade and protection of the environment are opposing concepts,<sup>863</sup> there is also an increasing tendency to integrate ideas of sustainable development into the world-trade architecture.<sup>864</sup> To such an extent, the legal dimension of sustainable development comprises a multitude of legal instruments from different regimes of international environmental, social, and economic law.

While the legal status of each of these instruments has to be assessed separately, the question arises as to whether some common legal principles may have emerged under the umbrella of sustainable development. Remarkable efforts in this direction have been undertaken by the International Law Association (ILA), which through a comprehensive analysis of treaty regimes, tribunal decisions and other international legal practices distinguished seven principles of special interest in the context of sustainable development.<sup>865</sup> As a first principle, the sovereignty of states and their right to manage their own natural resources pursuant to their own environmental and developmental policies has been highlighted. The second principle accentuates equity as central to the attainment of sustainable development and the eradication of poverty.<sup>866</sup> Equity in this sense comprises the right of all peoples within the current generation to fair use of the world's resources (intra-generational equity) as well as the right of future generations to have fair access to these resources (inter-generational equity). Third, the principle of common but differentiated responsibilities has been emphasised to express a duty of all states as well as all other actors at the international level, such as international organisations, civil society and multinational corporations, to cooperate and contribute appropriately in order to achieve global sustainable development. Fourth, the precautionary principle

<sup>863</sup> See only Lowenfeld (above fn. 3), pp. 388 et seq.

<sup>864</sup> See, e.g. *United States - Import Prohibition of Certain Shrimp and Shrimp Products* (above fn. 392); thereon see also Chapter 4, section B, '3(d) Article XX of the GATT'. See also the reference to sustainable development in WTO, *Ministerial Declaration*, WT/MIN(01)/DEC/1 (2001), para. 6. For a comprehensive analysis of the interrelationship between both concepts, see M. W. Gehring and M.-C. Cordonier Segger (eds.), *Sustainable Development in World Trade Law* (2005).

<sup>865</sup> See ILA, *New Delhi Declaration of Principles of International Law Relating to Sustainable Development*, Published as Annex to UN Document A/57/329 (2002). For a more detailed elaboration on these principles, confer ILA, *Final Conference Report New Delhi* (2002), pp. 8–12; and Cordonier Segger and Khalfan (above fn. 857), pp. 103 et seq.

<sup>866</sup> On the concept of equity in sustainable development, see also Francioni (above fn. 509), *mn.* 22–25.

was invoked as an important means of assessing and managing risks that could significantly harm human health, natural resources and ecosystems. The fifth principle enshrines a right to public participation in decision-making processes and access to appropriate and timely information, as well as a right of access to effective judicial and administrative procedures in order to be able to review state measures. Connected to the latter, good governance, as the sixth principle of sustainable development, was identified as an essential concept to encompass decision-making procedures in accordance with due process and the rule of law, and to combat effectively official and other forms of corruption. Last, the principle of integration is highlighted as reflecting the interdependence of and the quest to resolve apparent conflicts arising from the interplay of social, economic and human rights aspects of rules of international law.<sup>867</sup>

The list of these principles – some already well established, some still emerging – provides a survey of the legal dimension of sustainable development that is increasingly acknowledged in the jurisprudence of international courts and tribunals. For instance, the WTO Appellate Body in the above-mentioned case of *US-Shrimps* expressly recognised sustainable development and various related treaties of environmental protection as relevant for the interpretation of Article XX of the GATT.<sup>868</sup> In doing so, this case represents an express application of the principle of integration. Furthermore, it may be understood as recognition of the principle of cooperation and differential responsibilities because the Appellate Body ultimately disapproved the unilateral and undifferentiated US measures.<sup>869</sup> Another example is especially provided by the ICJ in the case concerning the *Gabčíkovo-Nagymaros Project*, relating to a treaty between Hungary and Slovakia for the construction of a cross-border barrage system on the river Danube.<sup>870</sup> In assessing the impact of this project, the court pointed out:

[N]ew norms and standards have been developed, set forth in a great number of instruments during the last two decades. Such new norms have to be taken into

<sup>867</sup> On the principle of integration, see furthermore ILA, *Toronto Conference* (2006); see also Chapter 4, section C, 'Systemic integration of international law arguments'.

<sup>868</sup> *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (above fn. 392), at paras. 128 et seq.; on this case, see also Chapter 4, section B, '3(d) Article XX of the GATT'.

<sup>869</sup> *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (above fn. 392), at paras. 164 et seq.

<sup>870</sup> *Gabčíkovo-Nagymaros Project (Hungary v. Slovakia)*, ICJ (Judgment of 25 September 1997).

consideration, and such new standards given proper weight, not only when states contemplate new activities but also when continuing with activities begun in the past. This need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development.<sup>871</sup>

A third example is presented by the decision administered by the Permanent Court of Arbitration (PCA) in the arbitration regarding the *Iron Rhine Railway*, concerning a dispute about environmental impact assessments due to the planned reactivation of a historical railway track.<sup>872</sup> In its analysis of the legal status of principles of sustainable development, the arbitral tribunal observed that '[t]here is considerable debate as to what, within the field of environmental law, constitutes "rules" or "principles"; what is "soft law"; and which environmental treaty law or principles have contributed to the development of customary international law'.<sup>873</sup> The tribunal further noted that the 'mere invocation of such matters does not, of course, provide the answers', but that the emerging principles of sustainable development law are relevant for the case and '[e]nvironmental law and the law on development stand not as alternatives but as mutually reinforcing, integral concepts'.<sup>874</sup>

An extreme example of how economic development in cooperation with foreign investors may actually clash with the protection of human rights and the environment, and of how these interests are balanced under the umbrella of sustainable development, is presented by the *Ogoniland* case, decided by the African Commission on Human and Peoples' Rights.<sup>875</sup> In that case, a consortium consisting of a foreign investor and the Nigerian state oil company exploited oil reserves in the region of Ogoniland and thereby caused devastating harm to the people

<sup>871</sup> *Ibid.*, at para. 140.

<sup>872</sup> *Iron Rhine Railway (Belgium v. Netherlands)*, Permanent Court of Arbitration (Award of 24 May 2005); on the facts see paras. 16–25.

<sup>873</sup> *Ibid.*, at para. 58.

<sup>874</sup> *Ibid.*, at paras. 59–60. For further discussion, see ILA (above fn. 867), pp. 18–22.

<sup>875</sup> *The Social and Economic Rights Action Center and the Center for Economic and Social Rights v. Nigeria (Ogoniland Case)*, African Commission on Human and Peoples' Rights Communication No. 155/96 (2001) (Decision of 13 October 2001); the decision is based on the 1981 African Charter on Human and Peoples' Rights; for a discussion of the case, see D. Shelton, 'Decision Regarding Communication 155/96 (Social and Economic Rights Action Center and Center for Economic and Social Rights v. Nigeria)', *AJIL* 96 (2002), p. 937; and F. Coomans, 'The Ogoni Case Before the African Commission on Human and Peoples' Rights', *ICLQ* 52 (2003), p. 749.

and environment of that region by disposing toxic waste and producing numerous avoidable spills near villages. Nigerian security forces terrorising the region through killings and the destruction of villages, homes and crops exacerbated the detrimental effect of the oil production. The Commission held Nigeria responsible for the violation of a number of human rights obligations, inter alia, the right to life and the right to a general satisfactory environment.<sup>876</sup> In particular, the Commission did not deny Nigeria's right to produce oil, but, at the same time, emphasised the state's responsibility to take reasonable measures to prevent ecological degradation and to secure an ecologically sustainable development.<sup>877</sup> This included the obligation to monitor and regulate the behaviour of the oil companies as well as to protect the affected citizens from the damaging acts that were perpetrated by the private parties involved, rather than to facilitate the destruction of the region by giving a green light to the oil companies and the security forces.<sup>878</sup>

In summary, these examples reveal that the concept of sustainable development is increasingly established and applied in international jurisprudence so as to merge environmental protection, the promotion of economic development and the respect for human rights guarantees.<sup>879</sup> Nevertheless, the invocation of rules or principles of sustainable development has to be accompanied by a thorough analysis of the concrete legal status and content of the specific legal rule, principle or instrument that is applied.

<sup>876</sup> *The Social and Economic Rights Action Center and the Center for Economic and Social Rights v. Nigeria (Ogoniland Case)* (above fn. 875), see the operative provisions of the judgment after para. 69. The oil company has only recently agreed to compensate the Ogonis: see E. Pilkington, 'Shell pays out \$15.5m over Saro-Wiwa killing', *The Guardian*, 9 June 2009.

<sup>877</sup> *The Social and Economic Rights Action Center and the Center for Economic and Social Rights v. Nigeria (Ogoniland Case)* (above fn. 875), at paras. 52 and 54.

<sup>878</sup> See *ibid.*, at paras. 53, 57-58 and 67; the Commission thereby also referred to cases decided by the Inter-American Court of Human Rights and the European Court of Human Rights. The obligation of states to protect the environment and ensure that activities within their jurisdiction respect the environment has also been emphasised more recently by the ICJ in *Pulp Mills on the River Uruguay (Argentina v. Uruguay)*, ICJ (Order of 13 July 2006), at para. 72.

<sup>879</sup> See also the analysis of the normative status of sustainable development by V. Lowe, 'Sustainable Development and Unsustainable Arguments', in A. E. Boyle and D. A. C. Freestone (eds.), *International Law and Sustainable Development* (1999), p. 19 at p. 31, observing: 'Sustainable development can properly claim a normative status as an element of the process of judicial reasoning. It is a meta-principle, acting upon other legal rules and principles - a legal concept exercising a kind of interstitial normativity, pushing and pulling the boundaries of true primary norms when they threaten to overlap or conflict with each other'.

## (b) Fair and equitable treatment and sustainable development

As a general clause, fair and equitable treatment is especially apt to act as a gateway for the integration of external principles into the investment process.<sup>880</sup> This ability reveals conceptual parallels between fair and equitable treatment and sustainable development insofar as both concepts aim to integrate and reconcile competing objectives. In the case of sustainable development, these objectives include environmental protection as well as matters of social and economic development. Arguably, as the investment disputes below demonstrate, these three strands may also conflict under fair and equitable treatment. Therefore, the conceptual parallels between sustainable development and fair and equitable treatment militate in favour of the integration of arguments derived from social and environmental objectives within the present fairness discourse on fair and equitable treatment. The emphasis on a process of integration in both concepts is thus pivotal not only to achieve sustainable development, but also to explain the controversial relationship between fair and equitable treatment and other sources and norms of international law. In this vein, sustainable development may also provide certain guidance on the problem of what should be integrated into the concept of fair and equitable treatment. Some of the principles of sustainable development, which also reveal several inter-connections to the concept of fair and equitable treatment, shall therefore receive closer attention.

In particular, the aspect of equity, which is highlighted in the context of sustainable development with regard to the eradication of poverty and the dimension of inter-generational equity, represents an element that is also apparent in the fairness discourse on fair and equitable treatment.<sup>881</sup> Thereby, equity represents the pull towards change - the redistribution of wealth and resources so that present and future generations are able to receive fair access to these resources. The sovereignty of states to pursue their own economic, social and environmental policies, which is also emphasised under the umbrella of sustainable development, embodies one principle within the fairness discourse that expresses the pull towards change.<sup>882</sup> However, as the other aspects of sustainable development disclose, sovereignty and redistributive change are contextualised with duties of states to take a precautionary approach, to ensure

<sup>880</sup> In detail, see Chapter 4, section B.

<sup>881</sup> See Chapter 6, section B, '2 Equity', 'Impulses from international law for the construction of fair and equitable treatment'.

<sup>882</sup> On the principle of sovereignty, see Chapter 7, section A, '1 Sovereignty'.

transparency, public participation in decision-making processes, due process and the rule of law as encompassed by the general notion of good governance. All of these aspects tend to guarantee a certain level of legitimacy of the state measures pursuing sustainable development objectives.<sup>883</sup> Similarly, fair and equitable treatment demands legitimacy of state measures by requesting from states the protection of legitimate expectations, fair procedures, transparency and non-discrimination. To such an extent, fair and equitable treatment also reveals a substantial good governance dimension.<sup>884</sup> On a conceptual basis, sustainable development therefore provides principles which, within a fairness discourse on fair and equitable treatment, may be taken into account on the change as well as stability side. The tension between stability and change is thus also inherent in the concept of sustainable development; it may, however, enrich the balancing discourse as regards fair and equitable treatment by introducing an environmental and social perspective.

The connectivity to equity, which is a common feature of fair and equitable treatment and sustainable development, reveals something further. It has been outlined above that the concept of fair and equitable treatment demands a comprehensive balancing of all relevant factors and interests.<sup>885</sup> This implies that beyond the acts of the host state and its underlying public policy perceptions, the conduct of the particular foreign investor may also be a relevant factor.<sup>886</sup> The adoption of a comprehensive balancing process is buttressed by the notion of equity that is aspiring towards a state of equilibrium and that thereby expresses the idea of mutuality.<sup>887</sup> This idea is even more clearly expressed by maxims of equity originating from domestic law in the Anglo-American legal tradition, postulating for instance: 'one who seeks equity must do equity'.<sup>888</sup>

<sup>883</sup> On legitimacy, see Chapter 6, section B, '1 Legitimacy'.

<sup>884</sup> See also Wälde (above fn. 137), p. 385, fn. 35; and Dolzer (above fn. 323), p. 72.

<sup>885</sup> See Chapter 6, section C, '3 The imperative of balancing'.

<sup>886</sup> See the analysis of Muchlinski (above fn. 2), identifying three major duties of foreign investors: 'to refrain from unconscionable conduct', 'to engage in the investment in the light of an adequate knowledge of risk' and 'to conduct business in a reasonable manner'. According to him, these duties may be relevant at all stages; they may influence the finding of a breach of the fair and equitable treatment standard, the causal relationship between the conduct, the impugned act and the alleged losses suffered, and the payable amount of compensation. While the first duty may even vitiate the investor's right to claim, the latter ones seem to be less severe and hence result in a reduction of the amount of compensation to be awarded.

<sup>887</sup> See *ibid.*, p. 532; see also Francioni (above fn. 509), *mn.* 5.

<sup>888</sup> See Muchlinski (above fn. 2), p. 532.

Without being directly obliged to act fairly and equitably,<sup>889</sup> the concept of fair and equitable treatment therefore allows the taking of the foreign investors' conduct into account. In this respect, the umbrella of sustainable development provides for (mostly non-binding) legal instruments addressing such matters of corporate social responsibility that define benchmarks of the eligible conduct of foreign investors.<sup>890</sup> These instruments cover a broad scope of issues in the context of labour rights, human rights, environmental protection and the fight against corruption.<sup>891</sup> Accordingly, these instruments contribute to a comprehensive integration of all relevant aspects of international law and the overall aim of achieving sustainable development.

Therefore, the integrative concept of fair and equitable treatment and its affiliation to equity demand that the social and environmental implications of a case arising from the foreign investor's conduct and the pertaining legal instruments are also taken into consideration and are balanced in a principle-based fashion. For instance, assuming in the above-mentioned *Ogoniland* case that Nigeria would have stopped the wrongdoings of the oil companies and that the foreign investor would have been protected by a BIT, such an approach would avert the preposterous result that the investor (assuming that an investment tribunal would affirm its jurisdiction in such a case) could claim unfair and inequitable treatment because of measures imposed by the host state seeking to comply with international human rights or environmental law obligations.

The conceptual parallels between fair and equitable treatment and sustainable development notwithstanding, the absence of an environmental or social perspective in the current discussion on fair and equitable treatment or in international investment arbitration in general is frequently criticised by scholars.<sup>892</sup> Likewise, serious concerns are voiced that the disciplining effect of investment protection regimes on host states threatens the ability of these states to pursue their sustainable development policies.<sup>893</sup> Indeed, the previous review of the other principles of fair and

<sup>889</sup> See fn. 490.

<sup>890</sup> These are especially the 2000 OECD Guidelines for Multinational Enterprises and the principles of the 2000 UN Global Compact.

<sup>891</sup> In detail, see P. Muchlinski, 'Corporate Social Responsibility', in P. Muchlinski *et al.* (eds.), *The Oxford Handbook of International Investment Law* (2008), p. 637.

<sup>892</sup> See Sornarajah (above fn. 3), pp. 259 *et seq.*; and Chung (above fn. 158), p. 963. See also from an economic perspective J. E. Stiglitz, 'Multinational Corporations', *ASIL Proc.* 101 (2007), p. 3 at p. 44.

<sup>893</sup> See, e.g. *ILA, Rio de Janeiro Conference* (2008), Part B.

equitable treatment has disclosed that fair and equitable treatment may impose serious restrictions on the sovereignty of states. However, the review has also revealed that arbitral tribunals generally attest regulatory discretion to host states, which gives leeway to enact domestic, sustainable development strategies.

Furthermore, an empirical analysis of investment treaty arbitration has suggested that current case law does not necessarily support the impression of investment protection obligations as a measure that stifles sustainable development.<sup>894</sup> In conjunction with the European Energy Charter Treaty, it has also been pointed out that investment protection mechanisms may serve as tools to promote the transfer of technology, technical assistance and foreign capital in sustainable development projects, which otherwise would not be realisable in developing countries.<sup>895</sup> Hence, it appears too simple to stigmatise fair and equitable treatment as a threat to sustainable development. While it is true that the principles of sustainable development may often compete with other principles of fair and equitable treatment, they may also pull in the same direction and thereby increase the specific weight of arguments on either the change or stability side of the fairness discourse. The following selection of cases will address the question of whether at all, and if yes, how, investment tribunals take into consideration social and environmental concerns and the principles of sustainable development.

### (c) Sustainable development in arbitral jurisprudence

A first example touching the precautionary principle, as one of the aspects of sustainable development, in the context of an investment treaty arbitration is the case of *Emilio Augustín Maffezini v. Spain*.<sup>896</sup> In this case, an Argentine investor sought to establish a corporation for the production of various toxic chemical products, in which a Spanish state entity also participated, subscribing to 30 per cent of the capital. Nevertheless, the corporation was experiencing financial difficulties which ultimately led to the collapse of the project. Amongst other things, the investor alleged that the requisition and procedure of an environmental impact assessment increased the costs of the project,

<sup>894</sup> Franck (above fn. 69), pp. 34–35.

<sup>895</sup> See E. Sussman, 'The Energy Charter Treaty's Investor Protection Provisions', ILSA J. Int'l & Comp. L. 14 (2008), p. 391 at pp. 398 et seq.

<sup>896</sup> *Emilio Augustín Maffezini v. Spain* (above fn. 453); on the facts, see paras. 39 et seq.

contributing to the collapse of the entire project, and this resulted in a violation of the BIT.<sup>897</sup>

However, the tribunal rejected the investor's view and could not find a violation of the investment treaty with regard to the impact assessment. Moreover, the tribunal referred to various stipulations of environmental protection in Spanish constitutional and European Community law and highlighted the importance of environmental impact assessments: 'the environmental impact assessment procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures. This is true, not only under Spanish and EEC law, but also increasingly so under international law.'<sup>898</sup> The tribunal further noted that Spain had done no more than insist on strict observance of these legal provisions and that it therefore could not be held responsible in this respect.<sup>899</sup>

Another example addressing the topic of sustainable development is provided by the first partial award in *S.D. Myers Inc. v. Canada*, concerning an export ban of highly toxic chemical compounds in order to protect the fledgling Canadian disposal industry.<sup>900</sup> In its reasoning on fair and equitable treatment, the tribunal emphasised that the determination of a potential breach of the international obligation 'must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. The determination must also take into account any specific rules of international law that are applicable to the case'.<sup>901</sup> Upon further analysis, the tribunal found that the investor had been treated unfairly and inequitably and referred to the prior interpretation of the national treatment obligation.<sup>902</sup> In the context of the discriminatory motive, the tribunal acknowledged the objectives of the 1989 Basel Convention and the compliance of the Canadian measure with such international environmental law requirements as a possible argument in favour of the regulatory measure of the host state.<sup>903</sup> Nevertheless, it concluded that the protectionist intent outweighed this argument due to less restrictive measures at hand commensurate to these, in principle, legitimate goals.

<sup>897</sup> *Ibid.*, at para. 65. <sup>898</sup> *Ibid.*, at para. 67. <sup>899</sup> *Ibid.*, at para. 71.

<sup>900</sup> *S.D. Myers Inc. v. Canada* (above fn. 95); see also Chapter 3, section B, '1(a) The *Metalclad* and *S.D. Myers* approach'.

<sup>901</sup> *Ibid.*, at para. 263. <sup>902</sup> *Ibid.*, at para. 266. <sup>903</sup> See *ibid.*, at para. 255.

The most cited dispute with regard to the tension between environmental and investment protection is probably the case of *Methanex Corp. v. United States*.<sup>904</sup> The case concerned a Californian regulation banning the gasoline additive MTBE due to environmental concerns. The foreign investor, a producer of the MTBE component methanol, complained that the ban favoured national ethanol producers, since ethanol is a cleaner substitute of MTBE. The fact that the arbitral tribunal eventually dismissed all claims of the foreign investor was generally considered as a major win for the environmental community and was highlighted as a turnaround towards a more balanced approach in international investment arbitration.<sup>905</sup> Thereby, the discussion focused mainly on the tribunal's reasoning as regards the expropriation claim. While rejecting this claim, the tribunal determined that the Californian regulation was: accomplished with due process; for a public purpose; non-discriminatory;<sup>906</sup> and supported by a reasonable scientific basis.<sup>907</sup>

Despite the verbosity of the award, the *Methanex* tribunal's argumentation on fair and equitable treatment and the interrelatedness to principles of environmental protection remained rather sparse. The tribunal confined its analysis on fair and equitable treatment to the question of whether the standard entailed a protection against discriminatory behaviour, which the tribunal ultimately denied.<sup>908</sup> While this finding may support the view that reasonable differentiations between national and foreign investors should be possible, it does not reveal under which circumstances principles of sustainable development are capable of serving as reasonable justification for such differentiation. Furthermore, although it seems that the considerations leading the tribunal to reject the expropriation claim would have provided enough reasons to substantiate the tribunal's view as regards the fairness of the Canadian MTBE ban, the tribunal did not elaborate on this issue. To such an extent, the *Methanex* decision under-achieved the clarification

<sup>904</sup> *Methanex Corp. v. United States* (above fn. 275); for a more detailed description of the facts and further discussion, see Chapter 7, section A, '3(b) Non-discrimination in arbitral jurisprudence'.

<sup>905</sup> See J. C. Lawrence, 'Chicken Little Revisited: NAFTA Regulatory Expropriations after Methanex', Ga. L. Rev. 41 (2006), p. 261 at p. 263; Alvarez-Jiménez (above fn. 353), p. 427; and K. Dougherty, 'Methanex v. United States: The Realignment of NAFTA Chapter 11 with Environmental Regulation', Nw. J. Int'l L. & Bus. 27 (2007), p. 735 at p. 743.

<sup>906</sup> *Methanex Corp. v. United States* (above fn. 275), at part IV, chapter D, para. 15.

<sup>907</sup> *Ibid.*, at part III, chapter A, paras. 101-102. <sup>908</sup> *Ibid.*, at part IV, chapter C, para. 14.

of the role of sustainable development principles in the context of fair and equitable treatment.

An example relating to the social aspect of sustainable development is presented by the case of *Parkerings-Compagniet AS v. Lithuania*, concerning the creation of a modern parking system for the historic city centre of Vilnius, including the construction of two multi-storey car parks.<sup>909</sup> Amongst other things, the foreign investor alleged a breach of fair and equitable treatment due to discriminatory behaviour; the municipality insisted on relinquishing a planned underground car park in a particular site on the grounds of cultural heritage concerns, but shortly thereafter allowed another foreign investor to build a car park at the same site.<sup>910</sup> In the assessment of whether discrimination had in fact occurred, the tribunal observed that there existed similarities and differences between both projects: while both projects were almost identically located, the claimant's project was considerably bigger and extended further into the historic old town.<sup>911</sup> More important than the difference in size appeared to be the fact that various national administrative authorities were opposed to the project as planned by the claimant due to cultural and environmental concerns.<sup>912</sup> Thereby, these authorities also referred to international treaties, especially the 1972 UNESCO World Heritage Convention, and expressed their fear of infringing these international obligations if the claimant's plans were realised.<sup>913</sup> The tribunal acknowledged these concerns and observed:

[T]he fact that [the claimant's] project in Gedimino extended significantly more into the old town as defined by the UNESCO, is decisive. Indeed, the record shows that the opposition raised against the [project was] important and contributed to the municipality decision to refuse such a controversial project. The historical and archaeological preservation and environmental protection could be and in this case were a justification for the refusal of the project. The potential negative impact of the ... project in the old town was increased by its considerable size and its proximity with the culturally sensitive area of the cathedral.<sup>914</sup>

<sup>909</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138); for further facts and discussion, see Chapter 7, section A, '2(b)(i) Stability of the overall legal framework' and '2(b)(iii) Stability in the contractual relationship'.

<sup>910</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at para. 281; the presumably discriminatory behaviour was discussed by the tribunal in connection to the investor's most-favoured-nation claim, indicating, however, that the same reasoning would also apply to fair and equitable treatment: see para. 291.

<sup>911</sup> *Ibid.*, at paras. 379-381. <sup>912</sup> *Ibid.*, at para. 385. <sup>913</sup> *Ibid.*, at paras. 385-388.

<sup>914</sup> *Ibid.*, at para. 392.

To such an extent, the tribunal took the sustainable development dimension of the case into consideration and accepted the argument as regards the potential cultural and environmental damage of an investment as an ultimately decisive basis justifying the differential treatment between two investors. Accordingly, the tribunal refused to find any discriminatory behaviour on behalf of the host state.

In the long-awaited award in *Glamis Gold Ltd v. United States*, the arbitral tribunal had to evaluate the cultural and environmental impact of an open-pit gold mine project in proximity to sacred Native American sites.<sup>915</sup> In that case, the investor argued that governmental authorities departed from a well-established administrative practice when the investor's plan of operation was declined, as well as issued regulations that arbitrarily and unexpectedly impaired the mining project. In the assessment of an alleged violation of fair and equitable treatment, the tribunal took an extremely narrow approach and required – in questionable exaggeration – 'egregious and shocking' state actions beyond mere illegality, 'a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons'.<sup>916</sup> Measured against this standard, the tribunal consequently found that the investor did not adduce sufficient evidence to meet the high burden of proof and therefore rejected all claims. In particular, the tribunal determined that the state measures were pursuing legitimate objectives and were backed by scientific reports upon which the authorities could reasonably rely.<sup>917</sup> While the tribunal thus seemed to attach great value to the governmental flexibility in handling the case, the award remains relatively sparse in relation to the specific weight of the underlying environmental and cultural arguments at stake.

Although instances of arbitral practice taking into account instruments of corporate social responsibility are not yet apparent, the relevance of the foreign investor's conduct is best demonstrated by the case of *Robert Azinian and others v. Mexico* arising out of the nullification of a concession contract for waste disposal services.<sup>918</sup> In that case, the foreign investors achieved the obtainment of a long-term concession contract based on serious fraudulent misrepresentations with regard

to their personal background, experience in the waste disposal industry and resources.<sup>919</sup> The tribunal observed that the Mexican authorities 'were falsely led to believe [that the investors] were part of an experienced concern possessed of financial and technological resources adequate for the job'.<sup>920</sup> Due to this fraudulent behaviour and the subsequent non-performance of obligations, the tribunal could not find that the annulment of the concession contract constituted a breach of an international obligation of the host state.<sup>921</sup> Rather, the tribunal determined that the Mexican authorities were 'entitled to expect much more'<sup>922</sup> and that the investors 'obviously cannot legitimately defend themselves by saying that the Ayuntamiento should not have believed statements that were so unreasonably optimistic as to be fraudulent'.<sup>923</sup> Thus, the arbitral tribunal clearly relied on the foreign investor's conduct to dismiss the fair and equitable treatment claim on the merits. A similar balancing in consideration of the investor's conduct has also been carried out by other tribunals,<sup>924</sup> indicating that the flawed conduct of the investor may not only lead to a denial of a breach of fair and equitable treatment, but also to a fine-tuning at the compensation phase of a case.<sup>925</sup>

#### (d) The relative weight of sustainable development

The arbitral case law discloses the somewhat unsettled correlation between fair and equitable treatment and sustainable development. While a multiplicity of investment disputes relates to socially and environmentally sensitive areas such as waste management, public water and gas supply, or toxic chemical industries, only a few tribunals have yet established a linkage between fair and equitable treatment and the social and environmental implications of a case. The cases reviewed also show that tribunals are not, in principle, opposed to taking into account such implications and the pertaining legal instruments of environmental protection or social development. This may be considered as an early stage of systemic integration of such legal instruments into the concept of fair and equitable treatment. To such an extent, the *Parkerings-Compagniet* case is of particular importance as it takes the cultural concerns embodied in the UNESCO World Heritage

<sup>915</sup> *Glamis Gold Ltd v. United States* (above fn. 120).

<sup>916</sup> *Ibid.*, at para. 627. The tribunal thereby mainly relied on the language of the old *Neer* case.

<sup>917</sup> See *ibid.*, at paras. 756 et seq.

<sup>918</sup> *Robert Azinian and others v. Mexico* (above fn. 223); see also Chapter 7, section B, '1(b)(i) Denial of justice'.

<sup>919</sup> *Ibid.*, at paras. 29 et seq. <sup>920</sup> *Ibid.*, at para. 31. <sup>921</sup> *Ibid.*, at para. 124.

<sup>922</sup> *Ibid.*, at para. 115. <sup>923</sup> *Ibid.*, at para. 108.

<sup>924</sup> See, e.g. *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia* (above fn. 96).

<sup>925</sup> See, e.g. *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 246.



Convention as the ultimately decisive argument in its determination of whether a discrimination of the investor had taken place.

The growing awareness that investor-state disputes relate to matters of a wider public interest<sup>926</sup> suggests that investment tribunals will increasingly have to examine other sub-systems of international law and consider such external principles if they wish to produce decisions in coherence with the international legal system as a whole. It is therefore interesting to see how and if tribunals achieve the balancing of the inherent tensions of cases involving a wide range of environmental, social and economic issues.<sup>927</sup> The integrative concept of fair and equitable treatment and the existing parallels to the concept of sustainable development allow for such balancing at various levels and enable arbitrators to deal with conflicts that have not yet arisen. In particular, it permits arbitrators to address an investor's conduct not only in an all-or-nothing fashion by denying jurisdiction in the case of wrongdoings by an investor,<sup>928</sup> but also to address such conduct in the way of a fine adjustment at the liability or compensation phase. While up until recent times only economic malpractice of the investor seems to have been taken into account, it is suggested that environmental or social misconduct can also constitute relevant factors in the balancing process. Conversely, this entails that the economic, social or environmental value of an investment should not be disregarded and is able to militate in favour of increased investment protection.<sup>929</sup>

In summary, it is submitted that the concept and principles of sustainable developments may considerably enrich any balancing process in the context of fair and equitable treatment. Thereby, the conceptual parallels between fair and equitable treatment and

<sup>926</sup> See, e.g. Van Harten (above fn. 62); and M. W. Gehring *et al.* (eds.), *Sustainable Development in International Investment Law* (2011).

<sup>927</sup> In *Pantechniki SA Contractors and Engineers v. Albania*, ICSID Case No. ARB/07/21 (Award of 28 July 2009), at paras. 76–77, the argument has been made that, within an assessment of the standard of full protection and security, the level of the host state's development should also be taken into consideration; however, the arbitrator refused to extend this argument to the analysis of a denial of justice claim. For another interesting case involving questions of environmental protection, see, e.g. *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG v. Germany* (above fn. 70).

<sup>928</sup> In that way, see, e.g. *Inceysa Vallisoletane SL v. El Salvador*, ICSID Case No. ARB/03/26 (Award of 2 August 2006), especially at paras. 230 *et seq.*

<sup>929</sup> At least some investment agreements also protect non-profit investors (see, e.g. Article I(3) of the 2005 German Model BIT) presumably possessing a high social or environmental value.

sustainable development provide further guidance with regard to the substance as well as the methodology of balancing of interests in a particular case, since these parallels emphasise the need for reconciling the objectives of environmental protection as well as social and economic development. Thus, the integrative flexibility of fair and equitable treatment represents a crucial tool for arbitrators to take a comprehensive approach in balancing the interests of investors and host states with regard to their wider implications on sustainable development.

## B Procedural principles

While the previous principles pertained to questions of substantive law, the following principles mainly address the procedural rights of foreign investors protected by fair and equitable treatment. Thereby, the procedural principles of fair and equitable treatment demand a basic standard of fairness in judicial and administrative procedures, as well as a certain degree of transparency in the host state's legal system.

### 1 Fair procedure

An important aspect of fair and equitable treatment is the enshrining of fairness in the procedural relationship between the foreign investor and host state. The abidance to fair procedures considerably contributes to the legitimacy and stability of a legal system<sup>930</sup> and is therefore central for a form of treatment that may be perceived as fair and equitable. Arbitral tribunals deal with this principle mostly under the notions of administrative due process and denial of justice – conceptions that have a long tradition in national and international law and are introduced into the international investment law context through the vehicle of fair and equitable treatment.<sup>931</sup> These and other legal conceptions of procedural fairness, emanating also from the ECHR, have a strong impact on fair and equitable treatment. They thus become systemically integrated into international investment law.

<sup>930</sup> Thereon, see Chapter 6, section B, '1 Legitimacy'.

<sup>931</sup> This is expressly emphasised in the text of the 2004 US Model BIT, stating in Article 5(2):

(a) 'fair and equitable treatment' includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world ...

## (a) General concepts of procedural fairness

The idea of procedural fairness is most firmly rooted in common law systems,<sup>932</sup> considering it to be an element of 'natural justice' or 'fundamental fairness'.<sup>933</sup> Thereby, it is assumed that a general duty to act fairly in the execution of administrative functions exists, which, in its core, consists of the widely accepted maxim of *audi alteram partem*.<sup>934</sup> Procedural fairness or procedural due process, as stipulated in the Fifth and Fourteenth Amendments to the US Constitution, is generally deemed to be a flexible concept. It does not impose rigid rules, but seeks to establish adequate procedures by balancing private interests against public interests in procedural efficiency and against the likely contribution of various procedural elements to the correct resolution of disputes.<sup>935</sup> Its 'irreducible minimum' is essentially held to comprise the rights: to have prior notice of the decision; to a fair hearing; and to a decision by an unbiased tribunal.<sup>936</sup> Although the details of the procedural requirements may exhibit considerable variability, procedural fairness in any case aims to provide individuals with a fair opportunity to participate in the making of an administrative decision and so ensure the decision's integrity.<sup>937</sup>

Not clearly distinguishable from due process of law, but rather concerned with failures in the system of administration of justice of a state,<sup>938</sup> is the international law concept of denial of justice.<sup>939</sup>

<sup>932</sup> For a comparative analysis, see Schwarze (above fn. 498), pp. 1245 et seq.; and Woolf, Jowell and Le Sueur (above fn. 677), pp. 346 et seq.

