Arguments in Favour of Reconceptualising the Fair and Equitable Treatment (FET) Standard in International Investment Arbitration: Developing Countries in Context

By

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Dedication

To the beloved memory of my father, the sole inspiration for my PhD.

Declaration

I **Rumana Islam**, hereby declare, in fulfilment of the requirements of University of Warwick for the presentation of a thesis that this thesis is my original work which to the best of my knowledge, information and belief does not infringe on the rights of any third parties. I also confirm that it has not been submitted either in part or in full before any other University for the award of any Degree of Diploma and does not contain any publication(s) by me prior to the commencement of my PhD research.

Abstract

The Fair and Equitable Treatment (FET) standard is the most important and, because of its flexible nature and its status as a 'catch-all' provision, most controversial investment protection standard in international investment treaties. The standard imposes the most far-reaching obligation of any aspect of such treaties. This thesis' core contention is that the current investment tribunals' interpretation of the FET standard prioritises the interests of foreign investors and neglects the perspectives of host developing countries. Therefore there is a pressing need to reconceptualise the interpretation of the FET standard. In service to depicting the perspectives of host developing countries, this thesis advances an understanding of classifications such as 'developing' and 'developed' that reflects the issues and challenges that these countries face in the investment dispute context, such as their lack of resources, administrative capacity, technology, and infrastructure, as much as the economic and social level of development international organisations generally emphasise in their classifications. It addresses socio-political circumstances such as political instability, social unrest, conflict and its aftermath, social and political transition, and economic crises and their impact on host developing countries in the investment dispute context. Through a detailed study of the approaches they have taken to such issues in their interpretation of the breach of FET standard in disputes involving host developing countries, it shows that current investment tribunals have taken inconsistent and inadequate approaches to the issues host developing countries face. It argues that a reconceptualised interpretation of the FET standard which acknowledges the developmental issues and challenges this thesis has identified would accommodate the needs of the host developing countries while continuing to give reasonable protections to foreign investors and therefore serve the needs of the system as a whole.

List of Abbreviations

African, Caribbean and Pacific	ACP
Association of Southeast Asian Nations	ASEAN
Bilateral Investment Treaty	BIT
Centrally Planned Economies	CPEs
Charter of Economic Rights and Duties of States	CERDS
China International Economic and Trade Arbitration Commission	CIETAC
Code of Conduct on Transnational Corporations	CTC
Discounted Cash Flow	DCF
Economic Partnership Agreement	EPA
Energy Charter Treaty	ECT
Estonian Innovation Bank	EIB
Foreign Direct Investment	FDI
Free Trade Agreements	FTA
Free Trade Commission	FTC
Generalized System of Preference	GSP
Gross Domestic Product	GDP
Gross National Income	GNI
Gross National Product	GNP
Human Development Index	HDI
International Centre for Settlement of Investment Disputes	ICSID
International Chamber of Commerce	ICC
International Investment Agreements	IIAs
International Monetary Fund	IMF
International Trade Organization	ITO

Least Developed Country	LDC
London Court of International Arbitration	LCIA
London Interbank Offered Rate	LIBOR
Most Favoured Nation	MFN
Multilateral Agreement on Investment	MAI
Multilateral Investment Agency	MIGA
National Association of Certified Valuation Analyst	NACVA
New International Economic Order	NIEO
Non-Governmental Organization	NGO
North American Free Trade Agreement	NAFTA
Organization of Economic Cooperation and Development	OECD
Overseas Development Institute	ODI
Permanent Court of International Justice	PCIJ
Power Purchase Agreement	PPA
Producer Price Index	PPI
Southern Common Market	MERCOSUR
Treaties of Friendship, Commerce and Navigation	FCNs
United Nations	UN
United Nations Commission on International Trade Law	UNCITRAL
United Nations Conference on Trade and Development	UNCTAD
United Nations Development Programme	UNDP
United Nations Treaty Series	UNTS
World Bank	WB
World Economic Outlook	WEO
World Trade Organization	WTO
World War I	WWI

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Chapter 1

An Overview of the Study

1.1 Introduction

The principal contention of this thesis is that international investment tribunals, in the interpretation of the 'fair and equitable treatment' (FET) standard, have prioritized investors' protection over the developmental issues and challenges of the host 'developing countries.'[1] Therefore, there is a pressing need to revisit the interpretation of the FET standard by investment tribunals from the perspective of the host developing countries in receipt of foreign direct investment (FDI). Within this overarching argument, this thesis aims to (i) identify the key problems in the interpretation of the FET standard by the current investment tribunals from the perspectives of developing countries and (ii) to consider how the FET standard might be re-conceptualised to remedy these problems in order to facilitate more host developing country sensitive interpretation of the standard in the future.