<sup>933</sup> See, e.g. B. Schwartz, *Administrative Law*, 2nd edn (1984), p. 202; Bradley and Ewing (above fn. 678), pp. 718-719; and Woolf, Jowell and Le Sueur (above fn. 677), pp. 318 et seq. and 356-362.

<sup>934</sup> See Woolf, Jowell and Le Sueur (above fn. 677), p. 342; the *audi alteram partem* maxim has also been recognised at the international stage: see, e.g. *Nuclear Tests Case (Australia v. France)*, ICJ (Judgment of 20 December 1974), at p. 265.

<sup>935</sup> Schwartz (above fn. 933), pp. 266-268; J. L. Mashaw, R. A. Merrill and P. M. Shane, *Administrative Law*, 4th edn, 2nd reprint (2001), p. 292; and Woolf, Jowell and Le Sueur (above fn. 677), p. 377.

<sup>936</sup> See Schwartz (above fn. 933), p. 203; Bradley and Ewing (above fn. 678), p. 719; and W. Brugger, *Einführung in das öffentliche Recht der USA* (1993), p. 185.

<sup>937</sup> Woolf, Jowell and Le Sueur (above fn. 677), p. 317.

<sup>938</sup> A denial of justice is not necessarily limited to organs of the judicial branch, but may rather stem from all organs acting in connection with the administration of justice to aliens: see J. Paulsson, *Denial of Justice in International Law* (2005), pp. 44 et seq.

<sup>939</sup> To the extensive early literature on denial of justice, see, e.g. C. Eagleton, 'Denial of Justice in International Law', *AJIL* 22 (1928), p. 538; G. G. Fitzmaurice, 'The Meaning of the Term "Denial of Justice"', *BYIL* 13 (1932), p. 93; C. de Visscher, 'Le déni de justice en droit international', *RdC* 52 (1935 II), p. 369; O. J. Lissitzyn, 'The Meaning of the Term

Although the meaning of the term 'denial of justice' does not follow a clear-cut definition, an impression is given by Article 9 of the 1929 Harvard Research Draft on the Law of State Responsibility:

Denial of justice exists when there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice or a manifestly unjust judgment. An error of a national court which does not produce manifest injustice is not a denial of justice.<sup>940</sup>

Thereby, the most disputed issue is constituted by the question of what 'manifestly unjust judgment' means and to what extent an erroneous decision amounts to such manifest injustice.<sup>941</sup> However, it seems that international tribunals are not supposed to act as appellate courts reviewing decisions upon very fine points of national law.<sup>942</sup> To such an extent, it has been submitted that even 'gross or notorious injustice ... is not a denial of justice merely because the conclusion appears to be demonstrably wrong in substance; it must impel the adjudicator to conclude that it could not have been reached by an impartial judicial body worthy of that name'.<sup>943</sup> Hence, the mere misapplication of national law by the domestic judiciary may not lead to a denial of justice; it is rather a conception that relates to procedural fairness, that is to say the establishment of procedures appropriate to rehabilitate and enforce individual justice and the adherence to such procedures.

Further impulses for the shaping of fair and equitable treatment may be derived from European law,<sup>944</sup> which already exhibits sophisticated concepts of procedural fairness at an international stage that originate

Denial of Justice in International Law', *AJIL* 30 (1936), p. 632; and A. V. Freeman, *The International Responsibility of States for Denial of Justice* (1938); more recent explanations are, e.g. provided by Jennings and Watts (above fn. 124), pp. 543-545; Brownlie (above fn. 129), pp. 529-531; A. K. Bjorklund, 'Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims', *Va. J. Int'l L.* 45 (2005), p. 809; C. Focarelli, 'Denial of Justice', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (Online Publication) (2009); and especially Paulsson (above fn. 938).

<sup>940</sup> E. M. Borchard, 'The Law of Responsibility of States for Damage Done in their Territory to the Person or Property of Foreigners', *AJIL Spec. Suppl.* 23 (1929), p. 131 at p. 173. On the development of denial of justice, see also Focarelli (above fn. 939), mnn. 4-10.

<sup>941</sup> See Brownlie (above fn. 129), p. 530; and Paulsson (above fn. 938), pp. 64-67.

<sup>942</sup> See also Brownlie (above fn. 129), p. 530.

<sup>943</sup> Paulsson (above fn. 938), p. 65; similarly, Jennings and Watts (above fn. 124), p. 545; and Brownlie (above fn. 129), p. 530.

<sup>944</sup> See also Bjorklund (above fn. 939), pp. 861-862.

mainly from the common law ideas of natural justice and due process.<sup>945</sup> Most notably, Article 6(1) of the ECHR ensures the right to a fair trial, including in particular the right of access to courts and to a public hearing before an independent and impartial tribunal within a reasonable amount of time and the principle of due process of law.<sup>946</sup> These guarantees and the principle of due process with its specific sub-elements of, for instance, the right of access to files, the obligation to give reasons for decisions and the adequacy of duration of procedures, are also recognised in European administrative law and the jurisprudence of the ECJ.<sup>947</sup> Thereby, the obligation to give reasons in particular exceeds the classical idea of due process, but is considered in the European context as a vital element to enable the person concerned to understand the basis for the decision and to prepare their remedies.<sup>948</sup>

The flexibility of the procedural guarantees may be demonstrated by the ECJ's practice of counterbalancing the concession of wide discretionary powers to administrative bodies, especially in areas in which intricate economic assessments are to be made, by a stricter scrutiny of an orderly administrative procedure.<sup>949</sup> This practice is based on the assumption that the abidance to just procedures to some extent indicates equitable results,<sup>950</sup> and that the revision of procedures often remains the only means to direct and control administrative action in areas of wide regulatory space. The latter idea reveals the importance of procedural fairness and its connectedness to the substance of a matter. However, whether this idea could similarly be applied in international investment law, where of course host states possess wide latitude for

<sup>945</sup> F. Schorkopf, '§ 53 Recht auf ein faires Verfahren', in S. M. Heselhaus and C. Nowak (eds.), *Handbuch der Europäischen Grundrechte* (2006), p. 1414 at p. 1417, mn. 2.

<sup>946</sup> See, e.g. the annotations to Article 6 of the ECHR in J. Meyer-Ladewig (ed.), *Konvention zum Schutz der Menschenrechte und Grundfreiheiten*, 1. Aufl. (2003). The right to fair trial is, e.g. also protected by Article 14 of the 1966 International Covenant on Civil and Political Rights and by Article 8 of the 1989 American Convention on Human Rights.

<sup>947</sup> Thereon, see Schwarze (above fn. 498), pp. cxlviii et seq.

<sup>948</sup> See *ibid.*, pp. 1384 et seq. and 1400–1401. The latter is increasingly acknowledged in English law as well: see, e.g. Bradley and Ewing (above fn. 678), pp. 721–722.

<sup>949</sup> *Hauptzollamt München-Mitte v. Technische Universität München*, ECJ Case C-269/90 (Judgment of 21 November 1991), especially at para. 14; on the subsequent development of this jurisprudence in European economic law, see J. Schwarze, 'Strenge richterliche Verfahrenskontrolle bei weitem administrativem Ermessen', in P. Fischer et al. (eds.), *Die Welt im Spannungsfeld zwischen Regionalisierung und Globalisierung* (2009), p. 321.

<sup>950</sup> See the famous dictum of R. von Ihering, *Geist des römischen Rechts auf den verschiedenen Stufen seiner Entwicklung*, 4th edn, 8th reprint, Part 2 (1883), p. 471: 'Form [ist] die geschworene Feindin der Willkür, die Zwillingsschwester der Freiheit'.

the formation of their own legal and economic system, is another question. At least it seems that the host state's abidance to fair procedures may be easier to review for arbitral tribunals than the material appropriateness of economic decisions.

## (b) Procedural fairness in arbitral jurisprudence

### (i) Denial of justice

Although denial of justice claims have a long tradition in international law,<sup>951</sup> the present review of recent arbitral jurisprudence on denial of justice will be initiated with the case of *Robert Azinian and others v. Mexico*,<sup>952</sup> because it expediently summarises the main elements of that concept. The case emerged out of a concession contract for waste disposal services in a suburb of Mexico City, which was afterwards nullified by the contracting authority. In the subsequent judicial proceedings, the annulment was upheld by three levels of the Mexican courts. The arbitral tribunal acknowledged the possibility of holding a state internationally liable for judicial decisions, but emphasised that the international review of national court decisions must not be understood as appellate jurisdiction.<sup>953</sup> The tribunal found that a breach of Article 1105 of the NAFTA could arise out of a denial of justice and explained:

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.<sup>954</sup>

Since no complaints alleging such defects were made, the tribunal did not find any breach of Mexico's NAFTA obligations.

A further example of a denial of justice claim under Article 1105 of the NAFTA is presented by the case of *Mondev International Ltd v. United States*.<sup>955</sup> Thereby, Mondev unsuccessfully claimed before the national courts a breach of contract by the city of Boston and a tortious interference with contract by the Boston Redevelopment Authority. In the

<sup>951</sup> Some of the old cases that are still of relevance for the concept of denial of justice have already been described in relation to the international minimum standard; see Chapter 3, section A, '1 The international minimum standard'.

<sup>952</sup> *Robert Azinian and others v. Mexico* (above fn. 223); for the facts, see paras. 4 et seq.

<sup>953</sup> *Ibid.*, at para. 99. <sup>954</sup> *Ibid.*, at paras. 102–103.

<sup>955</sup> *Mondev International Ltd v. United States* (above fn. 100).

NAFTA proceeding, the investor questioned the substantive correctness of the national court decisions and, in addition, the statutory immunity for intentional torts of the Boston Redevelopment Authority. In accordance with the reasoning adopted in the *Azinian* case, the arbitral tribunal at first highlighted that 'it is not the function of NAFTA tribunals to act as courts of appeal'.<sup>956</sup> Bearing this in mind, the tribunal asked whether the national court decisions were surprising or shocking to the extent that justified concerns existed as to the judicial propriety of the outcome.<sup>957</sup> The tribunal noted:

In the end the 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 all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment. This is admittedly a somewhat open-ended standard, but it may be that in practice no more precise formula can be offered to cover the range of possibilities.<sup>958</sup>

In the application of this standard of denial of justice to the *Mondev* case, the tribunal could not find any violation of the fair and equitable treatment obligation and ultimately dismissed the investor's claims in their entirety.<sup>959</sup> In particular, the tribunal found it clear that the making of new law or the development of judge-made law falls within the margin of appreciation of domestic courts.<sup>960</sup> In contrast, the tribunal's reasoning, concerning the clash between the statutory immunity of a public authority and the investor's right of access to court, appears more laborious and the tribunal sought guidance from comparative law and especially from the jurisprudence of the ECtHR on Article 6(1) of the ECHR.<sup>961</sup> The tribunal concluded that, generally, a public authority's

<sup>956</sup> *Ibid.*, at para. 126. <sup>957</sup> *Ibid.*, at para. 127. <sup>958</sup> *Ibid.*

<sup>959</sup> *Ibid.*, at para. 157. <sup>960</sup> *Ibid.*, at para. 133.

<sup>961</sup> The *Mondev* tribunal, inter alia, referred to the ECtHR's decisions that have been reviewed earlier in relation to the systemic integration of international law: see Chapter 4, section B, '3(c) European Court of Human Rights'. However, the tribunal distinguished the present case from the situations referred to in the mentioned ECtHR cases: it found that the doctrine of state immunity would not present a useful analogy because the present situation did not concern the immunity of a foreign state, but rather the statutory immunity of a domestic state agency before its own courts (see *Mondev International Ltd v. United States* (above fn. 100), at para. 142). Nevertheless, the *Mondev* tribunal also referred to more suitable ECtHR cases and determined that these cases 'provide guidance by analogy as to the possible scope of NAFTA's guarantee of [fair and equitable treatment]': see *ibid.*, at para. 144. In doing so, it is hence submitted that the *Mondev* tribunal implicitly considered fair and equitable treatment to be a

immunity could amount to a breach of fair and equitable treatment, but, in the present case, found that rational reasons for the authority's immunity might be imagined, outweighing the investor's interest to have access to courts.<sup>962</sup>

Another frequently cited case in this context is presented by *Loewen Group Inc. and others v. United States*, concerning a jury trial proceeding that arose out of a commercial dispute between the foreign Loewen company and the local O'Keefe family, being competitors in the funeral home and insurance business in Mississippi.<sup>963</sup> In that litigation, the trial judge allegedly allowed O'Keefe's attorneys to make extensive irrelevant and highly prejudicial references to the foreign investor's nationality, race and class. Subsequently, O'Keefe won the litigation and the jury awarded the largest damages award in Mississippi history (US\$500 million, including \$400 million punitive damages). Because the trial and appellate courts refused to reduce the US\$625 million appeal bond, which was required by Mississippi law to be posted by the claimant within seven days in order to lodge an appeal without facing immediate execution of the judgment, Loewen could not pursue any domestic remedy and ultimately had to enter into an unfavourable settlement agreement. In the ensuing NAFTA proceeding, Loewen claimed violations of Article 1105 of the NAFTA due to the irregularities in the conduct of the trial, excessive verdict and application of the bonding requirement.<sup>964</sup>

In the arbitral award, the tribunal iterated the views expressed in prior awards and in academic writing. It stated that denial of justice claims 'cannot be converted into an appeal against the decisions of municipal courts', but that a 'decision which is in breach of municipal law and is discriminatory against the foreign litigant amounts to manifest injustice' establishing a denial of justice.<sup>965</sup> In the eyes of the tribunal, the procedural defects of the trial and its resultant verdict were thus 'clearly improper and discreditable' and could not conform to treatment that could be considered fair and equitable.<sup>966</sup> Hence, for the finding of a denial of justice, a mere *ultra vires* act under national law was not deemed sufficient, but had to be accompanied by a

gateway for the systemic integration of ECHR law as described in Chapter 4, section B, '2 The gateway character of fair and equitable treatment'.

<sup>962</sup> See *Mondev International Ltd v. United States* (above fn. 100), especially at paras. 151-154.

<sup>963</sup> *Loewen Group Inc. and Raymond L. Loewen v. United States* (above fn. 276): for an introduction to the facts, see paras. 3-7.

<sup>964</sup> See *ibid.*, at para. 39. <sup>965</sup> *Ibid.*, at paras. 134-135. <sup>966</sup> *Ibid.*, at para. 136.

discriminatory act or bad faith.<sup>967</sup> The conduct of the domestic courts was considered to fulfil all of these requirements.

However, such wrongdoing notwithstanding, the tribunal somewhat startlingly – as it also admitted itself<sup>968</sup> – rejected Loewen's complaints in their entirety because Loewen was blamed for not having sufficiently pursued local remedies.<sup>969</sup> After reviewing different instances of international jurisprudence and scholarly writing, the tribunal was of the opinion that the concept of denial of justice, to some extent apart from the procedural local remedies rule,<sup>970</sup> contained a rather substantive requirement to exhaust local remedies:

The principle that a court decision which can be challenged through the judicial process does not amount to a denial of justice at the international level has been linked to the duty imposed upon a state by international law to provide a fair and efficient system of justice.

...  
The purpose of the requirement that a decision of a lower court be challenged through the judicial process before the state is responsible for a breach of international law constituted by judicial decision is to afford the state the opportunity of redressing through its legal system the inchoate breach of international law occasioned by the lower court decision.<sup>971</sup>

As regards the scope and content of this requirement, the tribunal noted that '[i]t is an obligation to exhaust remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which it is situated'.<sup>972</sup> Although the tribunal did not deem

<sup>967</sup> See also *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 442.

<sup>968</sup> See the postscript conclusion, *Loewen Group Inc. and Raymond L. Loewen v. United States* (above fn. 276), at paras. 241–242.

<sup>969</sup> *Ibid.*, at para. 217. Another ground for rejecting the claim was the bankruptcy reorganisation of the Loewen Group, which thereby lost the requisite foreign nationality during the NAFTA proceeding: thereon see paras. 220 et seq.

<sup>970</sup> The tribunal frequently calls the substantive requirement to exhaust local remedies the principle of finality. Generally, the principle of finality is not considered to be different from the local remedies rule, but is held to be not affected by Article 1121 of the NAFTA in any case, possibly waiving the local remedies rule in cases of violations of international law by non-judicial acts. See *ibid.*, at paras. 158–164.

<sup>971</sup> *Ibid.*, at paras. 153 and 156. The *Loewen* tribunal thereby implicitly rejected the view of the *Mondev* tribunal, stating that 'under NAFTA it is not true that the denial of justice rule and the exhaustion of local remedies rule "are interlocking and inseparable"' (citing *Eagleton* (above fn. 161), at p. 133); see *Mondev International Ltd v. United States* (above fn. 100), at para. 96.

<sup>972</sup> *Ibid.*, at para. 168.

the possibility of pursuing the appeal without posting the bond to be a reasonably available remedy, it was not convinced that there were no other reasonable alternatives to signing the settlement agreement with O'Keefe.<sup>973</sup>

International investment law commentators controversially debated the outcome and the reasoning of the *Loewen* case.<sup>974</sup> In particular the distinction between the procedural local remedies rule, being frequently waived in investment agreements and generally considered as a question of admissibility anyway, and a substantive requirement inherent in the concept of denial of justice that only final acts of a judicial system may possibly amount to an international wrong (which then has to be treated as a matter of the merits) is subject to criticism.<sup>975</sup> Moreover, it has been questioned whether the international delict of denial of justice, unlike other violations of international law, may be consummated only after the ordinary and reasonably available appeals have been pursued even if exhaustion of remedies is otherwise not required, for example, because of a waiver of the local remedies rule.<sup>976</sup>

Some scholars and tribunals have answered the latter question in the affirmative, opining that the concept of denial of justice requires a just system of administration of justice which falls short of international standards only if its final product is held to be

<sup>973</sup> *Ibid.*, at paras. 207–217. At least theoretically, conceivable alternatives would have been: (1) to seek bankruptcy protection under the domestic laws of the United States, resulting in a stay of execution against Loewen's assets; or (2) to file a petition for certiorari and seek a stay of execution in the US Supreme Court, acting mainly on a discretionary basis. However, the tribunal found that Loewen did not present sufficient evidence to prove that pursuing these alternatives would have been unacceptable.

<sup>974</sup> See, e.g. T. Weiler, 'Dodging Bullets', *JWI* 4 (2003), p. 659; J. A. Baccari, 'The Loewen Claim: A Creative Use of NAFTA's Chapter 11', *U. Miami Inter-Am. L. Rev.* 34 (2003), p. 465; W. S. Dodge, 'Loewen Group, Inc. v. United States and Mondev International Ltd. v. United States', *AJIL* 98 (2004), p. 155; L. J. Dhooge, 'The Loewen Group v. United States', *Conn. J. Int'l L.* 19 (2004), p. 495; and N. Rubins, 'Loewen v. United States', *Arb. Int'l* 21 (2005), p. 1.

<sup>975</sup> See Paulsson (above fn. 938), pp. 104–105; and McLachlan, Shore and Weininger (above fn. 63), pp. 232–233. Criticism as regards the application of this standard to the facts is also uttered by Weiler (above fn. 974), pp. 666–667; and Rubins (above fn. 974), pp. 17–22. However, a similar distinction was drawn by *Jan de Nul NV and Dredging International NV v. Egypt*, ICSID Case No. ARB/04/13 (Award of 24 October 2008), at para. 255.

<sup>976</sup> Paulsson (above fn. 938), p. 108.

internationally unlawful.<sup>977</sup> The reason why this should apply to the judicial branch of a state (and not, for instance, to the executive branch) is constituted by the idea to give states the greatest possible freedom to organise their national systems of justice and give them the chance to correct the system's failures.<sup>978</sup> This argument is objected to on the grounds that, due to the state's single legal personality in international law, there seemed to be no reason to distinguish between decisions of inferior courts and those of administrative officials in applying the *Loewen* tribunal's test regarding local remedies.<sup>979</sup> Furthermore, it has been submitted that the intention of creating a system of investment arbitration, at least for cases under ICSID jurisprudence,<sup>980</sup> was to substitute domestic remedies for international arbitration so that international relief would have to be granted although the undue administrative acts were not charged at the local courts.<sup>981</sup> While the controversy continues, both sides nevertheless concede that international intervention is only justified if a failure of the system is shown and that the prospects of success are lowered if obvious remedies are not pursued.<sup>982</sup>

In a somewhat different situation, the question of remedies has also been touched in the case of *Waste Management Inc. v. Mexico*, concerning the alleged breach of a concession contract for the provision of waste disposal services.<sup>983</sup> After having reviewed a number of precedents, the tribunal proposed the following general definition of fair and equitable treatment, including elements of procedural fairness:

[T]he 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

<sup>977</sup> *Ibid.*; similarly, see *Marvin Roy Feldman Karpa v. Mexico* (above fn. 452), at para. 140; and *Chevron Corp. and Texaco Petroleum Corp. v. Ecuador*, UNCITRAL (Interim Award of 1 December 2008), at para. 233; see also Focarelli (above fn. 939), mn. 30.

<sup>978</sup> See Paulsson (above fn. 938), p. 108.

<sup>979</sup> Bjorklund (above fn. 939), p. 858; and McLachlan, Shore and Weininger (above fn. 63), p. 232. This is also partly admitted by Paulsson (above fn. 938), p. 102.

<sup>980</sup> Confer Article 26 of the ICSID.

<sup>981</sup> McLachlan, Shore and Weininger (above fn. 63), p. 233.

<sup>982</sup> *Ibid.*; Paulsson (above fn. 938), p. 109; see also *Pantechniki SA Contractors and Engineers v. Albania* (above fn. 927), at para. 96.

<sup>983</sup> *Waste Management v. Mexico* (above fn. 102); see also Chapter 7, section A, '2(b)(iii) Stability in the contractual relationship'.

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.<sup>984</sup>

The tribunal rejected the investor's allegation that a breach of the concession contract amounted to a violation of Article 1105 of the NAFTA inasmuch as some remedy is open to the investor to address the problem.<sup>985</sup> The tribunal - similar to the *Loewen* tribunal's basic premise - further explained:

The importance of a remedy, agreed on between the parties, for breaches of the concession agreement<sup>986</sup> bears emphasis. It is true that in a general sense the exhaustion of local remedies is a procedural prerequisite for the bringing of an international claim, one which is dispensed with by NAFTA Chapter 11. But the availability of local remedies to an investor faced with contractual breaches is nonetheless relevant to the question whether a standard such as Article 1105(1) has been complied with by the state. Were it not so, Chapter 11 would become a mechanism of equal resort for debt collection and analogous purposes in respect of all public (including municipal) contracts, which does not seem to be its purpose.<sup>987</sup>

One of the few examples in which a breach of fair and equitable treatment has actually been determined due to an alleged denial of justice is the case of *Victor Pey Casado and others v. Chile*.<sup>988</sup> This case arose out of the ouster of a popular leftist newspaper by the Pinochet regime after their *coup d'état* in the 1970s and the planned restoration of the newspaper in the 1990s. Mr Pey Casado, a Spanish national, who had acquired the newspaper shortly before the business was shut down, sought compensation for the confiscation of his business since the new government had promised to remedy the losses sustained during the dictatorship. However, Pey Casado was unable to achieve any decision by the Chilean courts and could not obtain a response to his requests from the president of the republic for seven years. Instead, the Chilean Government, due to its

<sup>984</sup> *Waste Management v. Mexico* (above fn. 102), at para. 98. <sup>985</sup> *Ibid.*, at para. 115.

<sup>986</sup> The parties had agreed on a special arbitration procedure for the conciliation of disputes arising out of the concession agreement: see *ibid.*, at para. 53.

<sup>987</sup> *Ibid.*, at para. 116. See also the finding in the case of *Metalpar SA and Buen Aire SA v. Argentina* (above fn. 450), at para. 181, in which the tribunal rejected an alleged denial of access to justice because the regulatory changes affecting the investor included judicial and extrajudicial remedies to mitigate adverse effects that had not been pursued by the investor.

<sup>988</sup> *Victor Pey Casado and Prsident Allende Foundation v. Chile* (above fn. 452); on the facts, see paras. 55 et seq.; a summary of the facts as regards fair and equitable treatment is given at paras. 628-636.

disavowal of Pey Casado's ownership rights, indemnified the heirs of former shareholders of the company.

In its analysis on fair and equitable treatment, the tribunal affirmed that it comprised aspects of procedural fairness and the commitment not to deny justice to foreign investors.<sup>989</sup> The tribunal then ascertained that extraordinarily long protraction in a court procedure constituted one of the classical forms of committing a denial of justice and that the absence of any court decision for seven years would amount to such an international wrong.<sup>990</sup> Furthermore, the tribunal was of the opinion that the compensation paid by the Chilean Government to the heirs of former shareholders of the company, but not to Pey Casado, having been the real owner of the newspaper at the time of the confiscation, constituted a discriminatory conduct that was unfair and inequitable.<sup>991</sup>

Apart from the protraction of a court procedure, arbitral jurisprudence displays further instances of a denial of justice amounting to a violation of fair and equitable treatment. For example, a violation of fair and equitable treatment has been determined due to the retroactive extinguishment of the investor's right to arbitration.<sup>992</sup> Additionally, the direct and collusive intervention of a state official into the court proceeding has been identified as a clear breach of the host state's international obligations.<sup>993</sup> A state's non-compliance with numerous court rulings for a total period of over seven years was also considered to be an egregious denial of justice to a foreign investor.<sup>994</sup> Claims of a denial of justice based on an excessive delay of judicial proceedings or on a non-compliance with court rulings appear relatively independent of a possible requirement of exhaustion of local remedies.<sup>995</sup>

<sup>989</sup> *Ibid.*, at paras. 656–657.

<sup>990</sup> *Ibid.*, at para. 659. The tribunal, with reference to the *Azinian* award and other international authorities including the ECtHR, confirmed the following:

... [L]a ausencia de resolución por parte de los tribunales civiles chilenos en cuanto a las pretensiones del Sr. Pey Casado se considera una denegación de justicia. En efecto, la ausencia de una decisión de primera instancia en cuanto al fondo de las demandas de las partes demandantes durante siete años... debe calificarse como una denegación de justicia por parte de los tribunales chilenos. De hecho, los plazos procesales extraordinariamente largos constituyen una de las formas clásicas de denegación de justicia.

<sup>991</sup> See *ibid.*, at para. 674.

<sup>992</sup> *ATA Construction, Industrial and Trading Co. v. Jordan* (above fn. 452), at para. 125.

<sup>993</sup> See *Petrobart Ltd v. Kyrgyz Republic*, SCC Arbitration Institute Case No. 126/2003 (Award of 29 March 2005), at paras. 132–134.

<sup>994</sup> See *Waguih Elie George Siag and Clorinda Vecchi v. Egypt* (above fn. 449), at paras. 454–455.

<sup>995</sup> See *Jan de Nul NV and Dredging International NV v. Egypt* (above fn. 975), at para. 255.

(ii) *Administrative due process*

The category of administrative due process was addressed, for instance, in the case of *Alex Genin and others v. Estonia*, concerning the revocation of a banking licence by the Estonian central bank because the affected bank did not comply with certain information requests on its shareholder structure.<sup>996</sup> In relation to the administrative procedure applied, the tribunal determined that certain procedures indeed had to be characterised as being contrary to generally accepted practice. In particular, the tribunal criticised the fact that: no formal notice was given to the bank indicating that it was at risk of losing the licence; no opportunity was given to the bank to participate in the session dealing with the revocation; and the revocation was immediately effective with no possibility of challenging the decision before it was publicly announced.<sup>997</sup>

However, the *Genin* tribunal found that the actions of the Estonian central bank corresponded to national legislation and did not transgress the boundaries of the central bank's statutory discretion.<sup>998</sup> At the international level, the tribunal considered the procedural shortcomings to be justified by the 'serious and entirely reasonable misgivings regarding [the bank's] management, its operations, its investments and, ultimately, its soundness as a financial institution'.<sup>999</sup> Hence, since the revocation was deemed to reflect a clear and legitimate public purpose and since further malpractice, such as a discrimination or bad faith, were absent, the tribunal concluded that the procedural defects did not rise to the level of a violation of fair and equitable treatment or any other provision of the BIT.<sup>1000</sup>

Further guidance as regards administrative due process is given by the award in *International Thunderbird Gaming Corp. v. Mexico*.<sup>1001</sup> Thereby, the arbitral tribunal denied the alleged failure to provide due process, especially because a full opportunity was given to be heard and

<sup>996</sup> *Alex Genin, Eastern Credit Ltd Inc. and AS Baltoil v. Estonia* (above fn. 96); on the facts, see paras. 42–61.

<sup>997</sup> *Ibid.*, at para. 364. <sup>998</sup> *Ibid.*, at paras. 353, 355 and 363. <sup>999</sup> *Ibid.*, at para. 361.

<sup>1000</sup> See *ibid.*, at paras. 365–373. The tribunal's reasoning seems to indicate that bad faith on the part of the host state is a prerequisite for the finding of a breach of fair and equitable treatment. However, it is well accepted that bad faith does not represent a requirement *sine qua non*. Rather, the intentions of the host state – good or bad – may be a relevant element for the balancing process within fair and equitable treatment. See only McLachlan, Shore and Weininger (above fn. 63), p. 243.

<sup>1001</sup> *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275); for a description of the facts and further details, see Chapter 7, section A, '1(b) Sovereignty in arbitral jurisprudence' and '2(b)(ii) Stability in the administrative conduct'.

present counter-evidence.<sup>1002</sup> The tribunal further indicated that not every procedural irregularity is capable of constituting a violation of fair and equitable treatment:

The tribunal does not exclude that the ... proceedings may have been affected by certain irregularities. Rather, the tribunal cannot find on the record any administrative irregularities that were grave enough to shock a sense of judicial propriety and thus give rise to a breach of the minimum standard of treatment. As acknowledged by *Thunderbird*, the ... proceedings should be tested against the standards of due process and procedural fairness applicable to administrative officials. The administrative due process requirement is lower than that of a judicial process.<sup>1003</sup>

The case of *ADC Affiliate Ltd and others v. Hungary* arose out of various contracts between ADC and a Hungarian state agency for the renovation, expansion and operation of Hungary's principal airport near Budapest.<sup>1004</sup> However, after the conclusion of the construction phase, the Hungarian Government issued a decree which resulted in the take-over of all operational and management duties from ADC, depriving it of the possibility to collect the agreed revenues without granting compensation. In relation to the alleged failure to provide due process, the tribunal explained:

[Due process of law] demands an actual and substantive legal procedure for a foreign investor to raise its claims against the depriving actions already taken or about to be taken against it. Some basic legal mechanisms, such as reasonable advance notice, a fair hearing and an unbiased and impartial adjudicator to assess the actions in dispute, are expected to be readily available and accessible to the investor to make such legal procedure meaningful. In general, the legal procedure must be of a nature to grant an affected investor a reasonable chance within a reasonable time to claim its legitimate rights and have its claims heard. If no legal procedure of such nature exists at all, the argument that '*the actions are taken under due process of law*' rings hollow. And that is exactly what the tribunal finds in the present case.<sup>1005</sup>

Hence, the tribunal asserted that if a state authority made use of its regulatory powers, the state, at the same time, had to provide

<sup>1002</sup> See *International Thunderbird Gaming Corp. v. Mexico* (above fn. 275), at paras. 197-198.

<sup>1003</sup> *Ibid.*, at para. 200.

<sup>1004</sup> *ADC Affiliate Ltd and ADC & ADMC Management Ltd v. Hungary* (above fn. 443); on the facts, see paras. 79 et seq.; see also Chapter 7, section A, '1(b) Sovereignty in arbitral jurisprudence'.

<sup>1005</sup> *Ibid.*, at para. 435. The tribunal stated this in connection with its reasoning on the expropriation claim, but found that this approach would equally apply to fair and equitable treatment: see para. 445.

mechanisms for the foreign investor to address its legitimate interests. To such an extent, not only does a duty exist to comply with already established procedural guarantees, but also to create such procedures where they are non-existent.

### (c) The relative weight of procedural fairness

In conclusion, the presented cases confirm the importance of fair procedures in the context of fair and equitable treatment. However, despite the quite frequent reference to notions of denial of justice or due process, a clear perception of what kind of procedure is deemed fair or not has not yet emerged. Rather, it appears that arbitral tribunals handle procedural guarantees provided by the host state's legal system with considerable flexibility. This is understandable since it is certainly not the task of investment tribunals to enjoin a specific form of administrative or judicial procedure on host states. Due to their limited function in this respect, investment tribunals consequently aver not to act as courts of appeal over domestic judicial or administrative bodies.

To such an extent, the tribunals exhibit a reluctance to find an infringement of international law because of ordinary procedural irregularities or alleged deficiencies under national law. Thereby, the often-invoked differentiation between a 'mere error' and 'manifest injustice' is again perceived as a balancing operation, comprising a series of elements that tend to one side or the other: for instance, if procedural shortcomings may be remedied within the national legal system, a violation of fair and equitable treatment is difficult to establish. However, a denial of justice or of due process has been determined in cases in which a participatory procedure has been absent or in which the national system of administration of justice has not delivered any response to the investor's demands. Finally, the finding of a violation of fair and equitable treatment because of unfair procedures also appears more likely if the procedural irregularity is combined with some other form of hostility or discrimination against the foreign investor. Beyond that, however, the degree of the manifestness of the injustice, required for the establishment of a breach of fair and equitable treatment, remains relatively unclear indeed.

## 2 Transparency

Closely related to the adherence to a fair procedure but also to the protection of legitimate expectations is the concept of transparency, which is regularly mentioned as a *topos* under fair and equitable treatment.



Since fair and equitable treatment is an obligation that solely binds the parties to an international investment agreement, the notion of transparency in this context is concerned with the openness and clarity of the host state's legal regime and procedures.<sup>1006</sup>

#### (a) General meaning of transparency

The notion of transparency has become increasingly in vogue. It seems to have developed from a buzzword to a legal conception at various levels of the international legal architecture,<sup>1007</sup> although its concrete meaning appears far from settled and its elements seem to be covered by a number of other legal conceptions. Transparency is considered to enhance the predictability and stability of the investment relationship and thus to represent an incentive for the promotion of investment.<sup>1008</sup> As such, it is highlighted as a prominent feature of good governance, as a synonym for accountability or even as being central to a democratic polity.<sup>1009</sup> At a most general level, a legal system may be deemed transparent if its legal texts are clear, unambiguous and readily accessible, if the relevant information is provided in order to foresee the government's activities and policies, and if clear procedures are available, by means of which compliance to the announced rules and policies may be reviewed.<sup>1010</sup> Such meaning of transparency coincides with other legal

<sup>1006</sup> In other contexts, the notion of transparency may also be employed to describe the relationship between an international institution and its member states or the participatory process of international civil society within such an international institution; see the meanings of transparency within WTO law in Hilf and Oeter (above fn. 395), pp. 122–123. A further possible meaning of transparency within international investment law, which is also not addressed here, would be the description of corporate disclosure duties, obliging the foreign investor to provide information to the host state: thereon see UNCTAD, *Transparency*, UNCTAD/ITE/IIT/2003/4 (2004), pp. 18–22.

<sup>1007</sup> See T. N. Hale and A.-M. Slaughter, 'Transparency', Fletcher F. World Aff. 30 (2006), p. 153 at p. 153. Transparency is discussed as a (new) legal principle, e.g. in WTO law: see P. I. Hansen, 'Transparency, Standards of Review, and the Use of Trade Measures to Protect the Global Environment', Va. J. Int'l L. 39 (1999), p. 1017; in European Community law, see S. Prechal and M. de Leeuw, 'Dimensions of Transparency', *Review of European Administrative Law* (2007), p. 51; or also in German constitutional law, see J. Bröhmer, *Transparenz als Verfassungsprinzip* (2004).

<sup>1008</sup> See UNCTAD (above fn. 1006), p. 7; and C.-S. Zoellner, 'Transparency: An Analysis of an Evolving Fundamental Principle in International Economic Law', Mich. J. Int'l L. 27 (2006), p. 579 at pp. 586–588, providing an economic and game theory analysis on the positive impact of transparency as an incentive to invest.

<sup>1009</sup> See, e.g. Hale and Slaughter (above fn. 1007), pp. 153–154; and Craig (above fn. 677), p. 350.

<sup>1010</sup> Confer Zoellner (above fn. 1008), pp. 583–585; and Craig (above fn. 677), pp. 350–351.

conceptions, such as the principle of legal certainty as part of the rule of law or that of equal treatment, both being recognised in most legal systems. For instance, the principle of legal certainty already comprises the clarity and availability of legal texts; the principle of equal treatment implies a certain degree of transparency in order to create equality of opportunities and facilitate the control of compliance.<sup>1011</sup>

Nevertheless, a number of international investment agreements have expressly incorporated transparency obligations, usually requiring the host state to publish the laws, regulations, procedures and administrative practices that are in any way relevant to the foreign investor.<sup>1012</sup> These transparency provisions cover a broad range of items of governmental information to be provided, as well as possible procedures by means of which information is exchanged.<sup>1013</sup> If, however, an international investment agreement expressly specifies such transparency requirements and they are subject to investor-state arbitration, there is probably no need to introduce the concept of transparency into the general obligation of fair and equitable treatment. On the other hand, it is obvious that a relationship of fairness between the host state and the investor demands at least a minimum of transparency, even if such an express stipulation is absent.<sup>1014</sup> This is because the legitimacy and perceived fairness of a measure of the host state towards the investor also depends on whether that measure is rationally understandable.<sup>1015</sup> Hence, the question arises if and what kind of an idiosyncratic notion of transparency exists that is inherent in the concept of fair and equitable treatment.

Before examining that matter more closely, it is worth mentioning that the principle of transparency is also recognised in WTO law. In addition to the express publication and notification duties, especially in

<sup>1011</sup> In the context of European Community law, see Prechal and de Leeuw (above fn. 1007), pp. 52 et seq.

<sup>1012</sup> For a compendium of the various existing transparency provisions, see UNCTAD (above fn. 1006), pp. 14–17; see also A. Kotera, 'Regulatory Transparency', in P. Muchlinski et al. (eds.), *The Oxford Handbook of International Investment Law* (2008), pp. 625–628.

<sup>1013</sup> See UNCTAD (above fn. 1006), pp. 22 et seq. For very detailed transparency provisions, see also NAFTA Chapter 18.

<sup>1014</sup> See also Dolzer (above fn. 2), p. 92, speaking of a 'conceptual affinity' between transparency and fair and equitable treatment.

<sup>1015</sup> On the correlation between transparency and fairness, see P. Hilpold, 'Das Transparenzprinzip im internationalen Wirtschaftsrecht – unter besonderer Berücksichtigung des Beziehungsgeflechts zwischen EU und WTO', EuR (1999), p. 597 at pp. 597 and 619–620.

Article X GATT, the WTO Appellate Body in the *US-Shrimps* case has linked the principle of transparency with the principle of due process and the requirements of procedural fairness.<sup>1016</sup> The failure to provide the necessary information about certain trade regulations and the non-transparency of procedures pertaining to those measures was therefore considered to amount to an unjustifiable and arbitrary discrimination contrary to the requirements of the chapeau of Article XX of the GATT.<sup>1017</sup> This approach has been used in at least one other case decided by the Appellate Body.<sup>1018</sup> Thus, the transparency of a national regulatory framework and its procedures may be seen as an element of world trade law that is recognised to be of importance in a broader balancing process.<sup>1019</sup> Whether investment tribunals apply a similar approach towards fair and equitable treatment is a matter that will now be explored.

#### (b) Transparency in arbitral jurisprudence

A first controversial award on fair and equitable treatment and transparency, which has already been mentioned at various points, is provided by the tribunal in the *Metalclad* case.<sup>1020</sup> The tribunal incorporated a transparency obligation from another chapter into Article 1105 of the NAFTA and then observed, in relation to fair and equitable treatment:

Prominent in the statement of principles and rules that introduces the agreement is the reference to 'transparency' (NAFTA Article 102(1)). The tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the agreement should be capable of being readily known to all affected investors of another party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any party ... become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the

<sup>1016</sup> *United States - Import Prohibition of Certain Shrimp and Shrimp Products* (above fn. 392), at paras. 182-183.

<sup>1017</sup> *Ibid.*, at para. 184.

<sup>1018</sup> *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear*, WTO Dispute Settlement Body WT/DS24/AB/R (Report of the Appellate Body of 10 February 1997), at part VI.

<sup>1019</sup> On transparency and interest balancing in WTO law, see especially Hansen (above fn. 1007), pp. 1057 et seq.

<sup>1020</sup> *Metalclad Corp. v. Mexico* (above fn. 224); for a description of the facts and further discussion, see Chapter 3, section B, '1(a) The *Metalclad* and *S.D. Myers* approach', Chapter 4, section C, '1(b) The matter of limited jurisdiction' and Chapter 7, section A, '2(b)(ii) Stability in the administrative conduct'.

correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.<sup>1021</sup>

Despite such emphasis on transparency, the subsequent reasoning of the tribunal seems rather to be based on the investor's legitimate expectations, as described above. The tribunal found that the host state failed to ensure a transparent and predictable framework as required by fair and equitable treatment by breaching the investor's reasonable expectations that a permit for the construction of the waste landfill would have to be granted.<sup>1022</sup> Accordingly, the *Metalclad* award reveals the close connection between transparency and the investor's expectations.

A similar connection between these two principles has been established in the *TECMED* case, in which the tribunal determined that the investor expected the host state to act consistently and transparently.<sup>1023</sup> Therefore, it seems that ambiguous communication by state authorities is conducive to the creation and subsequent breach of expectations on the side of the investor. Conversely, this means that a clear and transparent behaviour by state authorities may avert the creation of false expectations and thus a possible violation of fair and equitable treatment. Additionally, the *TECMED* case displays transparency's affinity to the principle of procedural fairness. For instance, the *TECMED* tribunal underlined that, in order to be transparent, an administrative decision must be furnished with adequate and correct reasons.<sup>1024</sup> Such proximity to the conceptions of procedural fairness and legitimate expectations raises the question of whether transparency is of importance only in conjunction with other principles, or whether a lack of transparency alone is able to reach the level of a breach of fair and equitable treatment.<sup>1025</sup>

<sup>1021</sup> *Metalclad Corp. v. Mexico* (above fn. 224), at para. 76.

<sup>1022</sup> *Ibid.*, at paras. 85-89 and 99.

<sup>1023</sup> *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 154; on the *TECMED* case, see also Chapter 7, section A, '2(b)(ii) Stability in the administrative conduct'. Several tribunals follow this *TECMED* approach and treat transparency and the investor's expectations jointly: see, e.g. *Sahuka Investments BV v. Czech Republic* (above fn. 132), at para. 307; and *LG&E Energy Corp. and others v. Argentina* (above fn. 450), at para. 131.

<sup>1024</sup> See *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at paras. 123 and 164.

<sup>1025</sup> The latter is disbelieved in the context of tax laws by the tribunal in *Marvin Roy Feldman Karpa v. Mexico* (above fn. 452), at para. 133, stating, 'it is doubtful that lack of transparency alone rises to the level of violation of NAFTA and international law, particularly given the complexities not only of Mexican but most other tax laws'.

Evidence with regard to the possibility that transparency embodies a self-contained element of fair and equitable treatment seems to be provided by the award in the case of *Emilio Augustín Maffezini v. Spain*, concerning an Argentine investor trying to embark upon the production of chemical products in Spain.<sup>1026</sup> Among the various contentions submitted by Maffezini, the tribunal determined that a transfer of funds from Maffezini's personal account to the corporation, ordered by an official of a state entity participating in the investment project, infringed Spain's obligation to treat the investor fairly and equitably.<sup>1027</sup> The tribunal was of the opinion that: the official failed to consult with Maffezini; the manner in which the transaction was conducted was not transparent; and such treatment could not conform to the host state's international obligations.<sup>1028</sup> However, the tribunal unfortunately neglected to substantiate its view on the particular weight of transparency in the determination of the alleged violation of fair and equitable treatment.

Further explanation on transparency was given by the tribunal in the case of *Champion Trading Co. and others v. Egypt*, concerning certain regulations and the granting of subsidies in the course of the privatisation of the Egyptian cotton industry.<sup>1029</sup> The investor, whose company could not obtain any government payments, alleged that the procedure and manner in which only a selected group of companies were compensated fell below international standards, violating the international law principle of transparency.<sup>1030</sup> In its reasoning, the tribunal did not

<sup>1026</sup> *Emilio Augustín Maffezini v. Spain* (above fn. 453); see also Chapter 7, section A, '4(c) Sustainable development in arbitral jurisprudence'.

<sup>1027</sup> *Ibid.*, at para. 83. <sup>1028</sup> *Ibid.*

<sup>1029</sup> *Champion Trading Co. and Ameritrade International Inc. v. Egypt* (above fn. 453); on the factual background, see paras. 40 et seq.

<sup>1030</sup> See *ibid.*, at paras. 104 and 108. The transparency principle was developed by the claimants with reference to the mentioned WTO cases and the *TECMED* case: see paras. 161–162. The investor originally claimed a violation of fair and equitable treatment, but later changed this claim and alleged a lack of transparency. The transparency claim was addressed under Article II(4) of the 1986 US–Egypt BIT, which provides (without any stipulation of fair and equitable treatment):

The treatment, protection and security of investments shall never be less than that required by international law and national legislation.

The BIT also contains specific transparency requirements, which, however, were not expressly mentioned by the tribunal. That provision in Article II(8) of the BIT reads:

Each party and its subdivisions shall make public all laws, regulations, administrative practices and procedures, and adjudicatory decisions that pertain to [or] affect investments in its territory of nationals or companies of the other party.

elaborate on the issue of whether international law really obliges the host state to act transparently; it therefore seemed to accept implicitly the investor's arguments that such an obligation existed. The tribunal nevertheless denied a breach of the host state's transparency obligation due to a lack of evidence. It noted:

It was ... the obligation of the claimants to prove that the settlements were not made in a transparent manner. The tribunal notes that the laws and decrees regarding the organisation of the cotton trading structures ... were public, available, or have been published or produced by the respondent upon the request of the claimants. The claimants were in a position to know beforehand all rules and regulations that would govern their investments for the respective season to come. The claimants have not produced any evidence or even pertinent arguments that Egypt violated the principle of transparency under international law and this claim therefore also has to be denied.<sup>1031</sup>

In the case of *Siemens AG v. Argentina*,<sup>1032</sup> the tribunal determined a breach of fair and equitable treatment and partly based that finding on a lack of transparency by the host state. The case related to an integral services contract for the provision and maintenance of a computer-based personal identification system, including the delivery of national identity cards.<sup>1033</sup> After a change of government and after technical problems had occurred, the contract was reviewed and ultimately terminated by the Argentine Government on the basis of emergency laws, empowering it to renegotiate public sector contracts during the Argentine financial crisis. In the arbitral proceeding, the tribunal approved the arguments of the investor, claiming that Argentina's denial of access to administrative files for purposes of filing an appeal against the government acts showed a lack of transparency and therefore violated the obligation of fair and equitable treatment.<sup>1034</sup>

A lack of transparency was furthermore cited by the investor in the case of *Parkerings-Compagniet AS v. Lithuania*.<sup>1035</sup> Thereby, the investor

<sup>1031</sup> *Champion Trading Co. and Ameritrade International Inc v. Egypt* (above fn. 453), at para. 164.

<sup>1032</sup> *Siemens AG v. Argentina* (above fn. 779). The award was subject to a revision proceeding (registered at the ICSID Secretariat on 9 July 2008) due to corruption reproaches against Siemens during the tender process of the project in dispute. Meanwhile, the parties agreed to settle the dispute and the tribunal in the revision proceeding issued a note of discontinuance on 9 September 2009. See L. E. Peterson, 'Siemens waives Rights under Arbitral Award against Argentina', *Investment Arbitration Reporter* 2 (2009), No. 14.

<sup>1033</sup> On the facts, see *Siemens AG v. Argentina* (above fn. 779), at paras. 81–97.

<sup>1034</sup> See *ibid.*, at paras. 114 and 308.

<sup>1035</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138); for further facts and discussion, see Chapter 7, section A, '2(b)(i) Stability of the overall legal framework' and '2(b)(iii)

claimed a breach of fair and equitable treatment resulting from the failure of the host state to disclose information pertaining to the viability of the planned project prior to the execution of the project agreement.<sup>1036</sup> The retained piece of information was characterised by the tribunal as the opinion of a law firm as regards the contractual agreement – which, however, did not provide any information that was not accessible to the public or any other qualified law firm.<sup>1037</sup> The tribunal asked whether the failure to disclose a legal opinion to the counter-party before entering into an agreement should have international consequences and observed:

Such a conduct is often considered as a breach of good faith or a '*culpa in contrahendo*'. However, such a conduct, while objectionable, does not, in itself, amount to a breach of international law. It would take unusual circumstances to decide otherwise; in particular, the claimant has been unable to show that the Sorainen Firm (or the Municipality of Vilnius) was in possession of information unavailable to the public, especially to other legal experts.<sup>1038</sup>

The tribunal hence concluded that the failure to disclose such information was not to be considered as an arbitrary act contrary to fair and equitable treatment.<sup>1039</sup> This argumentation appears to be coherent with arguments mentioned in relation to other disputes that foreign investors owe an obligation of due diligence and so have to gather the factual and legal information that is relevant for the particular investment.<sup>1040</sup> Accordingly, the host state's transparency obligations to disclose certain information come into question only if an administrative entity has superior knowledge that is unfairly retained.

### (c) The relative weight of transparency

The case review shows that transparency is frequently called upon in investment disputes. Although incipiently controversial, it is increasingly acknowledged by many arbitral tribunals as a principle of fair and equitable treatment.<sup>1041</sup> However, the tribunals do not seem to have developed a uniform understanding of the notion of transparency in relation to fair and equitable treatment that would allow deriving a set of specific disclosure or notification duties from it. These specific

Stability in the contractual relationship', as well as '4(c) Sustainable development in arbitral jurisprudence'.

<sup>1036</sup> *Parkerings-Compagniet AS v. Lithuania* (above fn. 138), at para. 295.

<sup>1037</sup> *Ibid.*, at para. 304. <sup>1038</sup> *Ibid.*, at para. 307. <sup>1039</sup> *Ibid.*, at para. 309.

<sup>1040</sup> See, e.g. *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at paras. 168–178.

<sup>1041</sup> See also *Kotera* (above fn. 1012), p. 634.

obligations are therefore mainly preserved to express transparency clauses in international investment agreements. On the contrary, transparency plays a role in a series of different situations and is often invoked so as to buttress another principle of fair and equitable treatment. To such an extent, a clear communication between host state and investor may prevent the raising of false expectations; furthermore, the granting of access to certain files or information may facilitate the preparation of a remedy contributing to the creation of fair procedures. However, the cases exhibit that the host state is not obliged to provide any information that might be of interest to the investor and that could be obtained easily by other means. Furthermore, the complexity of a legal regime or of a particular regulation, as such, is not deemed an unfair and inequitable treatment if the pertinent legal texts are available to the investor.

However, the fact that transparency issues are often dealt with by tribunals in conjunction with other principles does not mean that it is not possible to consider transparency as an idiosyncratic principle of fair and equitable treatment, since tribunals increasingly attribute specific weight to transparency-related arguments within the balancing process. It is nevertheless admitted that these arguments only carry little weight as long as no further specific notion of transparency is developed in international investment law. Moreover, it appears that many of the unsubstantiated allegations of transparency obligations in investment disputes indeed relate to other principles of fair and equitable treatment and are therefore hardly capable of constituting weighty arguments that could establish a breach of fair and equitable treatment on their own.

## C The structure, intensity and rationality of review

After the analysis of the principles of fair and equitable treatment and their concretisation in arbitral jurisprudence, the structure and rationality of the process of balancing within the discourse on fair and equitable treatment will be discussed further. Also assessed is how the concept of proportionality may serve as a structural element in order to increase the rationality of the argumentative discourse. Furthermore, the intensity of review exercised by arbitral tribunals is explored, as well as the rationality deficits remaining in the discourse on fair and equitable treatment.

### 1 Proportionality as a structural element

Proportionality is inherently related to the structure and rationality of a judicial reasoning, as it tries to ensure that arguments are reasonably related to consented legal principles or objectives and that a certain balance between arguments from conflicting principles is achieved. As such, proportionality is increasingly recognised in different domestic and international legal contexts. Moreover, the interconnected notions of proportionality and reasonableness frequently appear in the lines of jurisprudence of investment tribunals. It is therefore necessary to review to what extent this concept is also acknowledged in the context of fair and equitable treatment.

#### (a) General meaning and function of proportionality

By definition, proportionality describes a proportional relation of one part to another and is inherently related to ancient perceptions of equilibrium and balancing.<sup>1042</sup> Not surprisingly, proportionality is thus considered to be deeply rooted in the idea of justice<sup>1043</sup> and is frequently juxtaposed with some form of equity.<sup>1044</sup> In this vein, proportionality sets limits to freedoms, actions or obligations destabilising the proportional balance and is concerned with the just distribution of rights and burdens. Furthermore, it is grounded on the assumption that law pursues certain objectives and purposes and that therefore a quantifiable causal relationship between means and ends exists.<sup>1045</sup> Due to this fundamental function, proportionality has gained major influence in the moral discourse on the limitation of conflicting rights and freedoms as well as the exercise of power.<sup>1046</sup> However, proportionality is also a concept of considerable vagueness covering a number of elements that, depending on the particular circumstances, are applied differently in national and international law contexts.

<sup>1042</sup> See J. Delbrück, 'Proportionality', in R. Bernhardt (ed.), *Encyclopedia of Public International Law*, Consolidated Library Edn (1997), Vol. III/V, p. 1140 at p. 1140.

<sup>1043</sup> See F. Wieacker, 'Geschichtliche Wurzeln des Prinzips der verhältnismäßigen Rechtsanwendung', in M. Lutter et al. (eds.), *Festschrift für Robert Fischer* (1979), p. 867 at pp. 875 et seq., referring especially to *iustitia vindicativa* and *iustitia distributiva*; see also Delbrück (above fn. 1042), p. 1141.

<sup>1044</sup> See, e.g. Wieacker (above fn. 1043), p. 873; Higgins (above fn. 361), pp. 219 et seq.; and M. Krugmann, *Der Grundsatz der Verhältnismäßigkeit im Völkerrecht* (2004), pp. 42–43.

<sup>1045</sup> See Wieacker (above fn. 1043), p. 878.

<sup>1046</sup> See B. Schlink, 'Der Grundsatz der Verhältnismäßigkeit', in P. Badura and H. Dreier (eds.), *Festschrift 50 Jahre Bundesverfassungsgericht* (2001), Vol. II, p. 445 at p. 448.

In the domestic law context, the concept of proportionality is primarily concerned with the setting of material limits to the interference of public authorities in the private sphere of citizens. Generally, this function of proportionality is considered to originate mainly from German administrative law and has, under the auspices of the German Federal Constitutional Court, developed into a guiding doctrinal element in German constitutional law.<sup>1047</sup> The proportionality of a state measure is assessed in three different steps, which are preceded by a question as to the objectives pursued by a state measure and whether these objectives are deemed legitimate.<sup>1048</sup> The steps concerning the means applied to achieve the objective are as follows:<sup>1049</sup> first, it is required that the adopted measure is suitable or appropriate to achieve the objective it pursues ('suitability'). Second, the suitable measure must be necessary to achieve the objective ('necessity'); necessity in this sense presupposes that, among a conceivable variety of equally effective, i.e. suitable, measures, the adopted measure must be the least restrictive alternative. The third step ('proportionality *stricto sensu*') demands that the effects of the adopted measure are not disproportionate in relation to other rights and interests affected and that a fair balance between the competing interests is established.

This structured test of proportionality has increasingly penetrated other legal systems. Most notably, the adoption of the proportionality test in the ECJ's jurisprudence has contributed to the diffusion of this legal concept into the domestic legal systems of European states.<sup>1050</sup> A similar influence may be ascribed to the jurisprudence of the ECtHR, in which proportionality is firmly established as an important tool to delimit the margin of appreciation left to state authorities and to scrutinise the legitimacy of their measures.<sup>1051</sup> Beyond a European context,

<sup>1047</sup> On the development of proportionality in German public law, see L. Hirschberg, *Der Grundsatz der Verhältnismäßigkeit* (1981), pp. 2 et seq.

<sup>1048</sup> See Schlink (above fn. 1046), pp. 449 et seq.

<sup>1049</sup> For a concise summary of the elements of proportionality, see, e.g. Hesse (above fn. 623), p. 142; and Schwarze (above fn. 498), p. 687.

<sup>1050</sup> See especially J. Schwarze, 'The Principle of Proportionality and the Principle of Impartiality in European Administrative Law', *Rivista Trimestrale di Diritto Pubblico* 53 (2003), p. 53; for an analysis of proportionality in the legal systems of different European states, see Schwarze (above fn. 498), pp. 680 et seq.; the diffusion of proportionality has also outreached the European context – see, e.g. A. Stone Sweet and J. Mathews, 'Proportionality Balancing and Global Constitutionalism', *Colum. J. Transnat'l L.* 47 (2008), p. 72 at pp. 111 et seq.

<sup>1051</sup> See J. J. Cremona, 'The Proportionality Principle in the Jurisprudence of the European Court of Human Rights', in U. Beyerlin et al. (eds.), *Recht zwischen Umbruch und Bewahrung*.

the concept of proportionality is also well known in WTO law and is considered as a requirement of balancing that is inherent in many WTO provisions, especially in Article XX of the GATT.<sup>1052</sup> In all of these legal systems, the proportionality tests are not always applied in the described three-step pattern, but in a more flexible way. However, the recognition of a proportionality test in each of these systems is acknowledged as an expression of relative legal maturity, as it allows the particular judicial body to balance the rights, interests, values or principles at stake and thereby develop a particular perception of legitimacy in a structured and rationally traceable way.<sup>1053</sup> Moreover, the ECtHR and WTO Appellate Body in particular have systemically integrated legal principles from other sub-systems of international law through the balancing operation as part of a proportionality analysis and have thereby contributed to greater coherence in international law generally.<sup>1054</sup>

While the above-mentioned examples stick quite closely to the traditional function of proportionality – to limit the power of state authorities in relation to individuals – public international law also features other concepts of proportionality governing the relations between equal and sovereign states. For instance, proportionality is an important criterion for determining the legality of countermeasures in the international law of state responsibility<sup>1055</sup> and for assessing the boundaries of self-defence as well as the relation between military objectives and damages in the law of armed conflicts.<sup>1056</sup> In the area of continental shelf delimitation, the interconnectedness of proportionality and equity has become especially apparent because proportionality is considered one of the guiding factors to be taken into account in the delimitation of

Festschrift für Rudolf Bernhardt (1995), p. 323; and Stone Sweet and Mathews (above fn. 1050), pp. 145 et seq.

<sup>1052</sup> See M. Hilf and S. Puth, 'The Principle of Proportionality on its Way into WTO/GATT Law', in A. von Bogdandy et al. (eds.), *European Integration and International Co-ordination* (2002), p. 199; and especially M. Andenas and S. Zleptnig, 'Proportionality', *Tex. Int'l L.J.* 42 (2007), p. 371; against the recognition of general requirement of proportionality, see, however, A. Desmedt, 'Proportionality in WTO Law', *J. Int'l Econ. L.* (2001), p. 441.

<sup>1053</sup> See Andenas and Zleptnig (above fn. 1052), pp. 424 et seq.

<sup>1054</sup> See the cases reviewed in Chapter 4, section B, '3(c) European Court of Human Rights' and '3(d) Article XX of the GATT'.

<sup>1055</sup> This is expressly stipulated in Article 51 of the ILC's Articles on State Responsibility: see Crawford (above fn. 185), pp. 294–296; and see generally T. M. Franck, 'On Proportionality of Countermeasures in International Law', *AJIL* 102 (2008), p. 715.

<sup>1056</sup> See Delbrück (above fn. 1042), pp. 1141–1142.

boundaries in accordance with equitable principles.<sup>1057</sup> In the context of fair and equitable treatment, proportionality is arguably better understood in the manner as applied by the ECtHR or WTO Appellate Body. However, in all of these examples of international law, proportionality is quite firmly established in both case law and literature and, although some doubts remain, is either deemed part of customary international law or recognised as a general principle of law.<sup>1058</sup>

Closely related to proportionality is the notion of reasonableness. Especially in British law, the discussion of this notion has been dominated by the famous *Wednesbury* test ('so unreasonable that no reasonable decision-maker could come to it'), which, however, has come under pressure in recent decades due to the growing influence of the concept of proportionality in European law.<sup>1059</sup> Although reasonableness appears less structured than proportionality, both concepts reveal a considerable overlap insofar as they require a fair balance between different interests, a rational connection between means and ends and forbid unduly oppressive decisions.<sup>1060</sup> In a similar way, the notion of reasonableness may also be found in many instances of international law where it is considered to provide a certain degree of flexibility and legitimacy by being able to mask and balance contradictions of the international legal system.<sup>1061</sup> Thereby, the literal sense of the notion already suggests that it is concerned with a justificatory discourse of providing reasons capable of convincingly establishing a link between the measure in question and the legitimate objective that is pursued.<sup>1062</sup> However, whether there remain substantial differences between reasonableness and proportionality in the sense that proportionality could imply a much more far-reaching judicial control, as it is

<sup>1057</sup> See Brownlie (above fn. 129), p. 218.

<sup>1058</sup> See Delbrück (above fn. 1042), p. 1144; for a more reluctant view, see Higgins (above fn. 361), p. 236. In EU law, proportionality has initially been recognised as a general principle of law, but is now prominently stipulated in the treaties: see Article 5(1) of the Treaty on European Union (TEU). In the ECHR, proportionality tests are adumbrated (by the word 'necessary') in several provisions, most notably in paras. (2) of each of Articles 8–11 of the ECHR. Thereon, see also Schwarze (above fn. 1050), pp. 54–55.

<sup>1059</sup> See Woolf, Jowell and Le Sueur (above fn. 677), pp. 551 et seq.

<sup>1060</sup> See *ibid.*, pp. 590–591.

<sup>1061</sup> Confer O. Corten, 'The Notion of "Reasonable" in International Law', *ICLQ* 48 (1999), p. 613 at pp. 613 et seq.

<sup>1062</sup> See *ibid.*, pp. 620 et seq.; see also Hector (above fn. 617), p. 147.

sometimes suggested,<sup>1063</sup> is ultimately dependent on the particular standard of intensity of review actually being applied.

### (b) Proportionality in arbitral jurisprudence

The notions of proportionality and reasonableness appear in various instances of arbitral jurisprudence on fair and equitable treatment, usually without further explanation of their meaning.<sup>1064</sup> In this respect, the review of the principles of fair and equitable treatment has revealed that these principles provide criteria for a tribunal's assessment of a state measure's proportionality: first of all, the principle of sovereignty enshrines that, from an international perspective, a state is generally free to pursue any objective it chooses. Nevertheless, the other principles affect the degree of legitimacy of the pursued objective or the means applied and arguably disqualify means or ends that, for example, are borne by purely discriminatory motives. The extent to which the reasoning of arbitral tribunals in this regard follows the structure of a proportionality analysis is exemplified by the ensuing decisions.

In the review of an export ban on certain chemical compounds, the tribunal in the case of *S.D. Myers Inc. v. Canada*<sup>1065</sup> applied a test that adhered to a common proportionality analysis. The tribunal held:

CANADA was concerned to ensure the economic strength of the Canadian industry, in part, because it wanted to maintain the ability to process PCBs within Canada in the future. This was a legitimate goal, consistent with the policy objectives of the Basel Convention. There were a number of legitimate ways by which CANADA could have achieved it, but preventing [the investor] from exporting PCBs for processing in the USA by the use of the interim order and the final order was not one of them. The indirect motive was understandable, but the method contravened CANADA's international commitments under the NAFTA. CANADA's right to source all government requirements and to grant subsidies to the Canadian industry are but two examples of legitimate alternative measures. The fact that the matter was addressed subsequently and the border re-opened also shows that CANADA was not constrained in its ability to deal effectively with the situation.<sup>1066</sup>

<sup>1063</sup> See, e.g. *Stone Sweet and Mathews* (above fn. 1050), pp. 160 et seq.; on unreasonableness as particularly extreme behaviour, see also *Woolf, Jowell and Le Sueur* (above fn. 677), p. 553.

<sup>1064</sup> See, e.g. *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 109.

<sup>1065</sup> *S.D. Myers Inc. v. Canada* (above fn. 95); see also Chapter 3, section B, '1(a) The *Metalclad* and *S.D. Myers* approach', and Chapter 7, section A, '3(b) Non-discrimination in arbitral jurisprudence' and '4(c) Sustainable development in arbitral jurisprudence'.

<sup>1066</sup> *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 255.

Apparently, the tribunal had no difficulty in affirming the legitimacy of the goal pursued by Canada, especially because it also emphasised the 'high measure of deference that international law generally extends' to matters of domestic regulation.<sup>1067</sup> The leeway to adopt regulatory objectives flowed not only from the sovereignty of Canada, but was in this case also sustained by, or at least did not conflict with, the principle of sustainable development, as the objectives also complied with the Basel Convention. The suitability of the export ban in relation to that goal was obvious and therefore probably not worth mentioning for the tribunal. Difficulties arose with regard to the necessity of the measure, which was explicitly scrutinised by the tribunal. It found that at least two other alternative, and arguably less restrictive, measures existed. Because the necessity of the export ban was denied, a balancing at the stage of proportionality *stricto sensu* did not take place. Without expressly referring to the notion of proportionality, the tribunal thus carried out a structured proportionality analysis. However, to be ultimately convincing, the tribunal should have adduced further arguments showing that the alternatives were, in fact, less restrictive, equally effective and available under fair and equitable treatment.

A different approach has been adopted by the tribunal in *Pope & Talbot Inc. v. Canada*, assessing a number of regulatory measures in connection with the implementation of the Softwood Lumber Agreement.<sup>1068</sup> As has already been outlined above in connection with the principle of sovereignty, the tribunal, in taking account of the difficult task of regulating a complex economic area, deemed Canada's measures to be a 'reasonable response' that could not trigger a breach of fair and equitable treatment.<sup>1069</sup> Against the background of these circumstances and complexities, the tribunal identified a rational relationship between the justifiable regulatory measures and the legitimate goal of implementing the agreement. Furthermore, in relation to a punitive 'super fee' for exceeding certain export quota, the tribunal stated:

Canada might have chosen another approach ... one that shared the burden more equitably ... However, it is not the place of this tribunal to substitute its

<sup>1067</sup> *Ibid.*, at para. 263.

<sup>1068</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245); see also the discussions in Chapter 3, section B, '1(b) The *Pope & Talbot* final merits award' and Chapter 7, section A, '1(b) Sovereignty in arbitral jurisprudence'.

<sup>1069</sup> See *Pope & Talbot Inc. v. Canada* (above fn. 245), at paras. 123, 125 and 128.

judgment on the choice of solutions for Canada's, unless that choice can be found to be a denial of fair and equitable treatment.<sup>1070</sup>

In contrast to the *S.D. Myers* case, the tribunal thus rejected a strict review of the necessity of this particular measure and affirmed Canada's margin of appreciation in choosing suitable and necessary measures to achieve the country's objective. The breach of fair and equitable treatment determined by the tribunal in relation to another issue resulted from the failure to provide reasoned arguments that supported the host state's proceeding and alleviate the burden of the investor.<sup>1071</sup> While not applying a structured proportionality test, the lack of a rational justification by way of reasoning sufficed for finding a violation of fair and equitable treatment.

Probably the most well-known discussion of proportionality appears in the case of *Técnicas Medioambientales, TECMED SA v. Mexico*, in which the tribunal expressly relied on the much more elaborated concept of proportionality in the jurisprudence of the ECtHR.<sup>1072</sup> In its assessment of an alleged expropriation, the tribunal thereby required a 'reasonable relationship of proportionality' between the effects and the goal of a measure, and that the relevant 'factors must be weighed when trying to assess the proportionality of the action adopted with respect to the purpose pursued by such measure'.<sup>1073</sup> However, although such analysis resembles some of the elements of a structured proportionality test, the tribunal did not review whether the host state actually applied the least restrictive measure in the sense of the necessity requirement. Moreover, the tribunal did not extend its particular concept of proportionality to the analysis of fair and equitable treatment.

The tribunal in the case of *Saluka Investments BV v. Czech Republic* provides clarity on the meaning of reasonableness in the context of fair and equitable treatment.<sup>1074</sup> Thereby, both the governmental assistance programme to bail out Czech banks and the investor's

<sup>1070</sup> *Ibid.*, at para. 155. <sup>1071</sup> See *ibid.*, at paras. 172-173.

<sup>1072</sup> See *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at paras. 122 et seq.; for further discussion on the case, see also Chapter 7, section A, '2(b)(ii) Stability in the administrative conduct'; on the proportionality analysis in the *TECMED* case, see furthermore X. Han, 'The Application of the Principle of Proportionality in *Tecmed v. Mexico*', *Chinese JIL* 6 (2007), p. 635; and Newcombe and Paradell (above fn. 3), pp. 363-365.