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[1] Convergent with the various phrases used to describe the large number of countries implicated within the discussions presented within Chapter 4 of this thesis, the phrase 'developing countries' is used throughout as a generic term. A structural bias in favour of the investors in the international investment regime has been discussed by some scholars. See e.g., Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press 2007) 12-43. Also see e.g. Gus Van Harten, 'Perceived Bias in Investment Treaty Arbitration' in Michael Waibel and others (eds), *The Backlash Against Investment Arbitration* (Kluwer Law International 2010) 433; M Sornarajah, 'A Developing Country Perspective of International Economic Law in the Context of Dispute Settlement' in Asif H Qureshi (ed), *Perspectives in International Economic* Law (Kluwer Law International 2002) 83, 103; David Schneiderman, 'Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes' (2010) 30 Northwestern Journal of International Law and Business 383; Surya P Subedi, *International Investment Law : Reconciling Policy and Principle* (2nd edn, Oxford University Press 2012) 2; M Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' in Catherine A Rogers and Roger P Alford (eds), *The Future of Investment Arbitration* (Oxford University Press 2009) 293; M Sornarajah, 'The Fair and Equitable Standard of Treatment: Whose Fairness? Whose Equity' in Federico Ortino, Lahra Liberti, Audley Sheppard and Hugo Warner (eds) *Investment Treaty Laws: Current Issues II* (British Institute of International and Comparative Law 2007) 167, 174. Such concerns for structural bias in in international law in general has been examined by other scholars, see generally e.g., Anthony Angie, *Imperialism, Sovereignty and the Making of the International Law* (Cambridge University Press 2007); Sundhya Pahuja, *Decolonising International Law: Development, Economic Growth and the Politics of Universality* (Cambridge University Press 2011).

The key arguments of this thesis are: (i) that the FET standard serves as a core (if not *the* core*)* protection instrument for foreign investors; (ii) that despite wide variations in constructions there remains sufficient similarity across the investment treaties to argue that there is an overarching and singular concept of FET that can be the subject of the detailed analysis in this thesis; (iii) that there is a need to identify a concept of development that is appropriate in the context of investment disputes, and that this will assist investment tribunals to deal with host developing countries more appropriately; (iv) that investment tribunals have adopted a wide variety of different approaches to the interpretation of the obligations created by the FET standard and the fact that the tribunals have largely failed to consider adequately certain pivotal developmental issues and challenges (v) as a consequence, that there is a need for a re-conceptualised FET standard which would provide a broader scope for investment tribunals to address the needs of host developing countries.

The thesis provides three different case studies in relation to different issues faced by host developing countries in investment disputes — (i) social and political circumstances (i.e. political crises and other serious socio-political circumstances faced by developing countries); (ii) transitory status (i.e. situations where the country is in transition from communism to a market based economy) and (iii) economic crises. These case studies will be utilized to demonstrate the thesis's core argument.

This present chapter will provide a background to the study, the research questions addressed, the methodology adopted for the research and an outline of the individual chapters. The next section will describe the choice to focus on the treatment of host

developing countries by investment tribunals in their interpretation of the FET standard.

1.2 Background of the Study

1.2.1 International Investment Law and the Settlement of Disputes

The domain of international investment law is one of most complex areas of international law and its breadth is still expanding.[2] A number of bilateral and regional investment treaties, customary international law, the jurisprudence developed by the investment tribunals, and some soft law instruments adopted under the United Nations (UN) provide the basis for international investment law.[3] While a considerable number of international treaties cover a wide range of areas of international activity,[4] no single comprehensive treaty deals with international investment law.[5] This absence has not however restricted the ever expanding body of the law regulating foreign investment; almost three thousand investment treaties[6] provide regulation, a majority of which are bilateral investment treaties (BITs)[7], although many free trade agreements (FTAs)[8] and regional investment treaties also exist. In addition to this large number of investment treaties an escalating body of arbitral jurisprudence has shaped the content of investment law over the past two decades.

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[2] For and overview of international investment law in general see e.g. Asif H Qureshi and Andreas R Ziegler, *International Economic Law* (3rd edn, Sweet and Maxwell 2011) Chapter 14.

[3] Surya P Subedi, 'International Investment Law' in Malcolm D Evans (ed), *International Law* (Oxford University Press 2014) 727; See generally e.g., Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2008); Surya P Subedi, *International Investment Law: Reconciling Policy and Principle* (n1).