<sup>1073</sup> *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at paras. 122 and 133.

<sup>1074</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132); see also Chapter 3, section C, '1(c) *Saluka Investments BV v. Czech Republic*', Chapter 7, section A, '1(b) Sovereignty in arbitral jurisprudence' and '3(b) Non-discrimination in arbitral jurisprudence'.

expectations to receive such assistance were requested to be based on reasonableness. Therefore, the investor's reasonable expectations had to take into account the host state's right to regulate in the public interest, which itself had to be exercised in an equally reasonable way.<sup>1075</sup> The reasonableness of the state measure was then defined to require 'a showing that the state's conduct bears a reasonable relationship to some rational policy'.<sup>1076</sup> Certainly, this definition is of no practical use as it explains reasonableness by referring, in a circular way, again to reasonableness and rationality. Nevertheless, this definition indicates that reasonableness in this sense requires the host state to deliver reasons that are capable of justifying the particular state measure by showing that the measure is consistently borne by the reasons adduced. After scrutinising in detail the soundness of the host state's arguments, the tribunal found that a reasonable justification had not been offered and that this failure involved a breach of fair and equitable treatment.<sup>1077</sup> As regards a possible margin of appreciation, the tribunal mentioned at one point that it was not the task of the tribunal to second-guess the Czech Government's privatisation policy, but observed at the same time that this would not relieve the host state from its obligation under fair and equitable treatment to provide a reasonable justification for state actions.<sup>1078</sup> Notwithstanding the tribunal's emphasis on sovereignty and the right to regulate, the *Saluka* award thus placed a relatively high justificatory burden on the host state.

A different but hardly less demanding understanding of reasonableness was advanced by the tribunal in the case of *BG Group Plc. v. Argentina*,<sup>1079</sup> representing one of the cases concerning the reorganisation of the Argentine gas sector during the country's economic crisis. In that case, the tribunal indeed refused 'to pass judgment on the reasonableness or effectiveness of [the host state's] measures as a matter of political economy'.<sup>1080</sup> Accordingly, reasonableness was not applied in order to assess the relation between the means applied and the goals pursued, but rather was said to constitute a standard the content of which is determined by the investment treaty, the intentions of the parties to that treaty and 'in its essence [by] the arbitrator's

<sup>1075</sup> See *Saluka Investments BV v. Czech Republic* (above fn. 132), at paras. 304-307.

<sup>1076</sup> *Ibid.*, at para. 460; see also at para. 309.

<sup>1077</sup> See *ibid.*, at paras. 327 et seq. and 407 et seq. <sup>1078</sup> *Ibid.*, at para. 337.

<sup>1079</sup> *BG Group Plc. v. Argentina* (above fn. 450). <sup>1080</sup> *Ibid.*, at para. 344.



judgment'.<sup>1081</sup> This led the tribunal to conclude that the 'withdrawal of undertakings and assurances given in good faith to investors as an inducement to their making an investment is by definition unreasonable and a breach of the treaty'.<sup>1082</sup> However, this approach of the tribunal is highly questionable because a notion of reasonableness that is shaped mainly by the arbitrator's judgment hardly appears capable of providing a tool to increase the rationality and legitimacy of state measures or judicial decisions. Reasonableness in this sense has little to do with a justificatory process of reasoning, but rather with judicial decisionism. Moreover, it seems that the withdrawal of undertakings is not unreasonable 'by definition', but rather because there are usually no good arguments that can justify such an act.

Finally, proportionality has played a role in the case of *EDF (Services) Ltd v. Romania*, which concerned a legislative act revoking licences obtained by the foreign investor for the provision of services in the duty-free business within Romanian airports.<sup>1083</sup> Allegedly, this act was mainly prompted by the need to fight corruption within the business. While the tribunal characterised this objective as a legitimate aim in the public interest, it also demanded 'a reasonable relationship of proportionality between the means employed and the aim sought to be realised'.<sup>1084</sup> Furthermore, the tribunal specified, 'proportionality would be lacking if the person involved bears an individual and excessive burden'.<sup>1085</sup> In the tribunal's eyes, such a burden was not apparent, since the legislative act only affected parts of the investment.<sup>1086</sup> However, such a truncated proportionality analysis seems to omit a number of reasons that would have made the decision more convincing. In particular, it appears problematic that the existence of an excessive burden was denied just because the investment was not destroyed in its totality. Much more interesting than that would have been to review whether: the act was generally suitable to limit corruption; the investor itself was involved in irregularities; the state had considered alternatives to the revocation of licences; or the loss of licences could have been

<sup>1081</sup> *Ibid.*, at para. 342, the tribunal thereby also referred to *CME Czech Republic BV v. Czech Republic* (above fn. 761), at para. 158.

<sup>1082</sup> *BG Group Plc. v. Argentina* (above fn. 450), at para. 343.

<sup>1083</sup> *EDF (Services) Ltd v. Romania* (above fn. 454); on the facts, see paras. 45 et seq.

<sup>1084</sup> *Ibid.*, at para. 293. <sup>1085</sup> *Ibid.*

<sup>1086</sup> The compensation sought in respect of the affected parts amounted to US\$400,000.00, which was not considered an excessive burden in itself and in light of the overall claim amounting to US\$136,576,000.00.

adequately compensated. Unfortunately, the tribunal did not address these questions.

In summary, arbitral case law reveals little consistency with regard to the structure and intensity of review in the context of fair and equitable treatment.<sup>1087</sup> Although a number of arbitral awards employ the notion of proportionality, it seems that it is not yet fully established in arbitral jurisprudence.<sup>1088</sup> This is especially true if one considers a structured proportionality analysis following the steps of suitability, necessity and proportionality *stricto sensu*, being at best rudimentarily applied by arbitral tribunals. Nevertheless, arbitral tribunals seem to recognise, at least implicitly, that all steps of proportionality analysis are relevant for the finding of a breach of fair and equitable treatment. It is indeed of importance whether: a state measure is suitable to pursue a legitimate public purpose; there are less restrictive measures available; and, in a broader balancing, the interests of the investor or those of the host state ultimately prevail. Usually, however, such considerations are not discussed under the concept of proportionality, but are shrouded by other notions, referring to the reasonableness of the state measure, the legitimacy or reasonableness of the investor's expectations or the existence of a reasonable basis for a differential treatment.

All of these notions seek to achieve a minimum of rationality. However, rationality is not achieved by means of circular definitions describing reasonableness through words like just, rational or legitimate and vice versa, but only by means of a justificatory process of reasoning.<sup>1089</sup> The adoption of a certain structure of reasoning would certainly help to increase the rationality and ultimately legitimacy of arbitral decisions.<sup>1090</sup> This is especially because a structured reasoning is forced to reveal more clearly the relevant arguments and thereby makes the argumentation and the particular weight allocation of a tribunal traceable and revisable. Whether such structure will follow the steps of a proportionality analysis or other steps suggested, for instance, in relation to the concept of reasonableness,<sup>1091</sup> is difficult to predict at the present stage and will arguably evolve over time.

<sup>1087</sup> See also Kingsbury and Schill (above fn. 120), pp. 37–38.

<sup>1088</sup> Pro: Schill (above fn. 491), p. 22; McLachlan, Shore and Weininger (above fn. 63), p. 245; and Behrens (above fn. 497), p. 78; contra: Han (above fn. 1072), p. 639.

<sup>1089</sup> See also Woolf, Jowell and Le Sueur (above fn. 677), pp. 559–560.

<sup>1090</sup> Similarly, see Kingsbury and Schill (above fn. 120), p. 40.

<sup>1091</sup> See Corten (above fn. 1061), pp. 621–623, proposing that reasonableness requires procedurally: (1) the provision of an explanation (2) in the form of reasoning that is

## 2 Intensity of review

The following section seeks to outline some remaining questions concerning the intensity of review in determining a breach of fair and equitable treatment. These questions are not necessarily related to specific principles of fair and equitable treatment, but affect the application and legitimacy of fair and equitable treatment in a more general way. Thereby, this section seeks to identify what kind of standard of review is actually applied by arbitral tribunals and to what extent judicial deference appears appropriate. In addition, it discusses the extent to which extraordinary circumstances like financial or economic crises influence the standard of review and the normativity of fair and equitable treatment.

### (a) Variability of the intensity of review

The survey of the cases on proportionality as well as on the other principles of fair and equitable treatment has disclosed the considerable variability of the intensity of review that is applied by arbitral tribunals. Thereby, the intensity of review may vary not only between different awards employing differing approaches towards fair and equitable treatment, but also between the different principles of fair and equitable treatment, as well as between the different steps of reasoning within a decision. The latter is exemplified by the above-mentioned *S.D. Myers* case, in which the tribunal emphasised the high measure of deference in pursuing a certain policy objective, but, at the same time, scrutinised the existence of alternative and less restrictive measures in a stricter way.

Notwithstanding the contradictions in the case law and the virtual absence of explicit discussions about questions related to the intensity of review, some loose trends may be identified. The fact that a number of tribunals accentuate notions like 'policy space', the 'right to regulate' or 'deference in regulatory matters' suggests that, at least with regard to general policy objectives at a legislative or regulatory level, a certain judicial self-restraint exists. This is confirmed by the case law on the investor's expectations, where arbitral tribunals tend to apply a stricter level of scrutiny where the regulatory or administrative commitments of the host state are more concrete. In addition, arbitral tribunals

- (3) capable of inter-subjective understanding, (4) exempt from contradictions and (5) supported by relevant legal authorities; substantively reasonableness demands: (1) a legitimate purpose, (2) a causal link between measure and purpose and (3) proportionality between the measure and the purpose sought.

frequently emphasise the importance of not acting as courts of appeal in relation to the domestic judiciary and thus mainly restrict their review to 'manifest errors' in the administration of domestic justice. Although the intensity of review appears therefore somewhat restricted, especially in sensitive areas of domestic law and policy, many tribunals are by no means reluctant to scrutinise in close detail the factual background or other questions that may arise in the proceedings of a case. In contrast, there are also tribunals furnishing their reasoning with exaggerating adjectives, requesting for instance 'blatant unfairness, complete lack of due process, evident discrimination', or a 'high level of shock'.<sup>1092</sup> Arguably, such language indicates a low intensity of review in relation to the state measures concerned.

However, these hesitant and contradicting trends appear insufficient for the formulation of a general doctrine of margin of appreciation in certain areas of international investment law, as it exists in the jurisprudence of the ECtHR<sup>1093</sup> or as discussed in EU<sup>1094</sup> and WTO law.<sup>1095</sup> Nevertheless, it is at least debatable, and arbitrators and scholars should therefore not evade any discussion on this point, whether and to what extent a margin of appreciation should be accorded in the context of fair and equitable treatment. Obviously, there are questions within the scope of fair and equitable treatment that are answered in fundamentally different ways, not only by the domestic law systems of the participating states, but also by different arbitral tribunals. Although it has been suggested that, generally, an overlapping consensus exists with regard to the principles of fair and equitable treatment, this does not involve such consensus necessarily extending to each of the more detailed questions comprised by these principles. As far as such consensus is not (yet) achieved, should a thinner form of justice<sup>1096</sup> thus apply, demanding judicial deference in relation to certain controversial matters and thereby maintaining a higher degree of legal plurality?

<sup>1092</sup> See, e.g. *Glamis Gold Ltd v. United States* (above fn. 120), at paras. 627 and 829.

<sup>1093</sup> See R. S. J. Macdonald, 'The Margin of Appreciation in the Jurisprudence of the European Court of Human Rights', in Istituto di Diritto Internazionale e della Navigazione (ed.), *Le droit international a l'heure de sa codification* (1987), Vol. III, p. 187; and I. de la Rasilla del Moral, 'The Increasingly Marginal Appreciation of the Margin-of-Appreciation Doctrine', *German LJ* 7 (2006), p. 611.

<sup>1094</sup> In the context of European economic law, see, e.g. Schwarze (above fn. 949).

<sup>1095</sup> See S. P. Croley and J. H. Jackson, 'WTO Dispute Procedures, Standard of Review, and Deference to National Governments', *AJIL* 90 (1996), p. 193; and C.-D. Ehlermann and N. Lockhart, 'Standard of Review in WTO Law', *J. Int'l Econ. L.* 7 (2004), p. 491.

<sup>1096</sup> On 'thick' and 'thin' justice, see Walzer (above fn. 554).

The determination of an appropriate standard of review is a key question in the delimitation of national sovereignty and the scope of international judicial scrutiny, which is faced at least implicitly whenever interpretive powers are yielded to international tribunals.<sup>1097</sup> This question appears to be of particular importance in the application of indefinite general clauses like fair and equitable treatment. Due to their inherent flexibility and capacity to embrace even contradictory tensions that could not be resolved at the stage of norm-generation, general clauses appear especially suitable for leaving a certain margin of appreciation to domestic decision-makers.<sup>1098</sup> Thus, the multi-layered complexity of fair and equitable treatment gives leeway to an appropriate degree of legal pluralism, especially where international tribunals may have limited decision-making capabilities, or where international decision-making would appear illegitimate due to a lack of inter-subjective consensus on the ultimately decisive criteria.<sup>1099</sup> However, this is not to say that an effective international scrutiny of domestic decisions would not be possible or legitimate. In order to be legitimate, a non-intrusive review must equally achieve homogeneity and legal certainty in the application of fair and equitable treatment. It is therefore important that arbitral tribunals clearly indicate where, why and to what extent judicial deference is appropriate and where and why it is not. After the identification of the *topoi* or principles of fair and equitable treatment, the question of the intensity of review marks a next step in the further development of the concept of fair and equitable treatment. On this question, a legal fairness discourse is just beginning.

#### (b) Intensity of review in times of economic crisis

Financial and economic crises are the stress tests of international investment norms and their ability to enshrine stability and change at the same time. Economic crises are recurring phenomena in the world economy putting great pressure on affected domestic governments to respond to hitherto unforeseen challenges. History reveals that policy responses to such crises are often accompanied by looming protectionism threatening, inter alia, the interests of

<sup>1097</sup> See Croley and Jackson (above fn. 1095), p. 211.

<sup>1098</sup> See Y. Shany, 'Toward a General Margin of Appreciation Doctrine in International Law?', *EJIL* 16 (2005), p. 907 at pp. 914–916; and J.-P. Cot, 'Margin of Appreciation', in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law*, 2nd edn (Online Publication) (2009), mn. 13.

<sup>1099</sup> On these and other policy arguments, see Shany (above fn. 1098), pp. 918 et seq.

foreign investors.<sup>1100</sup> Economic emergency measures impairing in some way the business of foreign investors are thus possible targets of investment claims. This is most notably evinced by the Argentine financial crisis of 2001/2002, which triggered a whole wave of investment litigation against Argentina.<sup>1101</sup> At least one further example is provided by the Czech bad debt crisis of the late 1990s, from which the *Sahuka* case arose. In this respect, the global economic crisis, beginning in 2008, entered a new dimension because it affected not one but virtually all states, including major industrialised states in Northern America and Europe. As the large-scale emergency measures of states like Australia, Germany, Switzerland, the United Kingdom and the United States seem to comprise elements of legal and factual discrimination, it appears at least possible that further investment disputes will emerge from these measures.<sup>1102</sup>

In times of economic crisis, states will always call for a low intensity of review and the flexibility to respond timely and effectively to a given situation. Since the international investment law regime is dependent on the continuing acceptance of the participating states, it is most likely that such calls impact on the system itself and that room for flexibility is created in one way or another.<sup>1103</sup> This is especially true for crises affecting all and not only one or a few individual states like Argentina or the Czech Republic, where a quite strict standard of review was applied. Arguably, such flexibility is achieved primarily by invoking treaty internal defences like so-called non-precluded measures clauses (NPM clauses) and exceptions for certain public policy measures, or by

<sup>1100</sup> On the history of financial crises, see, e.g. C. P. Kindleberger and R. Z. Aliber, *Manias, Panics, and Crashes*, 5th edn (2005).

<sup>1101</sup> As a consequence of the crisis, Argentina faced more than forty and partly still pending claims of foreign investors: see E. Kentin, 'Economic Crisis and Investment Arbitration', in P. Kahn and T. W. Wälde (eds.), *Les aspects nouveaux du droit des investissements internationaux – New Aspects of International Investment Law* (2007), p. 629; and W. W. Burke-White, 'The Argentine Financial Crisis', in M. Waibel et al. (eds.), *The Backlash Against Investment Arbitration* (2010), p. 407; see also the references provided in fn. 297 above.

<sup>1102</sup> See A. van Aaken and J. Kurtz, 'The Global Financial Crisis and International Economic Law', *University of St Gallen Law and Economics Working Paper* (2009), No. 4, analysing in detail the emergency measures of the mentioned states; see also UNCTAD, *Recent Developments in International Investment Agreements* (2008–June 2009), UNCTAD/WEB/DIAE/IA/2009/8, IIA Monitor, No. 3 (2009), pp. 10 et seq.

<sup>1103</sup> From the perspective of contract theory, see A. van Aaken, 'International Investment Law Between Commitment and Flexibility', *J. Int'l Econ. L.* 12 (2009), p. 507 at pp. 522 et seq.

relying on external defences of customary international law like necessity.<sup>1104</sup> However, these defences are not part of the present analysis because they are to be considered separate from, and are often not applicable to, fair and equitable treatment.<sup>1105</sup>

A further way to achieve flexibility touches the normativity of particular treaty obligations more deeply. This method takes into account the general clause character and the inter-systemic connectedness of international investment norms and adopts a flexible concept of fair and equitable treatment by lowering the intensity of review.<sup>1106</sup> However, the legitimacy of fair and equitable treatment is not only about flexibility, but requires stability and change at the same time. If investment treaty obligations are to represent a bulwark against unreasonable protectionism, extraordinary times should not give rise to insipid constructions depriving standards like fair and equitable treatment of their normativity and force. Thereby, the importance of stability is not only based on the awareness that extraordinary times are usually followed by normal times; it also helps to avoid the impression that a crisis of economically advanced states requires flexibility, whereas a crisis of weaker states does not. Thus, in times of economic crisis, just like at any other time, the challenge in applying fair and equitable treatment lies in finding an appropriate standard of review which grants sufficient flexibility, but at the same ensures the stability and predictability of the system.<sup>1107</sup>

### 3 Rationality deficits

Ultimately, it is time to question whether the described model of balancing principles of fair and equitable treatment within a fairness discourse between the poles of stability and change keeps its promise

<sup>1104</sup> On NPM clauses, see in detail Burke-White and von Staden (above fn. 141).

<sup>1105</sup> The latter is at least true for treaty internal defences the scope of which varies considerably from treaty to treaty and the applicability of which is further limited by MFN clauses. See also *ibid.*, p. 331, observing that only US, Indian and Canadian NPM clauses apply to the treaty as a whole (including fair and equitable treatment), while other BITs limit the scope of such clauses to particular standards of treatment (mostly excluding fair and equitable treatment).

<sup>1106</sup> See also *National Grid Plc. v. Argentina* (above fn. 133), at para. 180, advancing: 'What is fair and equitable is not an absolute parameter. What would be unfair and inequitable in normal circumstances may not be so in a situation of an economic and social crisis.' The importance of flexibility is furthermore highlighted by van Aaken (above fn. 1103), pp. 527 et seq.

<sup>1107</sup> See also UNCTAD (above fn. 1102), p. 11.

to represent a more or less rational and convincing way of justifying particular decisions. This involves the identification of bias and remaining rationality deficits pertaining to the system of legal adjudication in international investment law and their possible impact on the application and overall legitimacy of fair and equitable treatment. Thereby, two lines of critique in particular will be discussed. While one line of critique emphasises the existence of bias in the particular system of investment treaty arbitration, the other line questions the objectivity and rationality of international legal adjudication at a more general level.

#### (a) Structural bias in investment treaty arbitration

The first line of critique is particularly expressed by Van Harten, who emphasises the existence of perceived bias and constructional flaws in the system of investment arbitration that are due to a fundamental misconception of the system's public law character.<sup>1108</sup> He argues that investment arbitration represents a unique system which extends far into the regulatory sphere of states involving disputes between states and individuals that are best analogised to public law relationships in the domestic sphere rather than to reciprocal commercial relationships between two equal private parties.<sup>1109</sup> According to Van Harten, the combination of the public law character of the questions arising in investment disputes and the private law character of the adjudicatory system of investment law deriving mainly from commercial arbitration creates an uneasy liaison that does not meet the expected standards of judicial accountability, openness, coherence and independence.<sup>1110</sup> This is supposed to be due to the fact that the system virtually precludes a review of arbitral awards for errors of law, is based on the ideas of confidentiality constricting public access to information, invites inconsistent decisions and forum-shopping and is mostly determined by a limited group of arbitrators who lack judicial independence.<sup>1111</sup>

As a consequence, Van Harten claims that the mainly privatised system of investment arbitration is itself deeply flawed and that it structurally favours the interests of capital-exporting countries and foreign investors.<sup>1112</sup> The structural bias is said to be independent of the uncontested personal expertise and reputation of individual arbitrators.<sup>1113</sup> Rather, these shortcomings pertain to the system itself and

<sup>1108</sup> Van Harten (above fn. 62). <sup>1109</sup> See *ibid.*, pp. 70-71.

<sup>1110</sup> See *ibid.*, especially pp. 153 et seq. <sup>1111</sup> *Ibid.* <sup>1112</sup> See *ibid.*, pp. 95 et seq.

<sup>1113</sup> *Ibid.*, p. 175.

make an institutional reform of the system necessary. Van Harten therefore proposes the establishment of a public international investment court<sup>1114</sup> staffed by state-appointed judges and a restrictive interpretation of investment protection standards *in dubio mitius* and in line with common principles of domestic administrative law.<sup>1115</sup>

The presented concept of fair and equitable treatment has much in common with this critique. When considering the principles of fair and equitable treatment as outlined above, it is obvious that they are filled with vocabulary stemming from public law. Even though upholding the traditional dichotomy between public and private international law ultimately appears of little use in international investment law,<sup>1116</sup> the relevance of public law ideas for the construction of international investment law is equally acknowledged. While Van Harten focuses on an institutional reform of the system,<sup>1117</sup> the present approach has attempted to develop a doctrinal concept of fair and equitable treatment that is also informed by administrative and constitutional law theory. Thereby, it is suggested that this doctrinal approach complements Van Harten's critique by providing, in addition to his institutional prerequisites, substantive legal criteria to achieve balanced decisions. However, it is important to add that a balanced approach in this sense does not imply – as Van Harten's critique seems to insinuate at times – an about-turn creating structural bias in favour of host states. Accordingly, the question is again how to find the right balance between investment protection and regulatory freedom. This question can only be answered if all principles of fair and equitable treatment are generally accepted as being equivalent without any automatic trumping entitlement in favour of one or the other side.

<sup>1114</sup> See *ibid.*, pp. 180 et seq.

<sup>1115</sup> *Ibid.*, pp. 143 et seq.; see also Van Harten and Loughlin (above fn. 503).

<sup>1116</sup> See Douglas (above fn. 135), pp. 6 et seq.

<sup>1117</sup> The need and feasibility of institutional reforms, especially the introduction of an appellate system, are also discussed by others: see, e.g. ICSID, *Possible Improvements of the Framework for ICSID Arbitration* (2004); Franck (above fn. 369), pp. 1606–1610; J. Kalb, 'Creating an ICSID Appellate Body', *UCLA J. Int'l L. & Foreign Aff.* 10 (2005), p. 179; J. Crawford, 'Is There a Need for an Appellate System?', in F. Ortino *et al.* (eds.), *Investment Treaty Law* (2006), Vol. 1, p. 15; C. J. Tams, 'Is There a Need for an ICSID Appellate Structure?', in R. Hofmann and C. Tams (eds.), *The International Convention on the Settlement of Investment Disputes (ICSID)* (2007), p. 223; and A. H. Qureshi, 'An Appellate System in International Investment Arbitration?', in P. Muchlinski *et al.* (eds.), *The Oxford Handbook of International Investment Law* (2008), p. 1154.

Another question is whether the system is so flawed that it is unable to produce legitimate decisions at all. However, such a far-reaching conclusion is neither drawn by Van Harten, nor is it supported by empirical data.<sup>1118</sup> Nevertheless, it appears undisputed that questions of judicial accountability, openness, coherence and independence are of the utmost importance for the legitimacy of the system of investment arbitration. In particular, the openness of the system, including both access to awards and institutional data in the broadest sense as well as the clarity of awards in relation to the true reasons of a particular decision, is essential for a discourse in the described sense, simply because a meaningful discourse is only possible if the information necessary to comprehend and discuss the system of investment arbitration and its awards is available. However, even if institutional reforms addressing the perceived bias may be achieved in future, it remains questionable to what extent rational balancing and decision-making are possible at all.

#### (b) Rationality of balancing and legal politics

The process of balancing inherent in the concept of fair and equitable treatment may also be viewed from a perspective that questions the objectivity of balancing and judicial decision-making as a matter of principle. In this respect, critical voices emphasise the inherently political nature of international law and claim its objectivity to be nothing more than an illusion.<sup>1119</sup> As a distinguished representative of those voices, Koskenniemi has claimed: 'There is no space in international law that would be "free" from decisionism, no aspect of the legal craft that would not involve a "choice" – that would not be in a sense, a *politics of international law*.'<sup>1120</sup> This claim is based on the consideration that international law is necessarily indeterminate and that it is impossible to concretise the meaning of a norm of international law in an objective way:

The idea that law can provide objective resolutions to actual disputes is premised on the assumption that legal concepts have a meaning which is present in them in some intrinsic way, that at least their core meanings can be verified in an objective fashion. But modern linguistics has taught us that concepts do not

<sup>1118</sup> On the latter, see Franck (above fn. 69).

<sup>1119</sup> See M. Koskenniemi, 'The Politics of International Law', *EJIL* 1 (1990), p. 4; and D. Kennedy, *A Critique of Adjudication* (1997).

<sup>1120</sup> Koskenniemi (above fn. 466), p. 596.

have such natural meanings. In one way or other, meanings are determined by the conceptual scheme in which the concept appears.<sup>1121</sup>

However, according to Koskenniemi, any conceptual scheme and argument to concretise the meaning of an international norm is ultimately contradictory and thus unconvincing. Either a norm is concretised by reference to state behaviour, in which case the norm lacks normativity and merely represents an apology for a presumably opportunistic state behaviour, or the norm's content is derived from some sense of natural justice exposing the norm to the attack of being utopian.<sup>1122</sup>

Being a general clause of particularly indeterminate character, fair and equitable treatment is necessarily affected by this critique. This is because the *topoi* or principles concretising fair and equitable treatment, on the one hand, are perceived as aspects of fairness and justice, whereas, on the other hand, justice is said to be based on an overlapping consensus of states. Thus, in the usual debate concerning fair and equitable treatment, the content of the norm is construed in order to do justice to damaged foreign investors as well as to justify the behaviour of states. This dichotomy is best displayed by the dissatisfying discussion games in favour of or against the equation of fair and equitable treatment and the minimum standard, attempting to pinpoint a level of protection either as high or low as possible. In a similar way, the described dichotomy is inherent in Franck's theory and thereby described by the tension between stability and change, legitimacy and equity. The image of the fairness discourse, in which the arguments derived from the different principles of fair and equitable treatment are balanced, aims at reconciling this dichotomy by achieving systemically coherent decisions somewhere in between the extreme poles. However, Koskenniemi maintains that any attempt of reconciliation is ultimately impossible as it avoids only provisionally falling into the trap of being either 'apologist' or 'utopian'.<sup>1123</sup>

In relation to the relatively fragmented state of international law,<sup>1124</sup> the argument on the inherent indeterminacy and political nature of international law is combined with a presumption that every institutional scheme or sub-system of international law is accompanied by a structural bias of, at least de facto, preferring some outcomes or choices

<sup>1121</sup> Ibid., p. 503; see also pp. 36 et seq.

<sup>1122</sup> See *ibid.*, pp. 17 et seq.; similarly, D. Kennedy, *International Legal Structures* (1987).

<sup>1123</sup> See Koskenniemi (above fn. 466), pp. 52 et seq. and 63–65.

<sup>1124</sup> Thereon, see Chapter 4, section A, 'Fragmentation and international investment law'.

to others.<sup>1125</sup> It is submitted that every sub-system of international law represents a relatively closed box within which rules, principles, precedents and methods of balancing are arranged in such a way that certain outcomes appear methodologically privileged and seem to flow directly from the relevant legal material.<sup>1126</sup> This argument, again, suggests that the system of international investment law mainly employs the language of investment protection and leaves little room for other voices. It has already been discussed that this is indeed a valid and crucial point which increasingly exposes the system to criticism such as the one expressed by Van Harten. Although the empirical basis of such criticism is contentious, it appears even more important not to close fully the 'international investment box', but to recognise the possibilities of systemically integrating arguments from other boxes into the discourse on fair and equitable treatment.<sup>1127</sup>

After all, one might be tempted to conclude that the critique concerning the indeterminacy and the susceptibility to political instrumentalisation renders fair and equitable treatment 'singularly useless as a means for justifying or criticising international behaviour'.<sup>1128</sup> It is, of course, disputable whether the mentioned points necessarily involve such a far-reaching and sceptical conclusion.<sup>1129</sup> Nevertheless, the critique clearly demonstrates the threats and pitfalls of the actual legal discourse on fair and equitable treatment, which is interfused with political projects and ideological arguments in disguise.<sup>1130</sup> Since fair and equitable treatment does not encapsulate an intrinsic meaning or justice waiting for discovery, it is even more important to display clearly the arguments and correspondent background politics being adduced to justify a particular decision. If the ensuing balancing of those arguments is not fully rational or objective, this only reveals that the legal discourse, searching for the best reasons, also involves a political quest

<sup>1125</sup> See Kennedy (above fn. 1119), pp. 59–60; M. Koskenniemi and P. Leino, 'Fragmentation of International Law?', *Leiden J. Int'l L.* 15 (2002), p. 553 at p. 578; and Koskenniemi (above fn. 466), pp. 606–607.

<sup>1126</sup> Koskenniemi (above fn. 466), pp. 608–610.

<sup>1127</sup> See Chapter 4, section C, 'Systemic integration of international law arguments'.

<sup>1128</sup> Koskenniemi (above fn. 466), p. 67.

<sup>1129</sup> This is, e.g. denied by J. von Bernstorff, 'Sisyphus was an International Lawyer', *German L.J.* 7 (2006), p. 1015 at p. 1023; see also E. Voyiakis, 'International Law and the Objectivity of Value', *Leiden J. Int'l L.* 22 (2009), p. 51.

<sup>1130</sup> The extremes of the variety of ideological positions have been outlined in Chapter 2, section B, '1(a) Underlying ideologies'.

for the best concepts and arguments.<sup>1131</sup> Thus, fair and equitable treatment does not yet represent an embodiment of justice, but rather symbolises an 'expectation of justice'<sup>1132</sup> and it is questionable whether this is ever fully attained.

#### D Conclusion: principled fairness

In conclusion, any attempt to describe the concept and substance of fair and equitable treatment poses an enduring challenge. Scholars and arbitral jurisprudence struggling with this provision have often addressed the challenge by advancing overly simplistic conceptions. However, attempts to draw justificatory arguments from only freely adopted shorthand definitions or a nebulous minimum standard are deficient elements in the process of establishing a legitimate conceptual foundation of fair and equitable treatment. This is especially because such simplistic approaches tend to favour, in an unbalanced way, either stability or change and are therefore particularly vulnerable to the critique of the opposite side. Certainly, simplified conceptions are sometimes necessary in order to be able to decide a case in light of limited time and resources. Nevertheless, the widely accepted rationale of justice underlying fair and equitable treatment requires a discursive process of reconciliation of the opposing aspects of stability and change. As the challenge of balancing stability and change in matters of foreign investment is much older than the investment treaty regime, it is unsurprising that the establishment of an open-textured guarantee of fair and equitable treatment does not mark the end, but rather a new beginning of a fairness discourse in the investor-state relationship.

This discourse is gaining growing momentum in relation to fair and equitable treatment and addresses questions related to the concretisation and legitimacy of this international obligation. Within this discourse, certain patterns of argumentation have emerged as the main justificatory basis of arbitral decisions on fair and equitable treatment. In this sense, the concept of fair and equitable treatment is increasingly constructed as a carpet of interwoven principles which are to be balanced against each other. These principles give fair and equitable

treatment a multi-faceted appearance, enriched by a great variety of legal ideas originating from a number of fields of international law, in particular, the law of state responsibility, WTO law, global administrative law, human rights law and international environmental law. Most of these principles are firmly established in various contexts of international law and to such an extent provide a suitable justificatory foundation for decisions on fair and equitable treatment.

Nevertheless, further discourse is needed as to whether the principled concept of fair and equitable treatment is already complete or whether there are other principles that need to be taken into account. Moreover, the further concretisation of each principle still causes great problems. In particular, the relative weight of each argument derived from a principle is often uncertain and requires a more comprehensive and intensive process of reasoning. As long as such reasons are not delivered and openly displayed in arbitral awards, it is to be assumed that perceived legitimacy deficits of international investment law and contradicting strands of arbitral jurisprudence will persist. Arguably, many of these problems result from the fact that questions as to the structure, intensity and rationality of the review have been mainly disregarded thus far. The latter is true despite the fact that there are many doctrinal models available in international legal methodology that could be adapted to the system of international investment law.

However, irrespective of which approach is ultimately going to prevail, the principled concept of fair and equitable treatment is due to consolidate along the lines of the augmenting body of arbitral jurisprudence. Thereby, the image of the fairness discourse, balancing the tensions between principles of stability and change, provides for arguments to accompany - benevolently or critically - the ongoing development of fair and equitable treatment. Even if such a process may not deliver concrete and predetermined answers to every question, it certainly contributes to the identification and possible mitigation of perceived legitimacy deficits of the concept of fair and equitable treatment.

<sup>1131</sup> On the political issues involved in the international investment process, see also P. Muchlinski, 'Policy Issues', in P. Muchlinski *et al.* (eds.), *The Oxford Handbook of International Investment Law* (2008), p. 3.

<sup>1132</sup> See M. Koskeniemi, 'What is International Law for?', in M. D. Evans (ed.), *International Law* (2003), p. 89 at p. 111.

PART III

The position of fair and equitable  
treatment in the international  
legal system



## 8 Fair and equitable treatment in the system of international law sources

### A The categorisation of fair and equitable treatment

While the previous chapters tried to map out a possible way to construct a concept for fair and equitable treatment, this part seeks to embed this concept into the wider context of the international legal system. Thereby, the insights gathered earlier are necessary to embed fair and equitable treatment and gain a more comprehensive picture of this norm and its legal context. Before considering fair and equitable treatment in relation to the system of international investment protection standards and the overarching system of international economic law, the position of fair and equitable treatment in the system of international law sources will first be examined.

The three main sources of international law – treaties, custom and general principles of law – are most authoritatively described in Article 38(1) of the ICJ Statute, which provides:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply

- (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
- (b) international custom, as evidence of a general practice accepted as law;
- (c) the general principles of law recognized by civilized nations . . .<sup>1133</sup>

Based on the present concept of fair and equitable treatment, the analysis of its legal character will embrace the norm itself as well as the previously described principles connected to fair and equitable treatment.

<sup>1133</sup> Thereon generally, see, e.g. A. Pellet, 'Article 38', in A. Zimmermann *et al.* (eds.), *The Statute of the International Court of Justice* (2006), p. 677; and Graf Vitzthum (above fn. 129), pp. 56 *et seq.*

Thereby, the classification of fair and equitable treatment into one of the categories of international law sources appears far more demanding than one might expect at first glance.

### 1 *Fair and equitable treatment as a purely conventional norm?*

The construction and concept of fair and equitable treatment as outlined in the foregoing chapters was based on the assumption that it represented a conventional norm. This assumption is certainly justified in light of the multitudinous international investment agreements in force that actually incorporate a clause guaranteeing fair and equitable treatment to foreign investors.<sup>1134</sup> However, as the above-mentioned dynamic concept of fair and equitable treatment indicates, it is difficult to reduce fair and equitable treatment to a norm that stands exclusively on a conventional basis. Moreover, it could be questioned whether fair and equitable treatment really depicts a conventional norm, or rather a mere reflection of customary international law, or even something else like a general principle of law. The misguided controversy on the relation between fair and equitable treatment and the customary international minimum standard, in particular, has greatly obscured the classification of fair and equitable treatment within the system of international law sources.

The correlation between treaty norms and customary international law is complex and a topic of extensive scholarly writing.<sup>1135</sup> Basically, three different forms of interaction between treaty norms and customary international law may be distinguished:<sup>1136</sup> first, the conventional text may merely restate a pre-existing rule of customary law; second, the adoption of a treaty norm may catalyse the emergence of a customary rule *in statu nascendi*; or third, a treaty may create new rules that, in due course, themselves become accepted as customary law. All of these forms of interaction deserve closer attention in the context of fair and equitable treatment. To begin with, the question of whether a treaty

<sup>1134</sup> See the review of common fair and equitable treatment clauses in Chapter 2, section A, '3 Legally binding references to fair and equitable treatment'.

<sup>1135</sup> See especially R. R. Baxter, 'Treaties and Custom', RdC 129 (1970 I), p. 25; A. D'Amato, *The Concept of Custom in International Law* (1971), pp. 103-166; H. W. A. Thirlway, *International Customary Law and Codification* (1972); M. E. Villiger, *Customary International Law and Treaties* (1985); O. Schachter, 'Entangled Treaty and Custom', in Y. Dinstein (ed.), *International Law at a Time of Perplexity* (1989), p. 717; and more recently Pellet (above fn. 1133), mnn. 282 et seq.

<sup>1136</sup> See E. Jiménez de Aréchaga, 'The Work and the Jurisprudence of the International Court of Justice 1947-1986', BYIL 58 (1987), p. 1 at pp. 32-33; and Schachter (above fn. 1135), p. 718.

norm stipulating fair and equitable treatment itself can be characterised as a proper source of law<sup>1137</sup> focuses on the first two forms of interaction between treaty and custom.

The approach advocating an equation of fair and equitable treatment with the international minimum standard of customary law<sup>1138</sup> implies an understanding of fair and equitable treatment as being only reflective of customary law. The same understanding is inherent in the assertions of arbitral panels and scholars claiming that the classical minimum standard has evolved over time and that fair and equitable treatment is restating this evolved standard. On the contrary, the so-called plain meaning approach, by emphasising the self-contained nature of fair and equitable treatment, suggests that this norm has an existence independent of other sources of law so that it is different in substance from other sources such as the minimum standard.

The different approaches as regards fair and equitable treatment illustrate the diverse intentions that states commonly have when entering into a treaty. On the one hand, states may wish to reaffirm the existence of a customary rule or to declare more clearly, on a conventional basis, what a presumably existing but somewhat vague customary rule means.<sup>1139</sup> On the other hand, states may wish to stipulate a new norm in a conventional text because they think that such a norm is not yet existent in general international law or because they want to depart deliberately from a customary rule which they do not consider appropriate for the interrelationship of the parties to the agreement.<sup>1140</sup> Treaties thus have a twofold function for states: they either declare or support a rule of general international law, or they deviate or specify a rule *inter partes*.

In the case of the protection of foreign investments, arguably all of these considerations were conducive to the emergence of an investment treaty regime.<sup>1141</sup> Many states felt that an international minimum standard - whatever concrete contours it had - existed, but also that it had been challenged every now and again. Due to the failure to establish a multilateral framework for foreign investments, states pursued the reaffirmation and clarification of the legal status of foreign investments

<sup>1137</sup> See, e.g. Dahm, Delbrück and Wolfrum (above fn. 637), p. 51, considering treaties reflective of customary law as merely declaratory and not as a proper source of new law.

<sup>1138</sup> See Chapter 3, 'Fair and equitable treatment and the international minimum standard'.

<sup>1139</sup> See D'Amato (above fn. 1135), p. 104.

<sup>1140</sup> See K. Doehring, 'Gewohnheitsrecht aus Verträgen', ZaöRV 36 (1976), p. 77 at p. 78.

<sup>1141</sup> On the proliferation of BITs, see also Chapter 2, section B, '1(b) The proliferation of international investment agreements'.

through the conclusion of bilateral treaties. In this way, states tried to overcome the uncertainty pertaining to the customary law in this field and to establish a firmer set of rules that applied at least *inter partes*. To assume, therefore, that fair and equitable treatment is merely declaratory of customary law would require proof that the international minimum standard actually existed and that fair and equitable treatment restated this standard (or parts of it). Both questions have not been ultimately resolved with regard to the classical version of the minimum standard.<sup>1142</sup>

However, there are manifold assertions from arbitral tribunals that an evolved version of that minimum standard exists which is considered largely equivalent to fair and equitable treatment as a treaty standard.<sup>1143</sup> But beyond these assertions, it remains relatively unclear as to what extent this body of customary rules has evolved and how this process of evolution has taken place. Some arbitral tribunals have at least indicated that the content of the evolved minimum standard is shaped by the conclusion of more than 2,000 BITs incorporating a fair and equitable treatment provision.<sup>1144</sup> Consequently, the treaty standard of fair and equitable treatment, as stipulated in the BIT network, would provide the necessary state practice for the formation of a standard of customary law, whereas the treaty standard is said to reflect the customary standard. The circularity of this argument is obvious; it would entail that fair and equitable treatment is ultimately reflective of itself. Regardless of whether one thinks of fair and equitable treatment as restating pre-existing customary international law or as contributing to the crystallisation of an emerging customary norm, it appears impossible for these approaches to escape from the described circularity.

An understanding of fair and equitable treatment as a norm that is merely declaratory of customary law encounters further difficulties. Such difficulties lie in the somewhat utopian assumption that a treaty provision may be wholly and merely declaratory of pre-existing or emerging customary law.<sup>1145</sup> This is because any effort to codify a customary rule necessarily involves a political momentum to improve, supplement or reformulate the rule in light of contemporary conditions.<sup>1146</sup>

<sup>1142</sup> See Chapter 3, section A, '1 The international minimum standard'.

<sup>1143</sup> See the cases in Chapter 3, section C, '1 The controversy in non-NAFTA jurisprudence'.

<sup>1144</sup> See, e.g. *Mondev International Ltd v. United States* (above fn. 100), at para. 125.

<sup>1145</sup> See Schachter (above fn. 1135), p. 721; and similarly Baxter (above fn. 1135), p. 42.

<sup>1146</sup> M. Virally, 'The Sources of International Law', in M. Sørensen (ed.), *Manual of Public International Law* (1968), p. 116 at p. 142.

It is thus unlikely that the express stipulation of fair and equitable treatment in investment agreements has not caused any alteration of the legal obligations of states that are parties to such agreements in relation to foreign investors. Moreover, even assuming that fair and equitable treatment and the international minimum standard - evolved or not - are identical in content, this does not imply that both norms are one and the same.<sup>1147</sup> The separate existence of two such norms has been determined by the ICJ in the *Nicaragua* case:

[E]ven if two norms belonging to two sources of international law appear identical in content, and even if the states in question are bound by these rules both on the level of treaty-law and on that of customary international law, these norms retain a separate existence.<sup>1148</sup>

The separate sources, from which fair and equitable treatment and the customary minimum standard flow, are also practically relevant in the sense that each norm may be governed by different methods of interpretation and application.<sup>1149</sup> Irrespective of the existence and concrete shape of the (evolved) international minimum standard, fair and equitable treatment therefore represents a conventional norm, although not necessarily disconnected from customary law.

## 2 *Fair and equitable treatment as a norm of customary law?*

The third form of interaction between treaty and custom relates to the question of whether the treaty standard of fair and equitable treatment, due to its widespread acceptance, has generated customary international law. Provided that states are not already bound by the evolved minimum standard as a customary norm similar to fair and equitable treatment, the latter question would entail that states are obliged to treat foreign investors fairly and equitably even though they have not consented or actually refused to enter into an investment agreement incorporating such provision.<sup>1150</sup> The issue of fair and equitable treatment generating customary law is, of course, to some extent connected

<sup>1147</sup> See Pellet (above fn. 1133), mn. 287; and Shaw (above fn. 125), pp. 96-97.

<sup>1148</sup> *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. USA)* (above fn. 376), at p. 95, para. 178.

<sup>1149</sup> See *ibid.*; see also Jennings and Watts (above fn. 124), pp. 35-36.

<sup>1150</sup> See R. R. Baxter, 'Multilateral Treaties as Evidence of Customary International Law', *BYIL* 41 (1965-66), p. 275 at p. 300. This is, of course, only true for states that are not qualified as persistent objectors to the norm in question; on the latter, see, e.g. M. Akehurst, 'Custom as a Source of International Law', *BYIL* 47 (1974-75), p. 1 at pp. 23-27; and Graf Vitzthum (above fn. 129), p. 68.

to the prior enquiry that fair and equitable treatment may have catalysed the evolution of the international minimum standard. However, it exceeds that enquiry because fair and equitable treatment could also have spawned new customary law reaching beyond the international minimum standard.

The posed question implies the more general problem of whether and under what circumstances the generation of new customary international law occurs through the conclusion of treaties. Although an in-depth discussion of this problem is beyond the scope of the present analysis, it is alleged in the following that such a generation process is possible.<sup>1151</sup> As a matter of principle, the ICJ has also recognised that a treaty provision may form the basis for the origination of a customary norm,<sup>1152</sup> at least when a norm-creating or general provision is concerned.<sup>1153</sup> Notwithstanding all the controversy in the detail, it is admitted that the generation of new customary international law via written rules is part of the general theory of customary international law.<sup>1154</sup> Hence, the fundamental requirements of state practice (*consuetudo*) and a sense of legal obligation (*opinio juris*) must not be overlooked.<sup>1155</sup> While the general and law-making character that contributes to the formation of customary law is mainly attributed to provisions contained in multilateral agreements, it is acknowledged that bilateral treaties may also provide evidence of new customary law.<sup>1156</sup> Such evidence may result from a series of bilateral treaties containing similar clauses. On the multilateral as well as on the bilateral level, it is, however, quite commonly accepted that further requirements than the mere identification of the great number of treaties concluded are to be met in the generation process of new customary international law.<sup>1157</sup>

<sup>1151</sup> This is well accepted in scholarly literature: see Baxter (above fn. 1135), pp. 57 et seq.; D'Amato (above fn. 1135), p. 104; Doehring (above fn. 1140), p. 82; Villiger (above fn. 1135), pp. 197–198; and Shaw (above fn. 125), p. 96.

<sup>1152</sup> *North Sea Continental Shelf Cases (Federal Republic of Germany v. Denmark; Federal Republic of Germany v. Netherlands)* (above fn. 509), at 41, para. 71. The court observed: 'There is no doubt that this process is a perfectly possible one and does from time to time occur: it constitutes indeed one of the recognised methods by which new rules of customary international law may be formed. At the same time this result is not lightly to be regarded as having been attained.'

<sup>1153</sup> On the norm-creating element, see, e.g. Shaw (above fn. 125), pp. 94–96; on generality, see, e.g. D'Amato (above fn. 1135), pp. 105 et seq.

<sup>1154</sup> Baxter (above fn. 1135), p. 73; and Villiger (above fn. 1135), p. 193.

<sup>1155</sup> See generally Graf Vitzthum (above fn. 129), pp. 67 et seq.

<sup>1156</sup> See, e.g. Baxter (above fn. 1135), pp. 75 et seq.; and Shaw (above fn. 125), pp. 97–98.

<sup>1157</sup> See Doehring (above fn. 1140), pp. 92–93.

The influence of investment agreements and, in particular, of fair and equitable treatment on customary international law has received considerable attention.<sup>1158</sup> The search for a sufficient state practice and an *opinio juris* usually starts with an analysis of multilateral investment agreements stipulating fair and equitable treatment. While quite a number of such agreements exists,<sup>1159</sup> it has, however, been pointed out that these agreements either failed to enter into force or have been restricted to certain regions or sectors.<sup>1160</sup> Similarly, the stipulations of fair and equitable treatment in non-binding multilateral agreements or the statements of states in the negotiation of such agreements appear insufficient in order to justify the generation of a new customary norm.<sup>1161</sup> Taken together, the experience of the negotiation of multilateral investment agreements rather exhibits the persistent frictions and conflicts in the field of investment protection than a uniform practice of states that is accepted as law.

Surprisingly enough, such frictions appear absent in the process of concluding BITs.<sup>1162</sup> At first glance, due to the almost uniform presence of fair and equitable treatment in the dense network of BITs, there seems to be at least some evidence that new customary international law may have been created. It is indeed widely assumed that the proliferation of almost identical BITs is evidence of a valuable state practice that has influenced customary law.<sup>1163</sup> However, since express stipulations of

<sup>1158</sup> For a selection, see generally B. Kishoiyian, 'The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law', *Nw. J. Int'l L. & Bus.* 14 (1994), p. 327; Lowenfeld (above fn. 55); S. M. Schwebel, 'The Influence of Bilateral Investment Treaties on Customary International Law', *ASIL Proc.* 98 (2004), p. 27; S. Hindelang, 'Bilateral Investment Treaties, Custom and a Healthy Investment Climate', *JWIT* 5 (2004), p. 789, providing a list of further references in fn. 55; Sornarajah (above fn. 3), pp. 205–208; Wälde (above fn. 54), pp. 96 et seq.; Shaw (above fn. 125), p. 838; and J. Griebel, *Internationales Investitionsrecht* (2008), pp. 109–111; on fair and equitable treatment, see Vasciannie (above fn. 2), pp. 153 et seq.; Klein Bronfman (above fn. 2), pp. 670–672; Orakhelashvili (above fn. 2), pp. 76 et seq.; and Tudor (above fn. 2), pp. 54 et seq.

<sup>1159</sup> See Chapter 2, section A, 'Conventional basis of fair and equitable treatment'.

<sup>1160</sup> See Vasciannie (above fn. 2), pp. 153–156. <sup>1161</sup> Klein Bronfman (above fn. 2), p. 671.

<sup>1162</sup> Lowenfeld (above fn. 55), p. 123, consequently raised the question, 'why is it that multilateral agreements concerning international investment or multinational enterprises are impossible to achieve, while bilateral investment agreements multiply like fruit flies?'

<sup>1163</sup> See Mann (above fn. 47), p. 249; Kishoiyian (above fn. 1158), p. 374; Lowenfeld (above fn. 55), pp. 129–130; Schwebel (above fn. 1158), pp. 19–30; Hindelang (above fn. 1158), p. 808; and Salacuse and Sullivan (above fn. 57), pp. 114–115; explicitly on fair and equitable treatment, see Tudor (above fn. 2), pp. 83–85; and *Merrill & Ring Forestry L.P. v. Canada* (above fn. 326), at para. 211.

a pertinent *opinio juris* are rare, it appears much more difficult to determine whether states actually accepted fair and equitable treatment as a binding legal obligation of general international law. To overcome this difficulty, different possibilities have been suggested. At first, one could be inclined to consider the conclusion of BITs as well as a statement of *opinio juris*, or even try to abolish the requirement of an *opinio juris* in total.<sup>1164</sup> It has furthermore been argued that the generation of customary international law has to conform to a fundamental interest of states.<sup>1165</sup> Due to a reduced emphasis on sovereignty in more recent times and due to the surmise that a customary regime of investment protection derived from BITs only provides gains, such fundamental interest of states is said to exist.<sup>1166</sup> Finally, it is also proposed that the process of generating customary international law through the conclusion of BITs is breaking new ground and that 'perhaps the traditional definition of customary law is wrong, or at least in this area, incomplete'.<sup>1167</sup>

In contrast, other authors deny that BIT provisions such as fair and equitable treatment have achieved a customary status to date, mainly because the existence of an *opinio juris* has not yet been convincingly demonstrated.<sup>1168</sup> Further arguments against the general applicability of fair and equitable treatment are that BITs were, at least initially, considered as *leges speciales* and that the BIT process was mainly spurred and shaped by developed countries possessing a superior bargaining power.<sup>1169</sup> Additionally, other conventional norms like most-favoured-nation or national treatment clauses are often referred to, which despite their long tradition and widespread acceptance are generally not deemed to be part of customary law.<sup>1170</sup>

In summing up the discussion, it appears that both sides make valuable points. Nevertheless, each position is still, at least to some extent, affected by the ideological conflicts which have permeated the discussions on the normative status of investment rules for a

<sup>1164</sup> In this direction, see D'Amato (above fn. 1135), p. 104; critically Doehring (above fn. 1140), p. 81; and Shaw (above fn. 125), p. 96.

<sup>1165</sup> Doehring (above fn. 1140), p. 93. <sup>1166</sup> Hindelang (above fn. 1158), pp. 797 and 809.

<sup>1167</sup> Lowenfeld (above fn. 55), p. 130.

<sup>1168</sup> See Vasciannie (above fn. 2), p. 160; Sornarajah (above fn. 3), p. 206; Klein Bronfman (above fn. 2), p. 670; Griebel (above fn. 1158), p. 670; and Orakhelashvili (above fn. 2), p. 77.

<sup>1169</sup> See Vasciannie (above fn. 2), pp. 158-159; and Sornarajah (above fn. 3), pp. 106-207.

<sup>1170</sup> See only Doehring (above fn. 1140), p. 90.

long time.<sup>1171</sup> However, even if the overwhelming state practice - which is indeed represented by the sheer number of BITs incorporating fair and equitable treatment - may ease the requisition of an *opinio juris*, demonstrating that evidence of the latter is still a matter of great difficulty. This is also because the rise of arbitral decisions in recent years has created new controversies which also contributed to an increased textual diversity in relation to fair and equitable treatment clauses.<sup>1172</sup> Moreover, the identification of the exact moment of the generation of a customary norm prescribing fair and equitable treatment - its 'birth date' - appears hardly possible and quite futile, since the binding force of customary law is only achieved in degrees.<sup>1173</sup>

Irrespective of whether this birth date is ultimately considered to lie in the past or in the future, the whole issue is arguably of only limited practical relevance anyway.<sup>1174</sup> Due to the fact that a treaty norm and corresponding customary norm retain a separate existence, it is self-evident for the parties and arbitrators to apply the treaty standard of fair and equitable treatment. This is not only because the dispute settlement clauses are often expressly limited to disputes concerning an obligation under the particular BIT,<sup>1175</sup> but also because the reference to the relevant treaty provision avoids the difficult determination of the existence of a contested customary norm. To such an extent, the numerous arbitral decisions, purporting that the conclusion of BITs has contributed to the evolution of the minimum standard, do not directly apply this supposed customary version of fair and equitable treatment, but always and foremost refer to fair and equitable treatment as a conventional norm.

The preference for the treaty standard is evinced by the judicial reasoning in the case of *Rumeli Telekom SA and others v. Kazakhstan*,<sup>1176</sup> concerning an investment dispute under the BIT between Turkey and

<sup>1171</sup> On the relevance of political considerations in the relation between treaty and custom, see generally Schachter (above fn. 1135), pp. 720 et seq.

<sup>1172</sup> See Chapter 2, section A, '3(f) Conclusion: increasing variety of treaty language'.

<sup>1173</sup> Villiger (above fn. 1135), p. 194.

<sup>1174</sup> See also Newcombe and Paradell (above fn. 3), pp. 271-272.

<sup>1175</sup> See, e.g. Article 10(1) of the 2005 Germany Model BIT, which refers to '[d]isputes between the contracting states concerning the interpretation or application of this treaty'.

<sup>1176</sup> *Rumeli Telekom SA and Telsim Mobil Telekomikasyon Hizmetleri AS v. Kazakhstan* (above fn. 10).

Kazakhstan, which interestingly did not impose a fair and equitable treatment obligation on the host state. Nevertheless, the tribunal found Kazakhstan to have violated this standard.<sup>1177</sup> However, the tribunal did not apply fair and equitable treatment in a customary version, as one could have imagined if the applicable BIT had not already provided a treaty version of this obligation. Rather, the tribunal chose an indirect way to apply another treaty version of this norm, and by means of an available most-favoured-nation clause referred to the fair and equitable treatment obligation as stipulated in the 1995 UK-Kazakhstan BIT.<sup>1178</sup> The amazingly high density of the BITs incorporating fair and equitable treatment combined with the existence of most-favoured-nation clauses has therefore resulted in the fact that the litmus test is still to come on the question of whether fair and equitable treatment has in fact generated customary law. It is only after such a test that one could properly answer this question.

In addition, the discussion on fair and equitable treatment and the generation of customary international law does not appear to be free from the circularity described above. Assuming that fair and equitable treatment has created new customary law, it would hardly be possible to distinguish the different layers of customary law connected with fair and equitable treatment. Would an overlying customary norm of fair and equitable treatment supersede the international minimum standard or would it constitute a further evolution of the same minimum standard? The indiscernibility of the different layers of custom result in the confusing situation that fair and equitable treatment, on the one hand, is said to codify or reflect pre-existing customary law, but, on the other hand, also appears as the origin from which the same body of customary law descends. Such confusion in the construction of fair and equitable treatment considerably obscures the relation between treaty and custom in this context. It is therefore suggested that fair and equitable treatment is best perceived as a conventional norm and that the principles of fair and equitable treatment need to be taken into account when trying to assess appropriately the position of this norm in the system of international law sources.

<sup>1177</sup> *Ibid.*, at para. 618.

<sup>1178</sup> *Ibid.*, at para. 575; similarly, *Bayindir Insaat Turizm Ticaret ve Sanayi A Ş v. Pakistan* (above fn. 20), at paras. 153 et seq.

### 3 *Fair and equitable treatment as a general principle of law?*

A third possibility in the present categorisation along the lines of Article 38(1) of the ICJ Statute is the classification of fair and equitable treatment as a general principle of law. Since the heated controversy on the relation of fair and equitable treatment and the minimum standard does not affect this possibility, it has accordingly received far less attention. Nevertheless, there are at least some scholarly statements pointing in this direction.<sup>1179</sup>

General principles of law are a source of international law that appears equally opaque and affiliated to ideas of justice as fair and equitable treatment itself.<sup>1180</sup> Perhaps this is why a first associative link between both concepts can be established. Such vagueness notwithstanding, the main characteristics of general principles of law are well accepted: general principles of law are unwritten norms of wide-ranging character recognised in states' municipal laws and transferable to the international level.<sup>1181</sup> Based on this description, the fundamental differences between the concepts of general principles of law and fair and equitable treatment are easy to realise. As we have seen, fair and equitable treatment is expressed in a multitude of investment agreements and therefore depicts a written norm that originates in the international sphere. Although there may be examples of domestic laws on foreign investment providing guarantees to foreign investors, such as fair and equitable treatment,<sup>1182</sup> these cases have rather been influenced by the international sphere than vice versa.

Having said this, it is not intended to hide the fact that the elements of fair and equitable treatment are esteemed, to varying degrees, in the domestic administrative and constitutional legal systems of probably all states. To such an extent, a comparative legal methodology, which is indispensable for the formation of general principles of law, is also useful

<sup>1179</sup> See McLachlan, Shore and Weininger (above fn. 63), p. 260; Tudor (above fn. 2), pp. 101-104; and ambiguously Carreau and Juillard (above fn. 470), pp. 462-463, speaking of a 'principe générale du droit internationale'; similarly, Juillard (above fn. 84), pp. 131-133, who, however, distinguishes such a general principle of international law from the general principles of law as envisaged by Article 38(1) of the ICJ Statute.

<sup>1180</sup> See M. Akehurst, 'Equity and General Principles of Law', ICLQ 25 (1976), p. 801; and Schachter (above fn. 119), pp. 49 et seq.

<sup>1181</sup> See only Pellet (above fn. 1133), mn. 249.

<sup>1182</sup> See McLachlan, Shore and Weininger (above fn. 63), p. 42.

for the construction of fair and equitable treatment and international investment law in general.<sup>1183</sup> Similarly, there is of course a number of recognised general principles of law that are relevant for – and certainly enriching – the construction and application of fair and equitable treatment. As has already been indicated, many of the principles of fair and equitable treatment are at least partly informed by established or emerging general principles of law.<sup>1184</sup> In order to classify properly fair and equitable treatment in the system of international law sources, it is therefore – also in this respect – necessary to take a closer look at the normative character and basis of these principles. While it is thus clear that fair and equitable treatment does not in itself represent a general principle of law, there exists a similar cross-fertilisation between fair and equitable treatment and general principles of law as between fair and equitable treatment and the other sources of international law.

Finally, there is a functional similarity between fair and equitable treatment and general principles of law, which will be mentioned briefly. It is frequently observed that general principles of law, while depicting a real source of international law, nevertheless play a subsidiary role in relation to treaties and custom (as the other sources of international law).<sup>1185</sup> General principles of law are said mainly to step aside if a more elaborate treaty or customary norm is available and are, therefore, in the judicial practice, of a rather gap-filling character.<sup>1186</sup> To such an extent, international courts or tribunals are more likely to refer to treaty or customary norms than to general principles of law when deciding a case. This is because these sources usually deliver clearer and more established standards that possibly result in a higher degree of perceived persuasiveness in the judicial reasoning. A similar gap-filling character is often attributed to fair and equitable treatment.<sup>1187</sup> Due to its textual vagueness, it is thereby assumed that this general norm is especially relevant in cases where more specific provisions of investment protection cannot be applied. In practice, the function of fair and equitable treatment in the system of investment

<sup>1183</sup> Thereon see also Wälde (above fn. 54), pp. 100 et seq.

<sup>1184</sup> See the general meaning of each of the principles reviewed above (Chapter 7, 'Principles of fair and equitable treatment').

<sup>1185</sup> See Jennings and Watts (above fn. 124), p. 40; Shaw (above fn. 125), p. 99; and Graf Vitzthum (above fn. 129), p. 71. However, general principles of law are not to be considered as a 'subsidiary means for the determination of rules of law' as referred to in Article 38(1)(d) of the ICJ Statute.

<sup>1186</sup> Pellet (above fn. 1133), mnn. 289–290.

<sup>1187</sup> See, e.g. *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 259.

protection standards could thus reveal parallels to the function of general principles of law in the system of international law sources. However, the extent to which this is in fact the case will be discussed further below.<sup>1188</sup>

## B The principles of fair and equitable treatment and the sources of international law

The foregoing has revealed that fair and equitable treatment indeed depicts a norm of conventional status, but that it might be inchoate to consider it merely as a conventional norm, since it is also somehow related to the other sources of law. Nevertheless, these relations of fair and equitable treatment to customary law or even to general principles of law could not be convincingly explained thus far. The now-emerging principles of fair and equitable treatment offer a new starting point for the positioning of this concept in the system of international law sources. So far, the term 'principle' has been understood in the sense of a source of arguments and reasons being capable of justifying a particular decision in the context of fair and equitable treatment.<sup>1189</sup> It is therefore necessary to assess what the normative status of these principles is, and how these principles may be integrated into the traditional system of international law sources that is described by Article 38(1) of the ICJ Statute. It is suggested that only after such assessment is it possible to have a clearer view on the connection of fair and equitable treatment to the sources of international law.

### 1 The general characteristics of principles

The characteristics and structure of principles have been a focus of theoretical legal thinking for years, across different legal traditions and different areas of law.<sup>1190</sup> These discussions have not left international law

<sup>1188</sup> See Chapter 9, section B, '2 Fair and equitable treatment as a gap-filling obligation?'.  
<sup>1189</sup> See Chapter 6, section C, '2 Aspects of stability and change'.

<sup>1190</sup> See the following selection: Esser (above fn. 477); C.-W. Canaris, *Systemdenken und Systembegriff in der Jurisprudenz* (1969); J. Raz, 'Legal Principles and the Limits of Law', *Yale L.J.* 81 (1972), p. 823; Dworkin (above fn. 116); R. Alexy, *Theorie der Grundrechte* (1985); F. Bydlinski, *Fundamentale Rechtsgrundsätze* (1988); J.-R. Sieckmann, *Regelmodelle und Prinzipienmodelle des Rechtssystems* (1990); L. Alexander and K. Kress, 'Against Legal Principles', *Iowa L. Rev.* 82 (1997), p. 739; M. Atienza and J. Ruiz Manero, *A Theory of Legal Sentences* (1998); H. B. Ávila, *Theorie der Rechtsprinzipien* (2006); A. von Bogdandy, 'Constitutional Principles', in A. von Bogdandy and J. Bast (eds.), *Principles of European Constitutional Law* (2006), p. 3.

untouched, which is, as a whole, increasingly perceived as a principle-based legal system.<sup>1191</sup> The same is true for the sub-system of international economic law, which is said to feature, in addition to the principles of general international law, a number of principles specifically tailored for this area of international law.<sup>1192</sup> As we have seen, some of these principles are also relevant for the international law of foreign investments and, in particular, in the context of fair and equitable treatment. Thus, legal principles are somehow omnipresent in any legal system. Nevertheless, it remains a difficult and contentious task to describe the characteristics of legal principles.

Principles are often considered as norms of a relatively general and unspecific character.<sup>1193</sup> They are said to 'prescribe highly unspecific actions' and such acts usually 'can be performed on different occasions by the performance of a great many heterogeneous generic acts on each occasion'.<sup>1194</sup> Therefore, the general character of principles relates to the generality and vagueness of their content comprising certain situations or actions only at a relatively high level of abstraction. The generality of principles may also serve as a summarising reference to a bundle of legal rules without specifying their content in detail.<sup>1195</sup> As a consequence of their generality, it is emphasised that principles require further concretisation and cannot be applied to specific facts without the addition of further premises.<sup>1196</sup>

Another important characteristic of principles appears to be that they bear some reference to fundamental values and ideas of the legal system of which they are part. In this sense, principles give expression to the

<sup>1191</sup> See, e.g. M. Koskenniemi, 'General Principles', in M. Koskenniemi (ed.), *Sources of International Law* (2000), p. 359; V. Lowe, 'The Politics of Law-Making', in M. Byers (ed.), *The Role of Law in International Politics* (2002), p. 206; Kolb (above fn. 516); and M. Herdegen, 'Das "konstruktive Völkerrecht" und seine Grenzen', in P.-M. Dupuy et al. (eds.), *Völkerrecht als Wertordnung* (2006), p. 899.

<sup>1192</sup> On the rise of a principle-based legal thinking in international economic law, see, e.g. Schwarzenberger (above fn. 611), pp. 27 et seq.; Weiler (above fn. 104); and S. Kadelbach and T. Kleinlein, 'International Law - a Constitution for Mankind?', *GYIL* 50 (2007), p. 303 at pp. 337 et seq.; in the special context of WTO law, see, e.g. K. Rubenstein and J. Schultz, 'Bringing Law and Order to International Trade', *St John's J. Legal Comment.* 11 (1996), p. 271; and M. Hilf, 'Power, Rules and Principles', *J. Int'l Econ. L.* 4 (2001), p. 111.

<sup>1193</sup> See, e.g. MacCormick (above fn. 116), p. 152; and F. Reimer, *Verfassungsprinzipien* (2001), p. 181.

<sup>1194</sup> Raz (above fn. 1190), p. 838. <sup>1195</sup> *Ibid.*, p. 828.

<sup>1196</sup> Alexy (above fn. 445), p. 319; and K. Larenz and C.-W. Canaris, *Methodenlehre der Rechtswissenschaft*, 3rd edn (1995), p. 303.

overarching *ratio iuris* of a legal system and thereby help to achieve a minimum level of coherence within a legal system.<sup>1197</sup> It has thus been noted that '[w]orking out the principles of a legal system to which one is committed involves an attempt to give it coherence in terms of a set of general norms which express justifying and explanatory values of the system'.<sup>1198</sup> Principles are therefore also considered to provide the fundament of a legal system upon which other and more specific considerations are based and which serves as a justificatory basis for more specific rules or sub-principles of that system.<sup>1199</sup> As a further-reaching consequence of this fundamental function of principles in a legal system, they are also esteemed as being derived from 'justice or fairness or some other dimension of morality'.<sup>1200</sup>

Apart from their function in a legal system, legal principles may also be characterised by their special means of formation, which is said to distinguish them from rules. While rules are 'made', principles seem to 'grow'.<sup>1201</sup> It is thus observed that unlike rules '[p]rinciples are not made into law by a single judgment; they evolve rather like a custom and are binding only if they have considerable authoritative support in a line of judgments'.<sup>1202</sup> Thereby, however, it is contentious exactly in which way such grown principles act as a source of law, making considerations of morality and justice legally binding in an immediate way, and whether these principles thereby overturn the positivist distinction between law and morality.<sup>1203</sup>

This question leads to another controversial issue. While the reliance on the above-mentioned characteristics, especially the one of generality, suggests that the difference between principles and more specific

<sup>1197</sup> See Canaris (above fn. 1190), p. 46. On the relation of principles and the coherence of a legal system, see also Franck (above fn. 573), pp. 147-148: 'Coherence legitimates a rule, principle, or implementing institution because it provides a reasonable connexion between a rule, or the application of a rule, to (1) its own principled purpose, (2) principles previously employed to solve similar problems, and (3) a lattice of principles in use to resolve different problems.' See also Koskenniemi (above fn. 1191), p. 381.

<sup>1198</sup> MacCormick (above fn. 116), p. 153.

<sup>1199</sup> See Raz (above fn. 1190), p. 839; and Bydlinski (above fn. 1190), pp. 122-124.

<sup>1200</sup> Dworkin (above fn. 116), p. 22; see also T. Osterkamp, *Juristische Gerechtigkeit* (2004), p. 165.

<sup>1201</sup> See S. I. Shuman, 'Justification of Judicial Decisions', *Cal. L. Rev.* 59 (1971), p. 715 at p. 723.