[4] For example the Convention on the Law of the Sea, 1982; The Convention on International Trade in Endangered Species of Wild Fauna and Flora, 1975; or the UN Convention on the Rights of the Child, 1990.

[5] Subedi, 'International Investment Law' (n 3) 727.

[6] See e.g. <http://www.iisd.org/investment/law/treaties.aspx.> accessed 2 September 2014.

[7] For country specific BITs see e.g. <http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20(IIA)/Country-specific-Lists-of-BITs.aspx> accessed 25 August 2014.

[8] Which generally includes substantive provisions dealing with investment.

BITs have been popular because governments and investors believe they help to create an effective mechanism of 'depoliticization' of investment disputes.[9] Investment treaties generally contain a variety of core provisions on investment protection standards, such as the FET, Most Favoured Nation (MFN) treatment, national treatment, full protection and security, protection against expropriation, umbrella clauses, protection against arbitrary and discriminatory measures, and a clause containing the dispute settlement mechanism for the parties. Most rely on the existing instruments of international investment arbitration, primarily the World Banks' (WB) International Centre for Settlement of Investment Disputes (ICSID) based on the ICSID Convention of 1965[10] and the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) of 1958.[11] ICSID has become the main forum for settlement of investment disputes between foreign investors and the host countries. Many treaties refer to the arbitration rules created by the UN Commission on International Trade Law (UNCITRAL) in 1976[12] to govern claim filing by foreign investors.[13] The 1994 North American Free Trade Agreement (NAFTA), however, provides for its own dispute settlement mechanism.[14] Other treaties require the use of commercial arbitration such as the International Chamber of Commerce (ICC) or the London Court of International Arbitration (LCIA). These do not exclude investor-state

[9] Subedi 'International Investment Law' (n 3) 747.

[10] Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) signed in Washington on 18 March 1965 and entered into force on 14 October 1966. See generally Moshe Hirsch, *The Arbitration Mechanism of The International Centre For the Settlement Of Investment Disputes* (Martinus Nijhoff Publishers 1993) 11-15; John Graham Merrills, *International Dispute Settlement* (Cambridge University Press 2011) 113; Christoph H Schreuer, *The ICSID Convention: A Commentary* (2nd edn, Cambridge University Press 2009).

[11] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) signed in New York on 10 June 1958 and entered into force on 7 June 1959.

[12]Arbitration Rules of UNCITRAL, UN General Assembly Resolution 31/98 of 1976 <http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf>accessed 5 July 2014.

[13] Dispute Settlement: Investor-State, UNCTAD Series on Issues in International Investment Agreements (UNCTAD 2003) 35 <http://unctad.org/en/docs/iteiit20031_en.pdf> accessed 25 August 2014.

[14] Article 1120 of NAFTA provides for consent to alternatively under the ICSID Convention, under the Additional Facility and under the UNCITRAL Arbitration Rules, 1976.

arbitration despite a clear difference between classical commercial arbitration and investment arbitration between a foreign investor and the host country.[15] There are some regional arbitration centres, one example being the China International Economic and Trade Arbitration Commission (CIETAC).[16]

1.2.2 Developing Countries in Investment Dispute Arbitration

The bulk of the FDI flows into developing and former communist countries.[17] Dodge observed that investment treaties have been until recently 'reciprocal in theory but not in fact, for it is generally only the less developed country that bears the risk of being sued.'[18] This research focuses particularly on the claims against host developing countries because foreign investors have made a large number of them, and their implications for these countries raise concerns. This concern is reflected in the statistics provided below.

Gallagher and Shresthra have produced a detailed and in-depth study that reveals the scope of the problem, providing statistics on claims and the economic effects of the compensation foreign investors have received.[19] Their study responds in part to Susan Franck's econometric analysis studying the relationship between the development status of the host government and awards, both in terms of win-loss and amounts in each

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[15] Dolzer and Schreuer, *Principles of International Investment Law* (n 3) 225.
[16] For disputes in various other institutions see e.g. Julian DM Lew, 'Fundamental Problems in International Arbitration' in Loukas A. Mistelis and Julian DM Lew (eds), *Pervasive Problems in International Arbitration*, (Kluwer Law International 2006) 1-3.
[17] Harten, *Investment Treaty Arbitration and Public Law* (n 1) 6.
[18] William S Dodge, 'Investor-State Dispute Settlement between Developed Countries: Reflections on the Australia-United States Free Trade Agreement' (2006) 39(1) Vanderbilt Journal of Transnational Law 1, 3. Also see Philippe Sands, *Lawless World: Making and Breaking Global Rules* (Penguin 2006) 141.
[19] Kevin P Gallagher and Elen Shrestha, 'Investment Treaty Arbitration and Developing Countries: A Re-Appraisal' (2011) 12 Journal of the World Investment and Trade 919. On an account of implications of financial burdens of the Awards against developing countries with particular reference to cases against Argentina see e.g., Bernard Hoekman and Richard Newfarmer, 'Preferential Trade Agreements, Investment Disciplines and Investment Flows' (2005) 39(5) Journal of World Trade 949, 965-966.