<sup>1202</sup> Raz (above fn. 1190), p. 848.

<sup>1203</sup> The latter was the avowed aim of Dworkin considering his theory a 'general attack on positivism': see Dworkin (above fn. 116), p. 22. For a recent critical overview of the whole discussion, see, e.g. Osterkamp (above fn. 1200), pp. 160 et seq.



rules is only one of degree,<sup>1204</sup> it is also argued that there exists a logical distinction between legal rules and principles. Thereby, rules are described as norms applicable in an all-or-nothing fashion: 'If the facts a rule stipulates are given, then either the rule is valid, in which case the answer it supplies must be accepted, or it is not, in which case it contributes nothing to the decision.'<sup>1205</sup> Principles, in contrast, are believed to possess a 'dimension of weight' which entails that, in case of a collision of principles, the one with relatively more weight prevails without making the other invalid.<sup>1206</sup> An adaptation of this argument construes principles as optimisation requirements, characterised by the fact that they can be satisfied to varying degrees, whereas rules are described as definitive commands.<sup>1207</sup> Another version characterises principles as normative arguments and reasons for particular results of a process of balancing and weighing of arguments.<sup>1208</sup> All of these variations highlight a process of balancing as the judicial method of decision-making that is particularly connected to the idea of principles. The latter, however, is also acknowledged by other schools of thought, which do not endorse the proposed categorical distinction between principles and rules.<sup>1209</sup>

Irrespective of the fundamental conflicts pervading the general discussion on legal principles, the previously adopted preliminary description of principles as sources of arguments justifying a particular decision<sup>1210</sup> appears compatible with the different views on the structure and characteristics of principles. Moreover, the sub-elements of fair and equitable treatment resemble the general characteristics of such legal principles. All sub-elements of fair and equitable treatment express fundamental ideas of international investment law and of the wider international legal system in a relatively unspecific character.

<sup>1204</sup> See expressly Raz (above fn. 1190), p. 838.

<sup>1205</sup> Dworkin (above fn. 116), p. 24. <sup>1206</sup> Ibid., pp. 26–27.

<sup>1207</sup> R. Alexy, 'On the Structure of Legal Principles', *Ratio Juris* 13 (2000), p. 294 at p. 295; and Alexy (above fn. 620), pp. 47–48. For the characterisation of a rule as a definitive command, it shall be irrelevant whether the rule is or may be subject to exceptions.

<sup>1208</sup> See J.-R. Sieckmann, 'Principles as Normative Arguments', in C. Dahmann and W. Krawietz (eds.), *Values, Rights and Duties in Legal and Philosophical Discourse. Rechtstheorie, Beiheft 21* (2005), p. 197 at p. 197; and J.-R. Sieckmann, *Recht als normatives System* (2009).

<sup>1209</sup> See, e.g. Canaris (above fn. 1190), p. 55; and Raz (above fn. 1190), pp. 829 et seq.

<sup>1210</sup> See Chapter 6, section C, '2 Aspects of stability and change'. This preliminary definition was also applied to the notions of *topoi* or legal objectives, which would fulfil a similar function in the system of international law sources.

They also provide a multitude of arguments that are balanced and weighed against each other. To such an extent, the general discussion on the role of legal principles in law provides valuable assistance in an assessment of the normative status of fair and equitable treatment even without the need to resolve open questions of this complex discussion.

## 2 *The normative status of the principles of fair and equitable treatment*

Assessing the normative status of the principles of fair and equitable treatment and their position within the system of international law sources involves a number of issues that deserve closer attention. Most notably, it is of interest whether the principles of fair and equitable treatment are attributable to a particular source of law. If this is not the case, the question arises as to whether legal principles constitute an idiosyncratic source of international law or whether their normative status may be explained in a distinct way. The majority of questions arising from these issues have already been answered, at least implicitly, at some earlier stage. Thus, the following survey mainly seeks to unite those answers in order to make them illuminating for the present analysis.

The special process of the formation of principles may provide a suitable starting point for an assessment of whether principles, in general, are attributable to a particular source of law within the system of Article 38(1) of the ICJ Statute. If international legal principles 'grow' rather than being 'made',<sup>1211</sup> this characteristic distinguishes them from the norms derived from all three sources of international law. This seems especially true for treaty norms, which are certainly made by states. However, also in the case of norms deriving from custom and general principles of law, a positivist understanding of Article 38(1)(b) and (c) of the ICJ Statute could suggest that they are also somehow created by states, either because they need to be 'accepted as law' by states or because they need to be 'recognised' by some nations. Ultimately, a distinction focusing on the process of formation proves, however, not entirely convincing. This is because norms of customary law also tend to emerge slowly within a process that is comparable to

<sup>1211</sup> See also Lowe (above fn. 1191), p. 219, who observes that principles (he is referring to principles as 'interstitial norms') 'have no "authors" and that such principles "simply emerge" from within the international legal system'.

the emergence of legal principles.<sup>1212</sup> In addition, legal principles and general principles of law are already linguistically connected with each other. There is also an understanding of general principles of law that considerably expands the scope of Article 38(1)(c) of the ICJ Statute.<sup>1213</sup> Therefore, it appears hardly possible to discern clearly the difference between principles and custom, or between principles and general principles of law.<sup>1214</sup> The situation is not altogether different in the case of treaties, since it appears indeed possible that principles grow from various conventional norms just as, in domestic law, legal principles often grow from provisions stipulated in statutes.<sup>1215</sup>

This general impression is fortified when taking a closer look at the principles of fair and equitable treatment. All principles and sub-principles of fair and equitable treatment – sovereignty, the protection of legitimate expectations, *pacta sunt servanda*, non-discrimination, sustainable development, fair procedure, due process, denial of justice, transparency and proportionality – are accepted principles of international law deeply rooted within one or several of the sources of international law.<sup>1216</sup> Most of these principles are indeed derived from customary international law or accepted as general principles of law. However, they have also penetrated the system of international treaty law and are usually expressed in particular provisions in varying conventional agreements. This is to say that all principles of fair and equitable treatment have a footing in the sources of international law and that the principles do not exist in isolation from their footing. However, all principles also have an existence at a more abstract level which, in turn, is able to influence the concept and application of fair and equitable treatment by providing arguments and reasons to decide a case in a particular way. Thereby, the principles, as expressed in

<sup>1212</sup> See Raz (above fn. 1190), p. 848; see also Henkin (above fn. 522), pp. 27–28, observing that '[t]reaty law is made; customary law results' or 'grows'.

<sup>1213</sup> See, e.g. H. Mosler, 'Völkerrecht als Rechtsordnung', ZaöRV (1976), p. 6 at pp. 41 et seq.; and Schachter (above fn. 119), pp. 50 et seq. In addition to the general principles of municipal law recognised by civilised nations, they also refer, for instance, to principles derived from the specific structure and nature of the international community, to formative principles common to every legal order or to principles of justice founded on the very nature of man as a rational and social being.

<sup>1214</sup> See Koskenniemi (above fn. 1191), pp. 366–367; see also Kolb (above fn. 516), who does not distinguish between principles and general principles of law.

<sup>1215</sup> See the extrapolation of certain principles from the texts of different WTO agreements by Hilf (above fn. 1192), pp. 117 et seq.

<sup>1216</sup> See the respective analysis of each principle above in Chapter 7, 'Principles of fair and equitable treatment'.

certain treaty provisions or other norms, are not directly applicable to any given investment dispute. Rather, the arguments derived from these principles still need to undergo a process of balancing and, thus, operate only through the filter of fair and equitable treatment. Consequently, only the conventional norm of fair and equitable treatment is applied to the particular case, which, however, acts as a gateway for building inter-systemic linkages with external arguments and the content of which is, to a certain extent, influenced by these principles.<sup>1217</sup>

Due to the indirect way in which principles operate,<sup>1218</sup> it is not necessary to consider them as an idiosyncratic source of international law, possibly conflicting with the system of Article 38 of the ICJ Statute. Legal principles rather act at another and more abstract level than the sources envisaged by Article 38. This normative status of legal principles and their special way of operation, as described in the case of fair and equitable treatment, is also increasingly recognised in international law. In contradistinction to the classical sources of international law, it is for instance acknowledged that legal principles 'do not have a normative force of the traditional kind but instead operate by modifying the normative effect of other, primary norms of international law'.<sup>1219</sup> The latter reveals that principles may nevertheless be perceived as a legally relevant source, but in a much broader sense. In this vein, as already accomplished above, principles may be described as sources of legal arguments and reasons for the justification of particular judicial decisions.<sup>1220</sup> The importance and power of this justificatory function of principles is most obvious in the application of general clauses like fair and equitable treatment, which on their own are relatively vacant norms that need to be shaped by other means. However, legal principles do not simply 'emerge' or 'grow'; the existence and the normative validity of such principles is itself to be justified. One way of doing this is the described fairness discourse.<sup>1221</sup>

<sup>1217</sup> On systemic integration, see also Chapter 4, section C, 'Systemic integration of international law arguments'.

<sup>1218</sup> See also Koskenniemi (above fn. 1191), p. 381. <sup>1219</sup> See Lowe (above fn. 1191), p. 213.

<sup>1220</sup> Similarly, see Kolb (above fn. 516), p. 7, referring to principles as 'law-creating arguments' whose 'main characteristic is to be general, i.e., open to value-oriented arguments: principles are thus in the first place "transformators" of extra-positive (moral, social, or other) needs into the legal system'. Kolb also describes principles as 'norm-sources' that play an important role in the formative stage of new law and in the process of adapting law to certain legal necessities and new developments in accordance with basic value-ideas: see p. 9.

<sup>1221</sup> Thereon, see Chapter 6, section C, 'Fairness discourse on fair and equitable treatment'.

This is to say that not only a particular decision demands justification by reference to principles, but also the existence, selection and definition of the relevant principles by the judge or arbitrator has to be justified within a reasoned discourse. In this task, the individual judge or arbitrator is assisted by precedents and doctrine systemising and methodising the reasons and justificatory requirement for the shape and relevance of principles.

In conclusion, fair and equitable treatment represents a conventional norm which, due to its general texture, serves as a gateway for the integration of principled arguments that guide its application. The fact that fair and equitable treatment is systemically interlinked to arguments derived from legal principles, based on other conventional agreements, custom or general principles of law, does not change the position of fair and equitable treatment in the system on international law sources. Taking into account also the principles of fair and equitable treatment and their normative status helps to avoid the difficulties in the classification of fair and equitable treatment and provides a more comprehensive picture of fair and equitable treatment and the international law sources.

## 9 Fair and equitable treatment in the system of international investment law

### A Interplay with other standards of investment protection

In international investment agreements, fair and equitable treatment is usually part of a whole system of different standards of investment protection. While some of these standards of treatment are often combined with fair and equitable treatment in one clause, others are traditionally stipulated in distinct clauses. In any case, questions arise in relation to how fair and equitable treatment fits into that system and what intersections exist between the different standards. To this end, the interplay between fair and equitable treatment and a selection of other investment treaty provisions will be reviewed.

#### 1 National treatment

##### (a) Meaning of national treatment

National treatment standards aim at the creation of equal conditions in the host country market for the foreign investor in relation to domestic competitors.<sup>1222</sup> Pursuant to that aim, a national treatment standard imposes on the host country the obligation to accord a foreign investor, once established,<sup>1223</sup> with treatment no less favourable than the one granted to its own nationals. National treatment standards are well known and

<sup>1222</sup> UNCTAD (above fn. 144), p. 8.

<sup>1223</sup> In investment treaties, the requirement of national treatment (like all other standards of treatment) is mostly limited to the post-establishment phase; exceptions are provided by certain regional free trade agreements, such as Article 1102 of the NAFTA, and some US BITs that also apply the standard of national treatment to the admission phase: see, e.g. Article II(1) of the 1983 US-Haiti BIT or Article 3(1), (2) of the 2004 US Model BIT; see also Vandeveld (above fn. 137), pp. 71-72; further examples are provided by UNCTAD (above fn. 8), pp. 22-25; on the issue of admission and establishment of investments generally, see UNCTAD (above fn. 419), chapter 4.

prominent features in international economic law.<sup>1224</sup> As such, they have found their way into the WTO framework, where obligations of national treatment are expressed in a series of provisions.<sup>1225</sup> In this context, national treatment, together with most-favoured-nation treatment, is considered to be a specification of a broader precept of non-discrimination.<sup>1226</sup> However, national treatment standards are driven by the intent to inhibit protectionism against foreign products or services and are therefore intimately connected to governmental regulatory measures. Within the WTO framework, great importance is thus attached to the determination of a suitable standard of comparison, which presupposes the products or services to be in 'like' circumstances.<sup>1227</sup> National treatment is furthermore not freely granted, but is subject to various exceptions and provisions that allow for the justification of certain types of discrimination.<sup>1228</sup>

In investment treaties, the national treatment standard is also a provision of prominence,<sup>1229</sup> which occurs frequently in combination with a most-favoured-nation provision. A typical example of such a clause is, for instance, provided by Article 3(1) of the 2005 Germany Model BIT:

- (1) Neither contracting state shall subject investments in its territory owned or controlled by investors of the other contracting state to treatment less favourable than it accords to investments of its own investors or to investments of investors of any third state.

<sup>1224</sup> See, e.g. Schwarzenberger (above fn. 1), pp. 409–410; for a historical overview, see P. VerLoren van Themaat, *The Changing Structure of International Economic Law* (1981), pp. 19–24; such prominence notwithstanding, the national treatment obligation is, however, not considered part of customary international law.

<sup>1225</sup> See especially Article III of the GATT, Article 3 of the TRIPS and Article 2 of the TRIMS; as regards trade in services, the standard of national treatment according to Article XVII of the GATS may be limited to particular sectors; see also J. H. Jackson, *World Trade and the Law of GATT* (1969), pp. 273–279; R. Senti, *WTO* (2000), pp. 182–195; and M. Melloni, *The Principle of National Treatment in the GATT* (2005).

<sup>1226</sup> See J. H. Jackson, *The World Trading System*, 2nd edn (1997), p. 213; Hilf and Oeter (above fn. 395), pp. 116–118; and Dolzer (above fn. 9), pp. 504 and 507, mnn. 17 and 23.

<sup>1227</sup> See, e.g. Article III:1, 2 and 4 of the GATT; see also Hilf and Oeter (above fn. 395), pp. 186–190 and 398–399.

<sup>1228</sup> See, e.g. Articles III:8 and XX of the GATT; concerning trade in services, the exceptions already result from the requirement of a positive list in Article XVII of the GATS; see also Jackson (above fn. 1226), pp. 224–228; and Hilf and Oeter (above fn. 395), pp. 190–195.

<sup>1229</sup> Dolzer and Stevens (above fn. 5), p. 65; according to UNCTAD (above fn. 8), p. 33, fn. 44, more than fifty BITs concluded during the last decade (e.g. by Australia, Bahrain, Brunei Darussalam, Cambodia, Indonesia, Malaysia and Singapore) have not included a national treatment clause.

In dependence on the formulations in the GATT,<sup>1230</sup> some investment treaties only accord national treatment when a 'like' or otherwise comparable situation exists between the foreign investor and the domestic competitor.<sup>1231</sup> In the investment context, however, it appears to be a much more demanding task to determine the comparability of investors or investments than it is in the context of products or services.<sup>1232</sup>

In the application of the national treatment standard, tribunals first determine whether the foreign investor and its domestic competitor are placed in a comparable setting, and second whether the treatment granted to the foreign investor is less favourable than the one accorded to nationals.<sup>1233</sup> Although this appears to be an easily manageable formula, there are some salient issues in the determination of a breach of the standard which are deemed unsettled. Difficulties arise especially when assessing which domestic investors are in comparable circumstances with a foreign investor, whether there is a difference between de jure and de facto discriminations, what role is to be attributed to the intentions involved in the allegedly discriminatory state measure and how, if at all, it is possible to justify differential treatment of foreign and national investors.<sup>1234</sup>

In particular, the comparability of foreign and domestic investors appears to be a key question in the identification of the ambit of a

<sup>1230</sup> For a comparison between national treatment standards in the WTO and in investment agreements, see WTO Working Group on the Relationship between Trade and Investment, *Non-Discrimination, Most-Favoured-Nation Treatment and National Treatment*, WT/WGTI/W/118 (2002); with a special focus on China, see J. Zhou, 'National Treatment in Foreign Investment Law', *Touro Int'l L. Rev.* 10 (2000), p. 39.

<sup>1231</sup> See, e.g. Article 2(1) of the 2003 Japan–Vietnam BIT:

1. Each contracting party shall in its area accord to investors of the other contracting party and to their investments treatment no less favourable than the treatment it accords in like circumstances to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments.

<sup>1232</sup> See Dolzer and Stevens (above fn. 5), pp. 63–64; and Maniruzzaman (above fn. 800), pp. 72–73.

<sup>1233</sup> See, e.g. the *modus operandi* in *Champion Trading Co. and Ameritrade International Inc. v. Egypt* (above fn. 453), at para. 128; similarly, *United Parcel Service of America Inc. v. Canada*, UNCITRAL (Award of 24 May 2007), at para. 83; see also R. Dolzer, 'National Treatment', in ICSID, OECD and UNCTAD (eds.), *Making the Most of International Investment Agreements* (2005), p. 2; and Muchlinski (above fn. 51), p. 622.

<sup>1234</sup> See, e.g. *Marvin Roy Feldman Karpa v. Mexico* (above fn. 452), at para. 166; similarly, Dolzer (above fn. 1233), providing further references.

national treatment clause.<sup>1235</sup> This question thereby also emerges in the application of agreements that refrain from constricting national treatment to investors in 'like' circumstances, since any comparison implies by necessity the definition of a standard of comparison.<sup>1236</sup> Although the criteria for the determination of such a standard are not very clear, arbitral tribunals seem to advance rather low exigencies in order to find foreign and domestic investors in a comparable setting.<sup>1237</sup> However, a broad construction of national treatment obligations entails the question concerning the justification of differential treatment. As investment agreements do not usually provide any general exception clauses,<sup>1238</sup> arbitral tribunals tend to integrate arguments possibly justifying discrimination into the process of determining whether a comparable setting or differential treatment exists at all.<sup>1239</sup> To such an extent, the finding of discrimination has been denied when differential treatment was based on objective grounds and not guided by a protectionist intent.<sup>1240</sup>

<sup>1235</sup> See comprehensively Newcombe and Paradell (above fn. 3), pp. 159 et seq.

<sup>1236</sup> See also Krajewski and Ceysens (above fn. 617), p. 197.

<sup>1237</sup> For instance, the tribunal in *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 251, emphasised the affiliation to the same sector from a business perspective; similarly, *Marvin Roy Feldman Karpa v. Mexico* (above fn. 452), at para. 171. The tribunal in *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 173, referred to local producers in general and rejected to address 'exclusively the sector in which that particular activity is undertaken'; at para. 176, the tribunal refused to consider WTO criteria in the determination of like situations, since it viewed 'situations' to be broader than 'products', which necessarily relate to competitive or substitutable products. The tribunal in *Methanex Corp. v. United States* (above fn. 275), at part IV, chapter B, paras. 29–35, even more explicitly rejected the relevance of WTO criteria; on the latter, see also J. Kurtz, 'National Treatment, Foreign Investment and Regulatory Autonomy', in P. Kahn and T. W. Wälde (eds.), *Les aspects nouveaux du droit des investissements internationaux - New Aspects of International Investment Law* (2007), p. 311, especially pp. 349–351.

<sup>1238</sup> This exhibits a major difference between investment law and WTO law in this context, since the latter stipulates such provisions in Article XX of the GATT and Article XIV of the GATS.

<sup>1239</sup> Krajewski and Ceysens (above fn. 617), p. 200; and Muchlinski (above fn. 51), pp. 625–628.

<sup>1240</sup> See, e.g. *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 250, holding that the 'assessment of "like circumstances" must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest'; similarly, *Pope & Talbot Inc. v. Canada* (above fn. 245), at para. 78; and *United Parcel Service of America Inc. v. Canada* (above fn. 1233), at paras. 102, 119, 139–142 and 181. The absence of a protectionist intent is unable to justify a discrimination: see *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 177. Proof of such intentions may, however, serve as an indication in the finding of a discrimination: see again *S.D. Myers Inc. v. Canada* (above fn. 95), at paras. 252–254.

## (b) Intersections with fair and equitable treatment

Initially, it seems that the directions of fair and equitable treatment and national treatment are quite distinct from each other. While national treatment obligations are dependent on the treatment accorded to domestic investments, fair and equitable treatment provisions try to ensure a basic level of protection irrespective of the host state's law.<sup>1241</sup> Accordingly, it has been submitted that the application of fair and equitable treatment may trigger results that differ substantially from the protection provided by a national treatment standard.<sup>1242</sup> In particular, this means that the fair and equitable treatment standard may be violated even if the foreign investor is accorded with the same favourable treatment as that received by a domestic investor.<sup>1243</sup> A converse situation also appears imaginable, where an infringement of the national treatment standard may be found even if the foreign investor is treated in a fair and equitable manner, but not as favourable as the treatment of domestic investors.<sup>1244</sup> The latter suggests that the ambits of fair and equitable treatment and national treatment are not congruent.

However, the broad acceptance of non-discrimination as a principle of fair and equitable treatment and the fact that the two standards may be breached at the same time<sup>1245</sup> reveal a striking similarity between both concepts: both standards interdict certain forms of discriminatory treatment. In the case of a national treatment clause, discriminatory treatment is defined as any treatment less favourable than the one accorded to a comparable domestic investor when that treatment is not subject to any exceptions or may not otherwise be justified.<sup>1246</sup> However, all of these criteria are also relevant in the process of reasoning on fair and equitable treatment.<sup>1247</sup> To such an extent, while both treaty clauses may of course be subject to different treaty exceptions or other peculiarities, the principle of non-discrimination as comprised by the concept of fair

<sup>1241</sup> See, e.g. *United Parcel Service of America Inc. v. Canada* (above fn. 275), at para. 80.

<sup>1242</sup> See UNCTAD (above fn. 2), pp. 15–16; Vasciannie (above fn. 2), pp. 147–149; and Schreuer (above fn. 2), p. 367.

<sup>1243</sup> See, e.g. *Pope & Talbot Inc. v. Canada* (above fn. 245), at paras. 104 and 181.

<sup>1244</sup> This is at least indicated by *Methanex Corp. v. United States* (above fn. 275), at part IV, chapter C, paras. 13–14; see also Vasciannie (above fn. 2), p. 149.

<sup>1245</sup> See, e.g. *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at paras. 179 and 187.

<sup>1246</sup> See also Newcombe and Paradell (above fn. 3), p. 162.

<sup>1247</sup> See especially *Saluka Investments BV v. Czech Republic* (above fn. 132), at paras. 307 and 313.

and equitable treatment seems to entail, in its essence, the same arguments as discussed under a national treatment clause.

## 2 Most-favoured-nation treatment

### (a) Meaning of most-favoured-nation treatment

The provenance, purpose and functioning of most-favoured-nation standards show considerable parallels to national treatment standards. Most-favoured-nation standards are also aimed at the creation of competitive equality, although not between the foreign and domestic investor, but between the foreign investor and investors from third countries.<sup>1248</sup> According to that aim, a most-favoured-nation clause in an investment agreement obliges a host country to treat a foreign investor from a contracting state at least as favourably as investors from any third country.<sup>1249</sup> Most-favoured-nation clauses also have a long tradition in international economic law<sup>1250</sup> and feature prominently in the WTO framework, constituting 'central pillars of trade policy for centuries'.<sup>1251</sup> In the WTO context, the most-favoured-nation standard applies to like products or services and is also subject to an elaborate system of exemptions and justifications.<sup>1252</sup>

In the application of most-favoured-nation clauses contained in investment agreements, certain issues arising out of arbitral practice have been intensely discussed.<sup>1253</sup> To such an extent, the subject matter of a most-favoured-nation clause appears to be of particular importance.

<sup>1248</sup> UNCTAD (above fn. 144), pp. 8–9; and Muchlinski (above fn. 51), p. 628.

<sup>1249</sup> See Dolzer and Stevens (above fn. 5), p. 65; similar to the national treatment standard, there are also instances in which a most-favoured-nation treatment obligation also applies at the pre-establishment phase: see, e.g. Article 1103 of the NAFTA and the examples provided by UNCTAD (above fn. 8), p. 38, especially in fn. 53.

<sup>1250</sup> See only S. Vesel, 'Clearing a Path Through a Tangled Jurisprudence', Yale J. Int'l L. 32 (2007), p. 125 at pp. 128–136; however, most-favoured-nation treatment obligations are not deemed part of customary international law: see, e.g. ILC, 'Draft Articles on Most-Favoured-Nation Clauses', Document A/33/10, ILC Yearbook (1978 II), p. 7.

<sup>1251</sup> See, e.g. Article I:1 of the GATT, Article II:1 of the GATS and Article 4 of the TRIPS; furthermore, Jackson (above fn. 1226), p. 157.

<sup>1252</sup> See, e.g. Articles XIV, XX, XXI and XXIV of the GATT, and Article II:2, 3, V, XIII:1 and XIV of the GATS; thereon see Senti (above fn. 1225), pp. 159–182; Hilf and Oeter (above fn. 395), pp. 177–185, 191–195, 401–102 and 409–410; and Dolzer (above fn. 9), pp. 505–507.

<sup>1253</sup> See, e.g. S. Fietta, 'Most Favoured Nation Treatment and Dispute Resolution under Bilateral Investment Treaties', Int. A.L.R. 8 (2005), p. 131; R. Dolzer, 'Meistbegünstigungsklauseln in Investitionsschutzverträgen', in J. Bröhmer (ed.), *Internationale Gemeinschaft und Menschenrechte* (2005), p. 47; Y. Radi, 'The Application of the Most-Favoured-Nation Clause in the Dispute Settlement Provisions of Bilateral

Usually, as a reflection of the *eiusdem generis* maxim, it is stated that an investor by means of a most-favoured-nation clause may not refer to any other agreement or provision established by the host state with other states, but only to such treaty provisions pertaining to the same subject matter.<sup>1254</sup> In this context, it has been questioned whether, and if so under what circumstances, a most-favoured-nation clause allows an investor to invoke not only the more favourable substantive standards of treatment, but also the more favourable dispute settlement provisions contained in third-party investment agreements.<sup>1255</sup> However, it appears that at least the core elements of an investment agreement should be reserved to the autonomy of the contracting parties and must not be altered by means of a most-favoured-nation provision.<sup>1256</sup> Nevertheless, it seems that many questions concerning most-favoured-nation treatment clauses remain unresolved so far.<sup>1257</sup>

### (b) Intersections with fair and equitable treatment

At first glance, due to the focus of attention on jurisdictional matters, the intersections between fair and equitable treatment and most-favoured-nation treatment appear quite immaterial. Nevertheless, the two provisions share a commonality in substance, as both protect against certain forms of discriminatory treatment. Conceivably, fair and equitable treatment could also be constructed in a way that addresses unreasonable differentiations between foreign investors from different home countries, but it would appear that such cases have yet to arise. Furthermore, most-favoured-nation clauses entail a levelling effect, aligning existing variations in treaty practice, which is not to be underestimated. This effect also concerns fair and equitable

Investment Treaties', EJIL 18 (2007), p. 757; Vesel (above fn. 1250); and Schill (above fn. 3), at 139 (*et seq.*).

<sup>1254</sup> Thereon, see the cases *Anglo-Iranian Oil Co. (United Kingdom v. Iran)*, ICJ (Judgment of 22 July 1952); *Ambatielos (Greece v. United Kingdom)*, ICJ (Judgment of 19 May 1953); see also McLachlan, Shore and Weininger (above fn. 63), p. 255; and Muchlinski (above fn. 51), p. 629.

<sup>1255</sup> This was, e.g. accepted in *Emilio Agustín Maffezini v. Spain*, ICSID Case No. ARB/97/7 (Decision on Jurisdiction of 25 January 2000); and *Siemens AG v. Argentina*, ICSID Case No. ARB/02/8 (Decision on Jurisdiction of 3 August 2004); but denied in *Salini Costruttori SpA and Italstrade SpA v. Jordan*, ICSID Case No. ARB/02/13 (Decision on Jurisdiction of 29 November 2004); and *Plama Consortium Ltd v. Bulgaria*, ICSID Case No. ARB/03/24 (Decision on Jurisdiction of 8 February 2005).

<sup>1256</sup> In this direction, see *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 74; see also Dolzer (above fn. 1253), pp. 51–52; and Fietta (above fn. 1253), p. 138.

<sup>1257</sup> See the discussion in Newcombe and Paradell (above fn. 3), pp. 216 *et seq.*

treatment clauses. To such an extent, fair and equitable treatment may apply through an assurance of most-favoured-nation treatment, even though a host state has chosen not to include such a clause in an investment agreement, but incorporated it into agreements with third states.<sup>1258</sup>

In a similar vein, the *Pope & Talbot* tribunal proposed the application of the levelling effect of most-favoured-nation provisions on distinct constructions of fair and equitable treatment in order to render attempts at restraining the scope of the norm largely ineffective.<sup>1259</sup> Thereby, the tribunal was guided by the assumption that Article 1105(1) of the NAFTA, in the perception of the FTC note of interpretation, provided less protection than other fair and equitable treatment clauses with additive fairness elements.<sup>1260</sup> However, the approach of the *Pope & Talbot* tribunal is largely contested. In particular, it has been proposed that a narrow understanding of fair and equitable treatment belonged to the indefeasible core elements of the NAFTA being divested of the levelling effect of most-favoured-nation clauses.<sup>1261</sup> However, due to the widely accepted evolutionary character of the minimum standard and the pertaining refusal of arbitral tribunals to acknowledge different levels of protection,<sup>1262</sup> the whole issue appears of only limited practical relevance. Overall, the most-favoured-nation standard nevertheless exhibits a considerable potential to widen the ambit of fair and equitable treatment.

### 3 Arbitrary or discriminatory measures

#### (a) Meaning of arbitrary or discriminatory measures

A further provision concerning certain forms of discrimination traditionally contained in investment agreements is the duty to refrain from arbitrary and discriminatory measures.<sup>1263</sup> This or similar wording is commonly integrated into a general treatment clause in investment

<sup>1258</sup> See *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 104; *Rumeli Telekom SA and Telsim Mobil Telekomikasyon Hizmetleri AS v. Kazakhstan* (above fn. 10), at para. 575; and *Bayindir Insaat Turizm Ticaret ve Sanayi A Ş v. Pakistan* (above fn. 20), at paras. 153 et seq.

<sup>1259</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245); for further discussion, see Chapter 3, section B, '1(b) The *Pope & Talbot* final merits award'; see also *Dumbery* (above fn. 245), pp. 688–691.

<sup>1260</sup> *Pope & Talbot Inc. v. Canada* (above fn. 245), at para. 117.

<sup>1261</sup> See, e.g. *Dolzer* (above fn. 1253), p. 52.

<sup>1262</sup> See Chapter 3, section C, '2 The disappearance of a controversy?'

<sup>1263</sup> See *Dolzer and Stevens* (above fn. 5), p. 62.

agreements often combined with a stipulation of fair and equitable treatment, or with national treatment and most-favoured-nation treatment.<sup>1264</sup> An example of a stand-alone clause is provided by Article 2(3) of the 2005 Germany Model BIT:

- (3) Neither contracting state shall in any way impair by arbitrary or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of investors of the other contracting state.

Further variations in the text of pertaining treaty clauses exist insofar as some treaties instead refer to 'unreasonable or discriminatory' measures.<sup>1265</sup> However, whether the different elements of the provision relating to arbitrariness, reasonableness or discrimination involve an idiosyncratic meaning has not yet become sufficiently clear. In the context of arbitrariness, many arbitral tribunals<sup>1266</sup> draw from the pertaining definition in the *ELSI* case, providing: 'Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law ... It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.'<sup>1267</sup> However, arbitral definitions of unreasonable or discrimination do not seem to differ markedly from this definition.<sup>1268</sup> Furthermore, all of these definitions represent hardly more than coarse shorthand formulas, blurring any possible distinction between the notions of reasonableness, arbitrariness or discrimination.<sup>1269</sup> Nevertheless, it seems that arbitral tribunals require a cumulative breach of the elements of such a provision if they are connected with a

<sup>1264</sup> See Chapter 2, section A, '3(b) Fair and equitable treatment in combination with other standards'; for further examples, see *Newcombe and Paradell* (above fn. 3), pp. 298–299.

<sup>1265</sup> See, e.g. Article 3(2) of the 1994 Chile Model BIT (reprinted in UNCTAD (above fn. 14), p. 144); or Article 10(1) of the ECT.

<sup>1266</sup> See, e.g. *Azurix Corp. and others v. Argentina* (above fn. 102), at para. 391; and *LG&E Energy Corp. and others v. Argentina* (above fn. 450), at para. 146.

<sup>1267</sup> *Elettronica Sicula SpA ELSI (USA v. Italy)* (above fn. 200), at para. 128.

<sup>1268</sup> See, e.g. *Sahuka Investments BV v. Czech Republic* (above fn. 132), at para. 460, observing that "'non-discrimination" requires a rational justification of any differential treatment of a foreign investor', while reasonableness requires 'a showing that the state's conduct bears a reasonable relationship to some rational policy'.

<sup>1269</sup> According to *Vierdag* (above fn. 797), p. 67, combinations of terms like arbitrariness and discrimination represent pleonasm; similarly, C. H. Schreuer, 'Fair and Equitable Treatment (FET)', *TDM* 4 (2007), issue 5, p. 4; and *Dolzer and Schreuer* (above fn. 54), p. 173; in contrast, *Newcombe and Paradell* (above fn. 3), p. 303, suggest that arbitrariness entails a somewhat higher threshold and is distinct from unreasonableness.

conjunctive 'and',<sup>1270</sup> while a breach of just one element seems to suffice in cases where a disjunctive 'or' is used in the treaty.<sup>1271</sup>

#### (b) Intersections with fair and equitable treatment

In relation to fair and equitable treatment, it has already been determined that arbitrariness, unreasonableness and discrimination are also similarly recognised as relevant aspects.<sup>1272</sup> Consequently, many arbitral tribunals have felt themselves unable to draw a borderline between the two standards and, therefore, have considered them to be necessarily interlinked and correspondent.<sup>1273</sup> In this vein, the *CMS* tribunal found protection against arbitrariness and discrimination to be related with fair and equitable treatment and observed: 'Any measure that might involve arbitrariness or discrimination is in itself contrary to fair and equitable treatment.'<sup>1274</sup> Quite similarly, the *Saluka* tribunal was convinced that the notions of reasonableness or non-discrimination had an identical meaning under both provisions.<sup>1275</sup> Accordingly, it held:

Insofar as the standard of conduct is concerned, 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.<sup>1276</sup>

In summary, the examples from arbitral jurisprudence illustrate that the intersections between fair and equitable treatment and the duty to refrain from arbitrary or discriminatory measures appear exceptionally sizeable. Whether substantive differences between the two standards

<sup>1270</sup> See *Ronald S. Lauder v. Czech Republic* (above fn. 450), at para. 219, relating to Article II(2) (b) of the 1991 US–Czech Republic BIT (reprinted at para. 216 of the award).

<sup>1271</sup> See *Nykomb Synergetics Technology Holding AB v. Latvia* (above fn. 451), at 4.3.2(a); and *Azurix Corp and others v. Argentina* (above fn. 102), at para. 391.

<sup>1272</sup> See Chapter 7, section A, '3 Non-discrimination'.

<sup>1273</sup> See, e.g. *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey* (above fn. 450), at para. 261, stating that 'the anomalies that took place in connexion with the conduct just referred to are included in the breach of fair and equitable treatment and that there is no ground for a separate heading on liability on account of arbitrariness'.

<sup>1274</sup> *CMS Gas Transmission Co. v. Argentina* (above fn. 102), at para. 290.

<sup>1275</sup> *Saluka Investments BV v. Czech Republic* (above fn. 132), at para. 460.

<sup>1276</sup> *Ibid.*, at para. 461; the tribunal then concluded, at para. 465, that a breach of the fair and equitable treatment standard 'at the same time violated [the] non-impairment obligation under the same provision'. Similarly, *Noble Ventures Inc. v. Romania* (above fn. 767), at para. 182, considering the prohibition of arbitrary and discriminatory measures to be a specific application of the fair and equitable treatment standard.

nevertheless remain, and why virtually the same issues are treated in some cases under fair and equitable treatment and in others under the protection against arbitrary or discriminatory measures, appears ultimately unsettled.<sup>1277</sup> However, despite the obvious intersections, it has been argued that both provisions should be construed as conceptually different.<sup>1278</sup> For instance, the *Saluka* tribunal proposed that such differences might arise out of the stipulation of the 'more specific effects' of a violation of the non-discrimination standard, namely with regard to the operation, management, maintenance, use, enjoyment or disposal of the investment. However, these effects presumably cover all stages of an investment and are to such an extent of little value for a clear delimitation of both standards. Since decisions on either provision are often based on similar arguments of reasonableness, non-arbitrariness and non-discrimination, it seems at least improbable that arbitral tribunals draw differing conclusions in relation to an alleged non-discrimination when applying fair and equitable treatment or the duty to refrain from arbitrary and discriminatory measures in the same case.

#### 4 Full protection and security

##### (a) Meaning of full protection and security

The standard of full protection and security in investment treaties frequently emerges as an appendix to the fair and equitable treatment standard.<sup>1279</sup> Notwithstanding the variety of formulations stipulating the guarantees of 'protection', 'adequate protection and security' or 'full protection and security',<sup>1280</sup> the standard represents a well-established feature in investment treaty practice.<sup>1281</sup> The provision has

<sup>1277</sup> See also V. Heiskanen, "Unreasonable or Discriminatory Measures" as a Cause of Action under the Energy Charter Treaty, *Int. A.L.R.* 10 (2007), p. 104 at p. 109, suggesting that the order in which tribunals review the alleged breaches of different standards of treatment does not follow any clear rules. It appears to be dependent on the way in which a claimant pleads its case, but also on the evidence presented, according to which a finding of a violation of a specific standard of treatment is presumably easy to establish: see p. 107.

<sup>1278</sup> See Dolzer and Schreuer (above fn. 54), p. 175.

<sup>1279</sup> For an example of such a clause, see Chapter 2, section A, '3(b) Fair and equitable treatment in combination with other standards'.

<sup>1280</sup> See, e.g. the formulations in Article II(2) of the 2000 Indonesia–Algeria BIT, Article 3(1) of the 1998 Netherlands–Brazil BIT or Article 3(1) of the 1999 China–Qatar BIT (all reprinted in UNCTAD (above fn. 8), p. 29); see furthermore Newcombe and Paradell (above fn. 3), p. 308.

<sup>1281</sup> See Dolzer and Stevens (above fn. 5), pp. 60–61.



its provenance in the traditional US FCN treaties, in which the protection of persons and property was deemed a suitable complement to the standards of national treatment and most-favoured-nation treatment.<sup>1282</sup> As such, full protection and security, just like fair and equitable treatment, is recurrently associated with the concept of the international minimum standard,<sup>1283</sup> making it difficult to distinguish between both standards. Thereby, especially within early arbitral jurisprudence, several awards construed full protection and security as a guarantee against physical violence in reasonably close analogy to the cases traditionally assigned to the classical minimum standard.

For instance, the *Asian Agricultural Products Ltd (AAPL)* case<sup>1284</sup> concerned the destruction of a shrimp farm during a counter-insurgency operation by Sri Lankan security forces against local Tamil rebels. Thereby, the tribunal construed the provision in accordance with the due diligence standard of customary law of international state responsibility<sup>1285</sup> and rejected an understanding imposing strict liability on the host state that would require the prevention of the foreign investment from any damage whatsoever.<sup>1286</sup> A similar case of physical intrusion was presented in *American Manufacturing & Trading Inc. (AMT) v. Zaire*,<sup>1287</sup> concerning plundering and destruction of foreign property by Zairian soldiers during riots and civil commotion in Kinshasa. In this case, a breach of the guarantee of protection and security, perceived as the host state's obligation of vigilance, was also determined because no precautionary measures were taken by Zaire to avert the damages.<sup>1288</sup> A comparable reasoning was furthermore adopted in the case of *Wena Hotels Ltd v. Egypt*,<sup>1289</sup> relating to damages arising from a temporary seizure of hotels operated by a British investor and the violent expulsion

<sup>1282</sup> See Walker Jr (above fn. 157), pp. 822-823.

<sup>1283</sup> See *Elettronica Sicula SpA ELSI (USA v. Italy)* (above fn. 200), at para. 111; Schwarzenberger (above fn. 201), p. 221; and Schwarzenberger (above fn. 24), p. 114; on full protection and security and its relationship to customary international law, see also Dolzer and Schreuer (above fn. 54), pp. 152-153.

<sup>1284</sup> *Asian Agricultural Products Ltd (AAPL) v. Sri Lanka* (above fn. 204).

<sup>1285</sup> *Ibid.*, especially at paras. 76-78.

<sup>1286</sup> *Ibid.*, at paras. 45-48; see also *Elettronica Sicula SpA ELSI (USA v. Italy)* (above fn. 200), at para. 108.

<sup>1287</sup> *American Manufacturing & Trading Inc. (AMT) v. Zaire* (above fn. 205), on the facts, see especially para. 3.04.

<sup>1288</sup> *Ibid.*, at paras. 6.04-6.08; similarly, *Asian Agricultural Products Ltd (AAPL) v. Sri Lanka* (above fn. 204), at paras. 85-86.

<sup>1289</sup> *Wena Hotels Ltd v. Egypt*, ICSID Case No. ARB/98/4 (Award of 8 December 2000), on the facts, see paras. 17-62.

of hotel staff and guests. In the award, the tribunal addressed full protection and security and fair and equitable treatment jointly, and concluded that the refusal of the Egyptian authorities to take preventive measures or to restore promptly the investor's control over the hotels amounted to an infringement of both obligations.<sup>1290</sup>

#### (b) Intersections with fair and equitable treatment

While the focus on physical protection still appeared as a relatively clear-cut sphere, more recent arbitral decisions have further extended the ambit of full protection and security into the wider domain of fair and equitable treatment. In this respect, the *Azurix* tribunal, besides considering both standards as different obligations,<sup>1291</sup> noted that the requirement of full protection and security extends beyond mere physical security and affords a certain level of stability and a secure investment environment.<sup>1292</sup> Accordingly, the norm was constructed to embrace not only physical safety, but also legal security.<sup>1293</sup> In contrast, other arbitral tribunals have maintained that full protection and security should be limited, at least in principle, to its classical understanding requiring due diligence in relation to the physical protection of the investment:

There is no doubt that historically this particular standard has been developed in the context of physical protection and security of the company's officials, employees or facilities. The Tribunal cannot exclude as a matter of principle that there might be cases where a broader interpretation could be justified, but then it becomes difficult to distinguish such situation from one resulting in the

<sup>1290</sup> *Ibid.*, at paras. 84 and 95.

<sup>1291</sup> *Azurix Corp. and others v. Argentina* (above fn. 102), at para. 407; the tribunal thereby rejected the view expressed in *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), at para. 187, stating that 'the question whether in addition there has been a breach of full protection and security under this Article becomes moot as a treatment that is not fair and equitable automatically entails an absence of full protection and security'; similar to the latter, *Noble Ventures Inc. v. Romania* (above fn. 767), at para. 182.

<sup>1292</sup> *Azurix Corp. and others v. Argentina* (above fn. 102), at para. 408. According to the tribunal, this should at least apply to clauses qualifying the terms 'protection and security' with the adjective 'full'. However, other instances suggest that the varying formulations of 'full', 'most constant', 'adequate' or mere 'protection and security' do not have substantially different meaning: see, e.g. *Asian Agricultural Products Ltd (AAPL) v. Sri Lanka* (above fn. 204), at para. 50; similarly, Schwarzenberger (above fn. 24), p. 115; and Vandeveld (above fn. 137), p. 77.

<sup>1293</sup> See also *CME Czech Republic BV v. Czech Republic* (above fn. 761), at para. 613; and *Compañía de Aguas de Aconquija SA and Vivendi Universal SA v. Argentina* (above fn. 452), at para. 7.4.15.

breach of fair and equitable treatment, and even from some form of expropriation.<sup>1294</sup>

However, the limitation on physical invasion is questionable if the investment agreement includes intangible assets within its definition of an investment,<sup>1295</sup> since intangible assets are incapable of being physically harmed.<sup>1296</sup> To such an extent, a clear tendency in favour of the one or the other position is not yet apparent in arbitral practice.

A scholarly attempt to distinguish both norms irrespective of the previous controversy is provided by Schreuer, who points out that it is clearly better to perceive both standards as different obligations.<sup>1297</sup> In terms of substance, he discerns fair and equitable treatment to consist mainly of an obligation to refrain from a certain course of action, and full protection and security to require an active creation of a security framework, including mechanisms for the effective vindication of the investors' rights.<sup>1298</sup> However, this position appears not to be free from doubts. In particular, it has been argued that international investment law, including fair and equitable treatment, has evolved from a mainly negative to a positive obligation model, requiring host states to exercise their powers in order to comply with their duties instead of abstaining from certain actions.<sup>1299</sup> Furthermore, it has recurrently been underlined by arbitral tribunals that fair and equitable treatment requests more than a mere passive behaviour, but rather entails a proactive statement from the host state that goes beyond the avoidance of prejudicial conduct.<sup>1300</sup>

In dependence on the formulation in the 2004 US Model BIT,<sup>1301</sup> it has furthermore been submitted that full protection and security is principally concerned with the exercise of police power, while fair and

<sup>1294</sup> *Enron Corp. and Ponderosa Assets LP v. Argentina* (above fn. 302), at para. 286; see also *Ronald S. Lauder v. Czech Republic* (above fn. 450), at para. 308; and *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey* (above fn. 450), at para. 258.

<sup>1295</sup> This is true for most investment treaties: see, e.g. Article 1 of the Netherlands Model BIT (reprinted in McLachlan, Shore and Weininger (above fn. 63), p. 423).

<sup>1296</sup> See also *Siemens AG v. Argentina* (above fn. 779), at para. 303.

<sup>1297</sup> Schreuer (above fn. 1269), p. 3. <sup>1298</sup> *Ibid.*, p. 4.

<sup>1299</sup> See Robbins (above fn. 53), especially pp. 424 et seq.

<sup>1300</sup> See, e.g. *MTD Equity Sdn. Bhd. and MTD Chile SA v. Chile* (above fn. 97), at para. 113; and *Azurix Corp. and others v. Argentina* (above fn. 102), at para. 372.

<sup>1301</sup> Article 5(2)(b) of the 2004 US Model BIT stipulates: "full protection and security" requires each party to provide the level of *police protection* required under customary international law' (emphasis added).

equitable treatment extends to a wider process of decision-making by the organs of the host state.<sup>1302</sup> However, unlike the US Model BIT, most investment treaties do not contain such explicit reference to police protection. Although the stronger affiliation of fair and equitable treatment to legislative and administrative decision-making processes may at least provide a clue as to a possible difference, a guarantee of full protection and security seems to add little to a fair and equitable treatment clause in an investment agreement.<sup>1303</sup>

## 5 Expropriation

### (a) Meaning of expropriation

The protection against expropriation lies at the very heart of international investment law and has from the outset been a central pillar of international investment agreements.<sup>1304</sup> In contradistinction to the tenacious uncertainties in customary international law,<sup>1305</sup> investment treaty practice has established quite clear prerequisites according to which the legality of an expropriation of a foreign investor is to be determined.<sup>1306</sup> An exemplification of these requirements that are, in varying formulations, restated in virtually every investment agreement is provided by Article 6(1) of the 2004 US Model BIT:

Neither party may expropriate or nationalise a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation ('expropriation'), except:

- (a) for a public purpose;
- (b) in a non-discriminatory manner;
- (c) on payment of prompt, adequate, and effective compensation; and
- (d) in accordance with due process of law . . .<sup>1307</sup>

<sup>1302</sup> McLachlan, Shore and Weininger (above fn. 63), p. 247.

<sup>1303</sup> See also Newcombe and Paradell (above fn. 3), p. 314.

<sup>1304</sup> Generally, see R. Higgins, 'The Taking of Property by the State', RdC 176 (1982 III), p. 259; Dolzer (above fn. 165); and UNCTAD, *Taking of Property*, UNCTAD/ITE/IIT/15 (2000).

<sup>1305</sup> See Lowenfeld (above fn. 3), p. 494.

<sup>1306</sup> For a discussion of these requirements in light of recent arbitral case law, see A. Reinisch, 'Legality of Expropriations', in A. Reinisch (ed.), *Standards of Investment Protection* (2008), p. 171.

<sup>1307</sup> This wording mainly resembles the classical view of capital-exporting states as expressed in the Hull formula; thereon, see Chapter 3, section A, '1 The international minimum standard'.

The extension of treaty standards to 'measures equivalent to expropriation' has triggered a vivid debate concerning the appropriate delimitation of compensable indirect expropriations from other non-compensable measures of states.<sup>1308</sup> In the assessment of whether a state measure ultimately constitutes an indirect expropriation, arbitral case law recurrently employs an array of recognised and emerging criteria. Most importantly, the severity of a state measure's effects on a foreign investor and its ability to use and enjoy the investment is a relevant factor for the determination of whether or not the measure depicts a taking.<sup>1309</sup> Beyond that, it has turned out to be quite controversial whether and to what extent other factors should be taken into account besides the mere effects of the state measure. While some arbitral tribunals appear quite restrictive in this regard,<sup>1310</sup> others seem to favour a more comprehensive approach, embracing factors such as the host state's (discriminatory or other) intentions, the foreign investor's legitimate expectations or the legality, transparency, consistency and proportionality of the measure.<sup>1311</sup> Arguably, these criteria become increasingly established in arbitral practice and are applied by tribunals in the determination of an alleged expropriation by way of a case-by-case balancing approach.<sup>1312</sup> Due to the fact that the mentioned criteria are not clearly distinguishable from each other and that each of them reveals a certain degree of blurring, remarkable flexibility in the finding of an expropriation undoubtedly remains.

#### (b) Intersections with fair and equitable treatment

The concept of indirect expropriation seems to be closely interwoven with that of fair and equitable treatment. This is not only because both standards lack a clearly shaped definition and therefore reveal a notable

<sup>1308</sup> On the different categories of an indirect expropriation, see, e.g. *Técnicas Medioambientales, TECMED SA v. Mexico* (above fn. 98), at para. 114.

<sup>1309</sup> See, e.g. *Metalclad Corp. v. Mexico* (above fn. 224), at para. 103; critically thereon *Mexico v. Metalclad Corp.* (above fn. 224), at para. 99. See also generally R. Dolzer, 'Indirect Expropriations: New Developments?', N.Y.U. *Envtl. L.J.* 11 (2002), p. 64 at pp. 79–80; and A. K. Hoffmann, 'Indirect Expropriation', in A. Reinisch (ed.), *Standards of Investment Protection* (2008), p. 151 at p. 156.

<sup>1310</sup> With regard to expropriatory environmental measures, see, e.g. *Compañía del Desarrollo de Santa Elena SA v. Costa Rica*, ICSID Case No. ARB/96/1 (Final Award of 17 February 2000), at para. 72.

<sup>1311</sup> For further references, see A. Reinisch, 'Expropriation', in P. Muchlinski *et al.* (eds.), *The Oxford Handbook of International Investment Law* (2008), p. 407 at pp. 438 *et seq.*

<sup>1312</sup> See McLachlan, Shore and Weininger (above fn. 63), at 298.

degree of flexibility. It is also because the reasons invoked for the determination of a violation of fair and equitable treatment or of whether the state measures establish an expropriatory act resemble each other. Apart from arguments related to non-discrimination and fair procedure, the protection of legitimate expectations particularly appears to be a crucial issue for both standards.<sup>1313</sup> Accordingly, a number of arbitral tribunals have referred to the investor's expectations in their reasoning on indirect expropriation as well as on fair and equitable treatment.<sup>1314</sup> Such similarity notwithstanding, fair and equitable treatment is generally not considered to be congruent with protection against indirect expropriations.

Several arbitral tribunals have tried to explain the difference between fair and equitable treatment and protection against expropriation. As regards direct expropriation, the tribunal in the case of *PSEG Global Inc. and others v. Turkey* observed the following:

The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.<sup>1315</sup>

An explanation in relation to indirect expropriation is given by another tribunal in the case of *Sempra Energy*, emphasising the slight distinctions between the two concepts by pointing to the even greater flexibility of fair and equitable treatment:

It must also be kept in mind that on occasion the line separating the breach of the fair and equitable treatment standard from an indirect expropriation can be very thin, particularly if the breach of the former standard is massive and long-lasting. In case of doubt, however, judicial prudence and deference to state functions are better served by opting for a determination in the light of the fair and equitable treatment standard. This also explains why the compensation granted to redress the wrong done might not be too different on either side of the line.<sup>1316</sup>

<sup>1313</sup> See Fietta (above fn. 305); see also von Walter (above fn. 509), considering it unsettled, however, whether the recurrence to the investor's expectations in expropriation claims is of a different nature from that in fair and equitable treatment claims (p. 193).

<sup>1314</sup> See only *Azurix Corp. and others v. Argentina* (above fn. 102), at paras. 316 and 372.

<sup>1315</sup> *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey* (above fn. 450), at para. 238.

<sup>1316</sup> *Sempra Energy International v. Argentina* (above fn. 303), at para. 301.

These statements suggest that, beyond all similarities, the scope of the expropriation test is altogether narrower than the scope of fair and equitable treatment. Indeed, arbitral tribunals are to some extent reluctant to find an indirect expropriation<sup>1317</sup> and it seems that a violation of fair and equitable treatment is easier to demonstrate than the establishment of an expropriation, which in part explains the increased popularity of fair and equitable treatment in relation to expropriation standards.<sup>1318</sup>

Further practical differences arise from the fact that some investment agreements constrict the access to dispute settlement mechanisms – sometimes also with regard to fair and equitable treatment. In the NAFTA context, for instance, taxation measures are generally exempted from the protection provided under the investment chapter; however, an expropriation claim may still be admissible under certain circumstances.<sup>1319</sup> There again, the NAFTA expropriation clause requires compliance with Article 1105(1) of the NAFTA and therefore imports fair and equitable treatment into the prerequisites of a lawful expropriation.<sup>1320</sup> Against this background, the tribunal in the case of *Marvin Roy Feldman Karpa v. Mexico*, concerning the application of certain tax laws to the export of tobacco products, decided:

While there may be an argument for a violation of Article 1105 under the facts of this case (a denial of fair and equitable treatment), this Tribunal has no jurisdiction to decide that issue directly. As noted earlier, Article 1105 is not available in tax cases, but may be relevant in the cross-reference of Article 1110(1)(c).<sup>1321</sup>

<sup>1317</sup> For a summary of fact-situations in which an indirect expropriation has actually been determined, see Reinisch (above fn. 1311), pp. 451 et seq.

<sup>1318</sup> See Schreuer (above fn. 1269), p. 23. Various tribunals have found a breach of fair and equitable treatment without considering the state measures as expropriations: see, e.g. *Azurix Corp. and others v. Argentina* (above fn. 102), at paras. 322 and 377. The *Azurix* tribunal arrived at these differing conclusions, although it referred to the investor's expectations as a relevant factor in its reasoning on both standards: see paras. 316 et seq. and 372.

<sup>1319</sup> See Article 2103(1) and (6) of the NAFTA.

<sup>1320</sup> See Article 1110(1)(c) of the NAFTA; a similar reference to fair and equitable treatment is made in the abovementioned expropriation clause of the 2004 US Model BIT which in Article 21 also restrains the protection provided against taxation measures.

<sup>1321</sup> *Marvin Roy Feldman Karpa v. Mexico* (above fn. 452), at para. 141; similarly, *Enron Corp. and Ponderosa Assets LP v. Argentina*, ICSID Case No. ARB/01/3 (Decision on Jurisdiction of 14 January 2004), at para. 66; and *Pan American Energy LLC and BP Argentina Exploration Co. v. Argentina (joined case)*, ICSID Case Nos. ARB/03/13 and ARB/04/8 (Decision on Jurisdiction of 27 July 2006), at para. 136.

The tribunal therefore indicated that arguments related to fair and equitable treatment may also be relevant with regard to the reasoning on an alleged indirect expropriation.<sup>1322</sup> Hence, fair and equitable treatment and expropriation may be connected to the extent that fair and equitable treatment becomes a relevant factor for the determination of the lawfulness of an expropriation.<sup>1323</sup> However, to date, this approach of importing fair and equitable treatment into the concept of expropriation is limited to investment agreements expressly stipulating such a connection. It is not yet apparent whether it could also be applied in cases relating to investment agreements that do not suggest so.

## 6 Umbrella clause

### (a) Meaning of the clause

Umbrella clauses<sup>1324</sup> are not a standard for the treatment of foreign investors in a narrow sense. Umbrella clauses seek to extend the protection as provided by the investment treaty to the legal relationship between foreign investors and host states, which is laid down in an investor–state contract and is usually governed by domestic law.<sup>1325</sup> While there is broad textual variation in formulating umbrella clauses, a relatively common version of such a provision is to be found in the Swiss Model BIT practice:

Each contracting party shall observe any obligation it has assumed with regard to investment in its territory by investors of the other contracting party.<sup>1326</sup>

<sup>1322</sup> However, arguments of fair and equitable treatment are not necessarily decisive. To such an extent, the tribunal observed that, even if a breach of fair and equitable treatment were assumed, this would not automatically trigger a finding of an indirect expropriation: see *Marvin Roy Feldman Karpa v. Mexico* (above fn. 452), at para. 141.

<sup>1323</sup> See also *Link-Trading Joint Stock Co. v. Moldova*, UNCITRAL (Final Award of 18 April 2002), at para. 64.

<sup>1324</sup> Umbrella clauses are frequently denominated as sanctity of contract, mirror or *pacta sunt servanda* clauses.

<sup>1325</sup> See, e.g. the early attempts of E. Lauterpacht to elevate investor–state contracts to the level of an inter-state obligation by means of an 'umbrella treaty': thereon see A. C. Sinclair, 'The Origins of the Umbrella Clause in the International Law of Investment Protection', *Arb. Int'l* 20 (2004), p. 411 at pp. 412–413; comprehensively on the original intentions of umbrella clauses, see also T. W. Wälde, 'The "Umbrella" (or Sanctity of Contract/Pacta sunt Servanda) Clause in Investment Arbitration', *TDM* 1 (2004), issue 4, at pp. 4 et seq.; see also J. Wong, 'Umbrella Clauses in Bilateral Investment Treaties', *Geo. Mason L. Rev.* 14 (2006), p. 135 at pp. 142–149.

<sup>1326</sup> Cited from C. Yannaca-Small, 'Interpretation of the Umbrella Clause in Investment Agreements', *OECD Working Papers on International Investment* (2006), No. 3, p. 12, also containing a broad survey of other examples of umbrella clauses.

Earlier writings based on the sweeping language of such provisions have advocated a comprehensive construction of umbrella clauses. For instance, it has been argued that umbrella clauses protect an investor 'against any interference with his contractual rights, whether it results from a mere breach of contract or a legislative or administrative act, and independently of the question whether or no such interference amounts to expropriation'.<sup>1327</sup>

In the subsequent arbitral practice, several attempts have been advanced to narrow the scope of umbrella clauses. Most notably, the tribunal in the case of *SGS Société Générale de Surveillance SA v. Pakistan* rejected an understanding of umbrella clauses elevating any and all breaches of the investor-state contract to violations of the BIT.<sup>1328</sup> It opined that such a reading would open the floodgates to incorporate an unlimited number of investor-state contracts and other commitments to an investor into the ambit of the BIT's protection, rendering other standards of protection, such as fair and equitable treatment, superfluous.<sup>1329</sup> Accordingly, the tribunal denied its jurisdiction with regard to the contract claims<sup>1330</sup> and maintained that only such breaches of contract that constitute a violation of a standard of investment protection are capable of establishing an international wrong.<sup>1331</sup> A distinct but similarly restrictive approach has been adopted in *SGS Société Générale de Surveillance SA v. Philippines*.<sup>1332</sup> Thereby, the tribunal acknowledged that the provision in question should protect the contractual relationship between investor and host state, but that 'it does not convert the issue of the *extent* or *content* of such obligations into an issue of

<sup>1327</sup> Mann (above fn. 47), p. 246; supported, e.g. by Dolzer and Stevens (above fn. 5), pp. 81–82.

<sup>1328</sup> See *SGS Société Générale de Surveillance SA v. Pakistan*, ICSID Case No. ARB/01/13 (Decision on Jurisdiction of 6 August 2003), at paras. 166–167.

<sup>1329</sup> *Ibid.*, at para. 168. <sup>1330</sup> *Ibid.*, at para. 190.

<sup>1331</sup> Similarly, *Joy Mining Machinery Ltd v. Egypt* (above fn. 779), at para. 81, holding:

In this context, it could not be held that an umbrella clause inserted in the treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the treaty, unless of course there would be a clear violation of the treaty rights and obligations or a violation of contract rights of such a magnitude as to trigger the treaty protection, which is not the case.

<sup>1332</sup> *SGS Société Générale de Surveillance SA v. Philippines*, ICSID Case No. ARB/02/6 (Decision on Jurisdiction of 29 January 2004); for critical discussion, see, e.g. Wälde (above fn. 1325), pp. 73 et seq.

international law'.<sup>1333</sup> The tribunal eventually suspended the proceedings because it found that other tribunals were closer to the contract and that the tribunal established under the BIT should therefore exercise a mere subsidiary jurisdiction.<sup>1334</sup>

While the previous approaches were widely criticised for making umbrella clauses virtually meaningless,<sup>1335</sup> tribunals in other cases – in particular, *El Paso Energy International Co. v. Argentina*<sup>1336</sup> and *Pan American Energy LLC and others v. Argentina*<sup>1337</sup> – supported a limitation of umbrella clauses as a means of protection only against sovereign actions of states. In distinguishing 'the state as a merchant from the state as a sovereign',<sup>1338</sup> umbrella clauses were held not to comprise breaches of an ordinary commercial contract, but to cover additional investment protections contractually agreed by the state as a sovereign.<sup>1339</sup> However, other tribunals refused to differentiate between sovereign and commercial actions or commitments of states. For instance, the *Siemens* tribunal could not find that the wording of the particular umbrella clause referring to 'any obligation' distinguished commercial investment contracts from concession agreements of an administrative nature.<sup>1340</sup>

<sup>1333</sup> *SGS Société Générale de Surveillance SA v. Philippines* (above fn. 1332), at para. 128. The tribunal is thereby upholding the prevalent distinction between contract and treaty claims as expressed in the leading case of *Compañía de Aguas de Aconquija SA and Vivendi Universal SA v. Argentina*, ICSID Case No. ARB/97/3 (Decision on Annulment of 3 July 2002), at paras. 95–96. The approach was followed by *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16 (Decision on Jurisdiction of 11 May 2005), at para. 101; *Eureko BV v. Poland* (above fn. 450), at para. 246; and *Noble Ventures Inc. v. Romania* (above fn. 767), at paras. 51–52. However, especially the *Eureko* award seemed to have misconstrued umbrella clauses in a way that transforms contractual claims into treaty claims directly subject to treaty rules: thereon, see Douglas (above fn. 289), pp. 38 et seq.; and J. Crawford, 'Treaty and Contract in Investment Arbitration', TDM 6 (2009), issue 1, p. 18.

<sup>1334</sup> See *SGS Société Générale de Surveillance SA v. Philippines* (above fn. 1332), at paras. 128 and 141–143. This argument results in a re-introduction of the requirement of exhaustion of local remedies: see critically Wälde (above fn. 1325), pp. 82–83.

<sup>1335</sup> See, e.g. Yannaca-Small (above fn. 1326), p. 22; Wong (above fn. 1325), pp. 173–174; and Crawford (above fn. 1333), p. 19.

<sup>1336</sup> *El Paso Energy International Co. v. Argentina*, ICSID Case No. ARB/03/15 (Decision on Jurisdiction of 27 April 2006).

<sup>1337</sup> *Pan American Energy LLC and BP Argentina Exploration Co. v. Argentina (joined case)* (above fn. 1321).

<sup>1338</sup> *El Paso Energy International Co. v. Argentina* (above fn. 1336), at para. 79.

<sup>1339</sup> *Ibid.*, at para. 81. Similarly, see also *Sempra Energy International v. Argentina* (above fn. 303), at para. 310.

<sup>1340</sup> *Siemens AG v. Argentina* (above fn. 779), at para. 206; see also *Enron Corp. and Ponderosa Assets LP v. Argentina* (above fn. 302), at para. 274, emphasising, however, that the

Whether in the end a more far-reaching construction of umbrella clauses or a more restrictive view distinguishing between commercial and sovereign state measures prevails is still open to conjecture. Thereby, the more restrictive view draws attention to the assumed original intention of introducing umbrella clauses as a means of protection against governmental interference and not against any, merely commercial, kind of contractual under-performance.<sup>1341</sup> In contrast, the opinion favouring an expansive concept relies on the mostly sweeping formulation of umbrella clauses in BITs and the practical difficulties in differentiating between commercial and sovereign acts of the host state.<sup>1342</sup>

### (b) Intersections with fair and equitable treatment

The protection of the contractual relationship between a foreign investor and a state is not only a matter of umbrella clauses, but is also relevant in the context of fair and equitable treatment. In this respect, it has already been shown that fair and equitable treatment protects an investor's legitimate expectations with regard to the host state's abidance to contractual assurances.<sup>1343</sup> While it is deemed implausible that umbrella clauses should be constructed in such a way as to provide the same level of protection that is already offered by fair and equitable treatment,<sup>1344</sup> the exact degree of overlap is heavily dependent on the particular approach adopted in relation to fair and equitable treatment or the umbrella clause. In any case, all of the criteria forwarded for the determination of the scope of umbrella clauses are also apparent in the pertinent discussion surrounding fair and equitable treatment.

For instance, the disputed but prevalent approach towards fair and equitable treatment endorses the view that the investor may only expect protection against sovereign interference with investor-state contracts, but is not protected under fair and equitable treatment against any kind of breaches of contract.<sup>1345</sup> The thereby underlying

protection of umbrella clauses only extends to commitments given by the host state that are related to investment.

<sup>1341</sup> See especially Wälde (above fn. 1325), pp. 82 et seq.

<sup>1342</sup> In support of this view, see in detail S. W. Schill, 'Enabling Private Ordering', *Minn. J. Int'l L.* 18 (2009), p. 1, basing his opinion also on the history and object and purpose of umbrella clauses.

<sup>1343</sup> See Chapter 7, section A, '2(b)(iii) Stability in the contractual relationship'.

<sup>1344</sup> See Schreuer (above fn. 1269), p. 18.

<sup>1345</sup> See Chapter 7, section A, '2(b)(iii) Stability in the contractual relationship'.

dualist perception distinguishing between contract and treaty claims is said to reflect customary international law on state responsibility.<sup>1346</sup> In order not to render umbrella clauses superfluous and add something to the protection already provided by customary international law or fair and equitable treatment, some have argued that umbrella clauses should be constructed in a comprehensive way so as to protect also against merely commercial breaches of investor-state contracts.<sup>1347</sup> However, if a more far-reaching approach is also adopted in relation to fair and equitable treatment, this would in turn lead, again, to an increased convergence between umbrella clauses and fair and equitable treatment. Contrariwise, the availability of domestic legal remedies plays an important role in the measuring of state actions against fair and equitable treatment.<sup>1348</sup> The latter limits the ambit of fair and equitable treatment, whereas the similar approach adopted in *SGS Société Générale de Surveillance SA v. Philippines* with regard to umbrella clauses seems to have remained a minority position.

Whatever construction of umbrella clauses is chosen, other, more fundamental differences between fair and equitable treatment and umbrella clauses also exist. In particular, umbrella clauses function in a more simplistic way by obliging the host state (only) to abide to commitments elsewhere agreed to, whereby the extent and content of these commitments is always predetermined by the investor-state relationship.<sup>1349</sup> In contrast, the protection of the contractual relationship between investor and host state under fair and equitable treatment only depicts a fragment within a much broader sphere.

### B Fair and equitable treatment between dispensability and master norm

Considering the large intersections between fair and equitable treatment and other investment treaty provisions, a suitable characterisation of its position within the system of investment protection standards represents a difficult task. Not surprisingly, diverse visions of fair and equitable treatment have emerged in this respect, describing it as an

<sup>1346</sup> See Schill (above fn. 1342), pp. 27 and 32-33; on the law on state responsibility in this respect, see Crawford (above fn. 185), pp. 86 and 96.

<sup>1347</sup> See Schill (above fn. 1342), pp. 35 et seq. and 93.

<sup>1348</sup> Thereon, see Chapter 7, section B, '1(b)(i) Denial of justice'.

<sup>1349</sup> See also Schill (above fn. 1342), pp. 61-62.

absolute standard in contrast to relative ones, or as a kind of subsidiary gap-filler, or even as an overriding obligation encompassing all other treaty provisions. Altogether, these perceptions draw a quite contradictory picture of fair and equitable treatment as a standard of investment protection that is caught somewhere in between dispensability and master norm.

### 1 *Fair and equitable treatment as an absolute obligation?*

The standards of treatment in international investment agreements are often classified into two general categories of relative (or contingent) and absolute (or non-contingent) obligations.<sup>1350</sup> Relative obligations in this sense accord foreign investors with a level of protection that is determined by a comparative reference to rights and privileges given to other competitors.<sup>1351</sup> Classical examples of such standards in investment treaties are national treatment and most-favoured-nation treatment provisions which aim to ensure equality of competitive conditions between investors of different national backgrounds.<sup>1352</sup> On the contrary, absolute obligations by the use of non-contingent terms attempt to guarantee a level of protection independent from any reference to an exterior state of law or facts.<sup>1353</sup> The obligations to assure fair and equitable treatment, full protection and security, and the provisions relating to expropriation are often identified as examples of such absolute standards.<sup>1354</sup> These absolute obligations are generally designed to provide a basic safeguard upon which the investor may rely in any case. The term 'absolute', in contrast to 'relative', therefore implicates that the level of protection guaranteed by these obligations does not vary at all.

For all of these reasons, absolute treaty standards are frequently associated with the conception of a minimum standard of treatment.<sup>1355</sup> While a relative obligation is said to depict 'an empty shell' obtaining substantive content in relation to the treatment afforded to someone or

<sup>1350</sup> On this classification, see Walker, Jr. (above fn. 157), pp. 809-812; Fatouros (above fn. 137), p. 135; and McLachlan, Shore and Weininger (above fn. 63), p. 207.

<sup>1351</sup> See, e.g. Frick (above fn. 201), p. 85; and UNCTAD (above fn. 8), p. 28.

<sup>1352</sup> See, e.g. Vandevelde (above fn. 137), pp. 71-76; and Zagel (above fn. 211), p. 161.

<sup>1353</sup> See Kronfol (above fn. 44), p. 45; and UNCTAD (above fn. 8), p. 28.

<sup>1354</sup> See Frick (above fn. 201), p. 85; Vandevelde (above fn. 137), pp. 76-78; UNCTAD (above fn. 8), p. 28; and Schill (above fn. 3), pp. 75 and 78.

<sup>1355</sup> See Alenfeld (above fn. 44), p. 69; Frick (above fn. 201), p. 85; and Vandevelde (above fn. 137), p. 77; a different view is advanced by Preiswerk (above fn. 186), p. 26, listing the minimum standard among the relative clauses.

something else, an absolute or minimum standard is considered to enshrine an invariable 'intrinsic substantive content'.<sup>1356</sup> However, the entire foregoing analysis of fair and equitable treatment has already revealed that the differentiation between absolute and relative standards is based on a fundamental misconception related to the myth of the intrinsic content of vague general clauses like fair and equitable treatment. As it is impossible to grasp the presumably existing intrinsic meaning by means of a set of underdeterminate interpretative tools, every norm is to some extent the product of a constructivist process of judicial decision-making.<sup>1357</sup> Moreover, the gateway character of fair and equitable treatment and the associated process of balancing display the inherently flexible nature of this norm, resembling by no means the misguided image of an absolute standard of protection. Beyond that, the review of the other allegedly absolute obligations indicates that the meaning of these provisions is also constructed in a flexible way, often employing a whole array of open-ended criteria to determine whether or not such a standard has been violated.

The alternative terminology of contingent and non-contingent obligations appears somewhat less misleading, but ultimately suffers from a similar defect. Whilst it is true that the application of national treatment and most-favoured-nation treatment obligations is contingent on the treatment accorded to other investors, this criterion is not exclusive to these obligations. On the contrary, numerous arbitral tribunals have also emphasised the importance of discriminatory elements in the application of fair and equitable treatment or other allegedly non-contingent obligations. Accordingly, arbitral tribunals have constructed the concept of fair and equitable treatment in a way so as to incorporate arguments based on a comparative analysis of the treatment offered to other investors as well.

In conclusion, while the conception of non-contingent or absolute obligations provides, at first glance, an image of maximum positiveness and efficacy, this image is nothing more than an illusion.<sup>1358</sup> Consequently, the common distinction between relative (or contingent) and absolute (or non-contingent) obligations should be abandoned. In any case, the category of an absolute obligation does not appear to fit with a flexible and general clause like fair and equitable treatment.

<sup>1356</sup> Newcombe and Paradell (above fn. 3), pp. 148-149.

<sup>1357</sup> See Chapter 2, section C, '3 Underdetermination of the general rules of interpretation'.

<sup>1358</sup> See already Walker Jr (above fn. 157), pp. 811-812.

## 2 Fair and equitable treatment as a gap-filling obligation?

In the system of investment protection standards, fair and equitable treatment is often characterised as an instrument for filling gaps that are left by other treaty provisions.<sup>1359</sup> This gap-filling function is based on the assumption that the other investment treaty obligations are more specific and probably also more favourable to foreign investors. Accordingly, fair and equitable treatment is deemed 'residuary in the sense that it governs only where no other treaty provisions are specifically on point'.<sup>1360</sup> However, taking into consideration the broad variety of different situations that are already covered by numerous other standards of treatment, one might question whether any proper sphere of fair and equitable treatment remains. Any *topos* of fair and equitable treatment appears indeed relevant under at least one other investment treaty provision. To such an extent, the review of the other guarantees has shown that they are also of a relatively vague and flexible nature and are often constructed by arbitral tribunals in a way that overlaps considerably with fair and equitable treatment. Consequently, if fair and equitable treatment is understood as a norm with a merely gap-filling function, the overlap between the elements of fair and equitable treatment and other investment treaty provisions makes such a subsidiary safety net virtually dispensable.

However, this impression is at odds with arbitral jurisprudence, which provides no indications of a *lex specialis* character of other, presumably more specific, investment treaty provisions in relation to fair and equitable treatment. In contrast, the body of arbitral decisions exhibits that a breach of fair and equitable treatment may be found even though an infringement of other obligations has been established.<sup>1361</sup> Therefore, a single state measure may contravene a whole

<sup>1359</sup> See R. Berger, 'Vermögensschutz im Ausland durch Investitionsförderungsverträge', AWD 11 (1965), p. 1 at pp. 2-3; Frick (above fn. 201), p. 92; Gudgeon (above fn. 214), p. 112; M. Banz, *Völkerrechtlicher Eigentumschutz durch Investitionsschutzabkommen* (1988), pp. 70-71; Notter (above fn. 203), p. 124; Vandeveld (above fn. 137), p. 76; and Dolzer and Schreuer (above fn. 54), p. 122; this idea is also expressed in arbitral practice: see *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 259; and *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey* (above fn. 450), at para. 238.

<sup>1360</sup> See Gudgeon (above fn. 214), p. 125; similarly, Berger (above fn. 1359), p. 3; and Banz (above fn. 1359), p. 71.

<sup>1361</sup> For example, an indirect expropriation and a breach of fair and equitable treatment has been found in *Metalclad Corp. v. Mexico* (above fn. 224), at paras. 101 and 112. A violation of the fair and equitable treatment provision and the duty not to impair the investment by unreasonable and discriminatory measures based on the same

series of investment protection standards at the same time, including fair and equitable treatment.<sup>1362</sup> However, since other treatment provisions are sometimes subject to various exceptions, while fair and equitable treatment is usually not,<sup>1363</sup> it may serve in these particular cases as a safety net. Nevertheless, the general character of fair and equitable treatment is not exhaustively described if the standard is solely appreciated as a tool for filling gaps in the regime of investment protection. Rather, fair and equitable treatment is constructed by tribunals as a treaty provision that is applied concurrently to other obligations of an investment agreement. Whether there is a need for stipulating fair and equitable treatment in addition to other obligations is yet another question and is dependent on the particular construction of each of these norms.

Furthermore, the common characterisation of fair and equitable treatment as a residuary norm touches the more far-reaching problem of *lacunae* in international law.<sup>1364</sup> In order to justify a judicial decision in the case of a perceived gap, decision-makers often resort to the concept of equity *praeter legem* or to principles of international law.<sup>1365</sup> As previously discussed, fair and equitable treatment is deeply related to the concept of equity and certain principles of international law. Arguments derived from these ideas are employed to justify particular decisions on the vague obligation of fair and equitable treatment. The latter reveals that the challenge posed by the indeterminacy of norms is no different from the problem of gaps in international law.<sup>1366</sup> However, in the system of investment protection standards, the problem does not seem to be that a certain state measure could not

grounds was determined in *Sahuka Investments BV v. Czech Republic* (above fn. 132), at paras. 497 and 503. The majority opinion in *S.D. Myers Inc. v. Canada* (above fn. 95), at para. 266, found a breach of fair and equitable treatment as a corollary of the violation of the national treatment standard.

<sup>1362</sup> Another example is provided by *Occidental Exploration and Production Co. v. Ecuador* (above fn. 289), where the tribunal in the end determined infringements of the national treatment standard, the duty not to impair the investment by arbitrary and discriminatory measures, the fair and equitable treatment standard, and affiliated to the latter, the full protection and security standard: see at paras. 162-165, 179 and 187.

<sup>1363</sup> See UNCTAD (above fn. 2), pp. 23-24; UNCTAD (above fn. 144), pp. 12-13; and UNCTAD (above fn. 144), pp. 15-27.

<sup>1364</sup> See generally Lauterpacht (above fn. 589), pp. 65 et seq.; H. Kelsen and R. W. Tucker, *Principles of International Law*, 2nd edn (1967), pp. 438 et seq.; Bleckmann (above fn. 530), pp. 198 et seq.; and U. Fastenrath, *Lücken im Völkerrecht* (1991).

<sup>1365</sup> See Akehurst (above fn. 1180), pp. 805-806; Schachter (above fn. 119), pp. 57-58; and Koskenniemi (above fn. 1191), p. 372.

<sup>1366</sup> See also Koskenniemi (above fn. 466), pp. 40-41.



be grasped by at least one treaty provision, demanding for a gap-filler like fair and equitable treatment. To such an extent, the *lacunae* do not so much exist in between the mostly overlapping guarantees, but are rather built into each and every relatively indeterminate investment treaty provision. In applying these provisions, arbitral tribunals arguably rely on a similar set of justificatory principles, which also explains the manifold intersections between fair and equitable treatment and other obligations.

### 3 *Fair and equitable treatment as an overriding obligation?*

Far from dispensability, another understanding exalts fair and equitable treatment as a sort of master norm. In this sense, Mann in particular describes fair and equitable treatment as an 'overriding obligation' and observes:

So general a provision is likely to be almost sufficient to cover all conceivable cases, and it may well be that other provisions of the agreements affording substantive protection are no more than examples or specific instances of this overriding duty.<sup>1367</sup>

Mann challenges the belief that other standards of treatment can add anything substantial to an investment agreement already incorporating a fair and equitable treatment clause and therefore appears to make these obligations dispensable by attesting them an independent significance only in rare cases.<sup>1368</sup> Other instances similarly suggest that an assertion of fair and equitable treatment at the beginning of a clause comprises the subsequent obligations within this clause, being then part of the broader concept of fair and equitable treatment.<sup>1369</sup> The idea of an overarching nature of the fair and equitable treatment standard is also supported by the formulation in Article III(2) of the 1992 World Bank Guidelines,<sup>1370</sup> which accord fair and equitable treatment to foreign investors and, beyond that, relate the standard to the guidelines as a

<sup>1367</sup> Mann (above fn. 47), p. 243; see also Behrens (above fn. 497), p. 168.

<sup>1368</sup> Mann (above fn. 47), p. 245.

<sup>1369</sup> See *Noble Ventures Inc. v. Romania* (above fn. 767), at para. 182; and UNCTAD (above fn. 419), p. 222.

<sup>1370</sup> Article III(2) of the World Bank Guidelines recommends:

2. Each state will extend to investments established in its territory by nationals of any other state fair and equitable treatment according to the standards recommended in these guidelines.

whole.<sup>1371</sup> Further evidence that fair and equitable treatment also encompasses other standards may be derived from the practice of several states already stipulating fair and equitable treatment in the preamble of international investment agreements.<sup>1372</sup> All of these instances bolster the impression that the general concept of fair and equitable treatment embraces other standards of treatment, at least in investment agreements indicating such a relationship in their wording.

However, what is gained by construing fair and equitable treatment as a paramount conception in international investment agreements? Does this involve any breach of another standard amounting *ipso iure* to an infringement of the overriding obligation of fair and equitable treatment? While fair and equitable treatment is indeed expressive of paramount ideas of justice, the latter view is not supported by arbitral jurisprudence treating fair and equitable treatment mostly as an obligation that is distinct from the others.<sup>1373</sup> To such an extent, the interrelatedness of standards of treatment<sup>1374</sup> does not result from them being embraced by one overarching super standard, but by the fact that arbitral tribunals rely on a similar justificatory reasoning in the application of all of these obligations. While this reliance on comparable principles exhibits sizeable intersections between different investment treaty provisions, it does not by itself establish any relationship of superiority or subordination among those norms.

As the concept of fair and equitable treatment is of a comprehensive and relatively open-ended nature, it nevertheless appears possible to construe this provision as an overriding standard. However, this would involve a number of serious problems. In particular, it seems that, irrespective of the large intersections, every investment treaty norm has a well-established place in international economic relations and has, over time, acquired a particular shape and concept.

<sup>1371</sup> See also the Report to the Development Committee on the Legal Framework for the Treatment of Foreign Investment, in Shihata (above fn. 15), p. 204; for similar remarks, see WTO Working Group on the Relationship between Trade and Investment (above fn. 1230), pp. 9–10, comparing the standards of treatment within the WTO framework and investment treaties.

<sup>1372</sup> Examples are provided by several US FCN treaties: see UNCTAD (above fn. 419), p. 223.

<sup>1373</sup> See, e.g. *Noble Ventures Inc. v. Romania* (above fn. 767), at para. 182; and *PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Turkey* (above fn. 450), at para. 239; see also UNCTAD (above fn. 419), p. 223.

<sup>1374</sup> The relatedness of the different standards of treatment is also recognised by Wälde (above fn. 137), p. 202.

The construction of an all-embracing master norm would gradually obliterate the traditional provenance of the different provisions. Furthermore, it appears inherently implausible that various provisions merge into one paramount obligation, although the provisions are stipulated as distinct obligations in the text of an investment agreement.<sup>1375</sup>

Moreover, the idea of an overriding obligation carries an inherent danger that, even though a particular obligation has been deliberately omitted in an agreement, this obligation may be introduced into an agreement through the back door of fair and equitable treatment. Arguably, such a construction would hardly comply with the original intentions of the parties to the agreement. Even if, in this case, the pertinent background principle is still of relevance via fair and equitable treatment, it may be that the concept of fair and equitable treatment commands the consideration of additional arguments derived from other principles involving, therefore, a more comprehensive process of balancing. Consequently, the decision in favour or against the incorporation of a particular obligation in addition to a fair and equitable treatment clause may also result in different findings of arbitral tribunals.

In summary, any understanding of fair and equitable treatment as an overriding obligation or as an underlying gap-filler appears to be opposed by a number of arguments. These arguments rather militate in favour of a construction of fair and equitable treatment as a norm with a particular and distinct concept.

### C Conclusion: fair and equitable treatment and the idea of constitutionalism

The analysis of the system of investment protection standards has identified great commonalities in the argumentative *topoi* underlying the process of reasoning concerning the different investment treaty provisions. Accordingly, the principles, which have been reviewed in the context of fair and equitable treatment, are not exclusive to this provision, but are shared by other investment treaty obligations. This is not to say that each of the mentioned principles is relevant under every standard of investment protection, nor to say that there are no other

<sup>1375</sup> See also Vasciannie (above fn. 2), p. 148.

relevant principles. However, a set of principles seems to have emerged that serves as a joint justificatory basis within the system of international investment law. Moreover, it has been argued that this set of principles is not limited to international investment law, but extends to or is part of a body of principles common to international economic law as a whole.<sup>1376</sup> To such an extent, while leaving aside all variations and controversies in detail, the principles underlying fair and equitable treatment appear to be the nucleus of a consolidating trend in international investment law. In recognising this trend, some scholars have even suggested that international investment law is undergoing a process of constitutionalisation.<sup>1377</sup> In order to complete the picture of fair and equitable treatment, the following survey attempts to outline some arguments suggesting that the principles of fair and equitable treatment contribute to such a fundamental process.

Constitutions are traditionally reserved for nation states. Nevertheless, the idea of constitutionalism has been increasingly transposed to the international level.<sup>1378</sup> Particularly in the European context, the widespread usage of constitutional terminology has led to a general acceptance of the notion of constitutionalisation in relation to the legal developments occurring in the European Union.<sup>1379</sup> In addition, the idea of constitutionalism has been invoked with regard to the founding treaties of international organisations such as the UN Charter,<sup>1380</sup> or other fundamental norms of international law like *ius cogens*, obligations *erga omnes* and human rights.<sup>1381</sup> Finally, and most interestingly for the present purposes, constitutionalist thinking has entered the realm of international economic law and is thereby especially connected with the

<sup>1376</sup> Weiler (above fn. 104).

<sup>1377</sup> See A. Afilalo, 'Constitutionalization through the Back Door', N.Y.U.J. Int'l L. & Pol. 34 (2001), p. 1; Behrens (above fn. 497); and D. Schneiderman, *Constitutionalizing Economic Globalization* (2008).

<sup>1378</sup> See already A. Verdross, *Die Verfassung der Völkerrechtsgemeinschaft* (1926); see also P. Allott, *Eumomia* (1990), pp. 167 et seq.

<sup>1379</sup> See, e.g. J. Schwarze and R. Bieber (eds.), *Eine Verfassung für Europa* (1984); A. Peters, *Elemente einer Theorie der Verfassung Europas* (2001); and A. von Bogdandy and J. Bast (eds.), *Principles of European Constitutional Law* (2006). This process of constitutionalisation has been fortified by the adoption of the Treaty of Lisbon, although its text has been mainly freed from constitutional terminology.

<sup>1380</sup> See B. Fassbender, 'The United Nations Charter as Constitution of the International Community', *Colum. J. Transnat'l L.* 36 (1998), p. 529.

<sup>1381</sup> For an overview, see B. Fassbender, 'The Meaning of International Constitutional Law', in R. S. J. Macdonald and D. M. Johnston (eds.), *Towards World Constitutionalism* (2005), p. 837 at pp. 842 et seq.; and Kadelbach and Kleinlein (above fn. 1192), pp. 313 et seq.

creation of the WTO's institutional framework.<sup>1382</sup> However, what do all these concepts or regimes have in common in order to be associated with an idea of international constitutionalism?

A basic premise of constitutionalist thinking in international law emerges from the perception that international law increasingly exhibits a communitarian character, gradually displacing traditional paradigms of power and reciprocity by a global common interest and common objectives or values.<sup>1383</sup> Beyond that, however, an established set of criteria for the determination of the constitutional quality of a legal document or regime does not yet exist. Nevertheless, several attempts to circumscribe the essential functions of an international constitution have been made, portraying it mainly as the sum of hierarchically superior norms which express the fundamental structure and values of a legal entity, specify the production and application of inferior norms, as well as constitute, orientate, limit and legitimise the public power that is exercised within this entity.<sup>1384</sup> In various instances, the emergence of such fundamental norms has also been equated with the evolution of principles of a legal system.<sup>1385</sup> In this sense, the stages of development of international law, reaching from coordination and cooperation to a process of constitutionalisation, are also described as the change of a system's orientation from power to rules and ultimately to principles.<sup>1386</sup> Furthermore, it has been suggested that the constitutionalisation of international law is considerably propelled by a

<sup>1382</sup> See, e.g. E.-U. Petersmann, 'The Transformation of the World Trading System through the 1994 Agreement Establishing the World Trade Organization', *EJIL* 6 (1995), p. 161; and Jackson (above fn. 1226), pp. 339 et seq.

<sup>1383</sup> See C. Tomuschat, 'Obligations Arising for States Without or Against their Will', *RdC* 241 (1993 IV), p. 195 at pp. 216 et seq.; M. Nettesheim, 'Von der Verhandlungsdiplomatie zur internationalen Verfassungsordnung', *Jahrbuch für Neue Politische Ökonomie* 19 (2000), p. 48; and A. Peters, 'Global Constitutionalism in a Nutshell', in K. Dicke et al. (eds.), *Weltinnenrecht* (2005), p. 535 at p. 541; see also Chapter 6, section A, '2 The rise of justice in international legal relations'.

<sup>1384</sup> See Allott (above fn. 1378), pp. 167-177; A. Stone Sweet, 'What is a Supranational Constitution?', *Review of Politics* 56 (1994), p. 441 at pp. 444-447; Fassbender (above fn. 1380), pp. 551 et seq.; Nettesheim (above fn. 1383), p. 57; D. Z. Cass, 'The "Constitutionalization" of International Trade Law', *EJIL* 12 (2001), p. 39 at pp. 40-41; Peters (above fn. 1379), pp. 76 et seq.; and J. H. Jackson, *Sovereignty, the WTO and Changing Fundamentals of International Law* (2006), pp. 222 et seq.

<sup>1385</sup> See von Bogdandy (above fn. 1190); Kadelbach and Kleinlein (above fn. 1192), pp. 337 et seq.; and van Aaken (above fn. 360), p. 492.

<sup>1386</sup> See Hilf (above fn. 1192). He is inspired by Jackson's observation of the evolution of world trade law from a power-based to a rule-oriented system: see J. H. Jackson, *Restructuring the GATT System* (1990), pp. 49 et seq.

process of judicial decision-making that applies and is informed by domestic constitutional concepts and techniques.<sup>1387</sup> Finally, a process of constitutionalisation has also been considered to entail a shift from a mainly horizontally organised, private, law-like system to a more vertical, public, law-like system – a shift from contract to constitution.<sup>1388</sup>

Altogether, these explanations display a very broad spectrum of different facets of the idea of constitutionalism. Therefore, in one way or another it appears almost always possible to ascribe certain facets of this idea to a legal regime. The same is of course true for international investment law. Accordingly, the potential of investment protection guarantees to impose constraints on the exercise of public power by host states in relation to foreign investors and to limit the number of available policy options has been identified as an important constitutional function of international investment law.<sup>1389</sup> Moreover, the typical design of investment agreements, granting individuals access to an effective system of remedies for violations of treaty provisions, which thereby become directly effective, reveals a constitutional dimension that is elsewhere only acknowledged in some international human rights regimes and in EU law.<sup>1390</sup> However, while the investor-state dispute settlement mechanisms indeed represent ground-breaking features in public international law, the binding force of international obligations freely assumed by states appears far less innovative.

Another aspect of a possible constitutionalisation of international investment law relates to the emergence of the principles of fair and equitable treatment. These principles are increasingly established in arbitral jurisprudence and orientate the application of fair and equitable treatment as well as other investment treaty provisions by providing justificatory reasons for particular arbitral decisions. Moreover, it has formerly been discussed that these principles are representative of a certain overlapping consensus and to such an extent are reflective of an idea of international justice and common good.<sup>1391</sup> Not

<sup>1387</sup> Cass (above fn. 1384). <sup>1388</sup> See Peters (above fn. 1383), p. 545.

<sup>1389</sup> See Afilalo (above fn. 1377), pp. 6-7; Behrens (above fn. 497), p. 154; and Schneiderman (above fn. 1377), p. 69.

<sup>1390</sup> See Afilalo (above fn. 1377), pp. 32 et seq.; and Behrens (above fn. 497), pp. 153-154. In EU law, 'direct effect' has been recognised since *Van Gend en Loos v. Administratie der Belastingen*, ECJ Case 26/62 (Judgment of 5 February 1963), as a fundamental legal principle making obligations imposed by EU law upon member states directly enforceable by individuals before national and European courts.

<sup>1391</sup> See Chapter 6, 'Fair and equitable treatment and justice'.

surprisingly, principles like those of fair and equitable treatment are often considered as constitutional meta-norms which express the fundamental values of a legal system, infusing it with a sense of meaning and objectivity.<sup>1392</sup> In addition, the construction of such principles creates an impression of coherence and unity within a particular legal system. Combined with the justificatory function of the principles of fair and equitable treatment, all of this contributes to an increased legitimacy of international investment law also being recognised as an important facet of the idea of constitutionalism.<sup>1393</sup>

The process of arbitral decision-making pertaining to the principles of fair and equitable treatment exhibits additional potential for an incipient constitutionalisation of international investment law. This is especially because techniques of judicial balancing of competing principles and values mainly originate from domestic constitutional law.<sup>1394</sup> Furthermore, several arbitral tribunals seem to apply constitutional law doctrines like rationality and proportionality tests. Thereby, the growing tendencies of arbitral tribunals also to consider arguments not primarily connected with investment protection, derived for instance from the principle of sustainable development, contribute to an impression of universality similar to the integrative function of domestic constitutions.<sup>1395</sup> Taken together, these tendencies may well be indicative of the increasingly public, law-like character of international investment law<sup>1396</sup> and the gradual emergence of a principled deep structure of this legal system.

However, it appears premature to take these still tentative trends as positive proof of a robust process of constitutionalisation.<sup>1397</sup> In particular, the present understanding of the principled structure of international investment law does not establish a hierarchical legal system with a clear distinction between constitutional primary norms and inferior secondary norms. In this vein, the principles of fair and equitable treatment have been perceived as sources of justificatory arguments guiding the application and process of reasoning on particular investment treaty norms, and not as superior commands trumping any other norms. Consequently, perhaps with the exception of investor-state dispute settlement mechanisms, the normative structure of

<sup>1392</sup> See van Aaken (above fn. 360), pp. 507 et seq.

<sup>1393</sup> See Peters (above fn. 1383), pp. 549–550. <sup>1394</sup> See, e.g. Alexy (above fn. 620).

<sup>1395</sup> See also van Aaken (above fn. 357), pp. 124 et seq.

<sup>1396</sup> Thereon, see Van Harten (above fn. 62); and Kingsbury and Schill (above fn. 120).

<sup>1397</sup> See also Schneiderman (above fn. 1377), p. 44.

international investment law has not yet evolved to such an extent that it departs fundamentally from traditional normative patterns of international law.

Apart from that, the idea of constitutionalism encounters further difficulties in the context of international investment law. Such difficulties result especially from the weak institutional design and from the scattered appearance of investment protection obligations in thousands of different international agreements. In contrast to world trade law, international investment law is neither governed by one so-called world order treaty with quasi-universal membership,<sup>1398</sup> nor has it spawned a central international organisation that would establish a coherent system of international governance in investment matters. Rather, the dense network of different agreements stipulating investment protection obligations pertains to a whole range of distinct international institutions.<sup>1399</sup> Certainly, international investment law has made important steps towards a process of multilateralisation,<sup>1400</sup> such as the negotiation of similar investment agreements, the widespread adoption of most-favoured-nation obligations, the creation of centralised foreign direct investment competences at the European level<sup>1401</sup> and, in particular, the emergence of a principled structure. Nevertheless, international investment law is still struggling to overcome its own fragmented state. Whether this process will ultimately result in a multilateral investment agreement and whether such a step would leverage the idea of constitutionalism in international investment law, remains a matter of speculation.

After all, it seems that the extent to which one is inclined to accept and advance the idea of constitutionalism in international investment law is strongly dependent on the degree of perceived legitimacy of the system and its arbitral awards.<sup>1402</sup> The normative vigour of international investment law appears ultimately acceptable only if it facilitates

<sup>1398</sup> On 'world order treaties', see B. Simma, 'From Bilateralism to Community Interest', RdC 250 (1994 VI), p. 217 at pp. 322 et seq.

<sup>1399</sup> Just to mention a few examples: NAFTA Secretariat, ECT Conference, ICSID, UNCTAD, OECD, MIGA and WTO.

<sup>1400</sup> See comprehensively Schill (above fn. 3).

<sup>1401</sup> See Article 207(1) of the Treaty on the Functioning of the European Union (TFEU); see also T. Eilmansberger, 'Bilateral Investment Treaties and EU Law', CMLR 46 (2009), p. 383.

<sup>1402</sup> See Afilalo (above fn. 1377); and Schneiderman (above fn. 1377). Both authors criticise the constitutionalisation of international investment law due to the perceived illegitimacy of investment arbitration.

*good* governance for all affected parties- investors and states. At the very least, the idea of constitutionalism places a stronger emphasis on the question of how to constitute and legitimise a particular system of governance. This question is also addressed by the principles of fair and equitable treatment as a possible basis for a fairness discourse in international investment law.

## 10 Conclusion

This book has attempted to shed light on the guarantee of fair and equitable treatment for foreign investors in international investment law. As the most general clause in international investment agreements, fair and equitable treatment is, like no other investment protection obligation, Janus-faced. On the one hand, fair and equitable treatment depicts a norm which is couched in simple and plausible words, hardly controvertible by anyone. As such, it appears to be a universally accepted standard in international investment relations. On the other hand, the vagueness of this norm triggers fervid controversies on the concrete meaning of fair and equitable treatment and causes great difficulties in its judicial application on particular factual situations. Moreover, just as Janus is considered in Roman mythology as the deity of gates, bridges and transition, fair and equitable treatment has been referred to as a gateway to other sub-systems of international law and an overarching idea of justice. In the same vein, fair and equitable treatment has been described as a bridge between seemingly conflicting conceptions of investment protection and the sovereignty of states - the transition between stability and change.

However, unlike the figure of Janus, the concept of fair and equitable treatment neither emanates from an ancient legend nor from a mythical intrinsic meaning of its words, but is rather a man-made construction of arbitrators dealing with this norm. In spite of the norm's indeterminacy, the task of constructing and concretising fair and equitable treatment, being endowed upon arbitrators by the treaty-drafters, does not represent a sphere of free creative activity, but is accompanied by a requirement to justify the particular construction of fair and equitable treatment by means of reasoning. This constructive function of arbitrators and the relevant reasons requirement are often neglected in the discussion surrounding fair

and equitable treatment. In particular, the dichotomy between the so-called plain meaning and equating approaches appears to present a deficient justificatory basis for the construction of fair and equitable treatment. This is particularly because both approaches appear overly simplistic and thereby unable to cope with the inherently flexible and integrative nature of fair and equitable treatment as a general safeguard clause.

In this book, it has therefore been argued that a much broader justificatory basis of fair and equitable treatment is called for. This conceptual basis should not limit prematurely the scope of admissible arguments in the discourse on fair and equitable treatment to merely textual arguments based on the indeterminate wording of this norm or to historical arguments derived from the contentious international minimum standard. Rather, the concept of fair and equitable treatment should be seen as an integrative scheme that allows the introduction of arguments originating from various sub-systems of international law. Furthermore, the concept has to be anchored in a deeper idea of justice in order to contribute to an increased legitimacy and acceptance of the norm. However, this is not to say that any kind of argument derived from whatever source may be employed to combat any perceived injustice under the guise of fair and equitable treatment. Accordingly, a fairness discourse critically accompanying the development of fair and equitable treatment needs to be established so as to reconcile the competing interests at stake.

By tacitly approving such a broad and flexible concept, arbitral jurisprudence increasingly attributes certain sub-elements to fair and equitable treatment, of which sovereignty, legitimate expectations of investors, non-discrimination, sustainable development, fair procedure and transparency have received particular attention in this book. These principles have been said to serve as sources of justificatory arguments which need to be carefully balanced against each other in order to arrive at a well-reasoned decision. The further concretisation and deepening of these principles appears to be an enduring process. However, this process may and should be enriched by a comparative analysis of functionally equivalent principles in other spheres of domestic or international law. It has also been attempted in this book to provide such a comparative overview, which again reflects the integrative nature of fair and equitable treatment. Thereby, it has been revealed that virtually all principles of fair and equitable treatment are rooted in well-acknowledged legal concepts deriving from various sub-systems of international or even national law.

Crucial to the rationality of arbitral balancing of principles are furthermore the structure and intensity of the review, although these have received little attention so far. While many arbitral tribunals tentatively acknowledge a number of legitimate objectives a state action may pursue, they usually do not explain why certain questions arising in a dispute are scrutinised more strictly than others. This ignorance furthers the emergence of inconsistent arbitral decisions, threatening the overall legitimacy and rationality of fair and equitable treatment. Certainly, such deficits pose serious problems to international investment law as a whole, but are hardly a surprising phenomenon considering that this field of law is still very young. While the further concretisation of the principles of fair and equitable treatment may mitigate some of the rationality deficits, it is questionable whether they can be vanquished completely. Although many questions relating to fair and equitable treatment will therefore also remain contentious in the future, the concept of fair and equitable treatment is nevertheless revealing an increasing number of contours. These contours may be interpreted, indeed, as signs towards the emergence of an overlapping consensus with regard to the treatment of foreign investors.

These contours allow further statements as to the position of fair and equitable treatment in the overall system of international law. In particular, it appears that the cumbersome discussions surrounding the status of fair and equitable treatment in the system of international law sources are rendered moot. Since fair and equitable treatment is stipulated in international investment agreements, it should be perceived as a treaty obligation and not as something else. The parallels to other sources of international law are mainly due to the fact that fair and equitable treatment incorporates argumentative principles which are often recognised as norms of customary law or general principles of law, but which also act at a more abstract level. At this level, arguments derived from these principles are also taken into account by arbitral tribunals in order to justify decisions on other investment protection standards. The latter explains the substantive intersections that exist between fair and equitable treatment and various other provisions of investment agreements being phrased in similarly vague terms.

Whether the emergence of common principles of international investment law, or even of international economic law, is reflective of a deeper process of constitutionalisation is a question that ultimately extends beyond the scope of this book. While there might be certain arguments which buttress this conclusion, the idea of a constitutionalised system of

international investment law evokes strong concerns as to the legitimacy of such a system. The concept of fair and equitable treatment and the pertaining fairness discourse, as presented here, nevertheless appear to be a possible way of fortifying the legitimating foundation of fair and equitable treatment. Arguably, there are, however, still further steps to be taken in this direction in order to arrive at a discourse which actually focuses on the inherent fairness rationale of fair and equitable treatment. An attempt has been made in this book to discuss some important issues of such a discourse. However, only the handling of investor-state arbitration within the global economic crisis and other future challenges will reveal whether the system is capable of truly reconciling the pull for stability and the push for change.

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A breach of fair and equitable treatment is alleged in almost every investor–state dispute. It has therefore become a controversial norm, which touches many questions at the heart of general international law. Roland Kläger sheds light on these controversies by exploring the deeper doctrinal foundations of fair and equitable treatment and reviewing its contentious relationship with the international minimum standard. The norm is also discussed in light of the fragmentation of international law, theories of international justice and rational balancing, and the idea of constitutionalism in international law. In this vein, a shift in the way of addressing fair and equitable treatment is proposed by focusing on the process of justificatory reasoning.

ROLAND KLÄGER is currently a law clerk at the Higher Regional Court of Frankfurt and a research assistant with Clifford Chance, Frankfurt. After his legal studies at the University of Freiburg, he received a Dr. iur. from the University of Tübingen. He was also a research fellow at the Institute for Public Law, University of Freiburg, and a visiting fellow at the Lauterpacht Centre for International Law, University of Cambridge.

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