award.[20] Studying the data on awards up to 2007, she found no significant relationship between the development status of the host country, development status of the arbitrator, and the outcome of the arbitration. A number of scholars have disputed this finding,[21] including Harten, who provides an account of elaborate statistics on the disputes initiated against the developing countries and the amount of the award rendered against them and their economic effect.[22] Gallagher and Shresthra's study is more recent, which is why this thesis uses it here, along with a recent study by the UN Conference on Trade and Development (UNCTAD) and a non-governmental organisation (NGO).[23]

Gallagher and Shresthra show that the average claim US investors have brought against host developed countries has been around 150 million USD, while the average claim against host developing countries is around 451 million USD.[24] Furthermore, the available data and statistics from UNCTAD show larger numbers of investment claims against developing countries than developed countries.[25] Similarly, Harten's research shows that the primary target of the foreign investors in ICSID cases to date have been

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[20] Susan D Franck, 'Development and Outcomes of Investment Treaty Arbitration' (2009) 50 Harvard International Law Journal 435.

[21] Gus Van Harten, 'The Use of Quantitative Methods to Examine Possible Bias in Investment Arbitration' in Karl P Sauvant (ed), *Yearbook on International Investment Law and Policy* (Oxford University Press 2011) 859-882; Kyla Tienhaara, 'Regulatory Chill and the Threat of Arbitration: a View from Political Science' in Kate Miles Chester Brown (ed), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press 2011) 606-627.

[22] Harten, '*Investment Treaty Arbitration and Public Law* (n 1) 31-33.

[23] Press Release, Food and Water Watch, World Bank Court Grants Power to Corporations, 30 April 2007 <http://www.foodandwaterwatch.org/pressreleases/world-bank-court-grants-power-to-corporations/> accessed 25 August 2014; Also see e.g. Sarah Anderson and Sara Grusky, *Challenging Corporate Investor Rule : How the World Bank's Investment Court, Free Trade Agreements and Bilateral Investment Treaties have Unleashed a New Era of Corporate Power and What to do About it*, (Institute for Policy Studies 2007) < https://www.foodandwaterwatch.org/images/water/world-water/bank-policy/ICSID_print.pdf> accessed 25 August 2014; Investor-State Disputes Arising From Investment Treaties: A Review (UNCTAD, 2005) <http://unctad.org/en/docs/iteiit20054_en.pdf> accessed 27 August 2014; Latest Developments in Investor-State Dispute Settlement, IIA Issues Note, No.1 May 2013, 1, (UNCTAD 2013)<http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d3_en.pdf> accessed 27 August 2014.

[24] Gallagher and Shrestha (n 19) 927. Also see e.g. Gus Van Harten, 'Investment Treaties as a Constraining Framework' in Shahrukh Rafi Khan and Jens Christiansen (eds), *Towards New Developmentalism: Market as Means Rather Than Master* (Routledge 2011) 158.

[25] Gallagher and Shrestha (n 19) 923.

middle-size capital importing countries, especially Latin American countries and the former Soviet bloc.[26]

Gallagher and Shresthra describe the impact of investor's claims thus:

> 'such claims are in much larger proportion to the respective developing country share of foreign investment flows. "Upper middle income" developing nations only receive 10 percent of global FDI, but are subject to 46 percent of the claims. "Lower middles income" developing countries only receive 9 percent of global FDI inflows, but are subject to 29 percent of all claims. The "low income" developing nations receive less than one percent of FDI flows but are subject to five percent of the total claims.'[27]

Further they state,

> '[the] average award against developing countries relative to their annual government expenditure is 0.53% or 99 cents per capita. The average award amount Canada is liable for is 0.003% of its annual government spending and translates to 12 cents per capita. Thus compared to a developed country, the award amounts have a higher impact on the economy of developing countries.'[28]

A recent UNCTAD study shows that in 66 percent of the new cases filed in 2012, the respondent states were developing or transition economies.[29] The study also shows that at least 95 governments have responded to one or more investment treaty arbitrations, among which 61 were developing countries, 18 were developed countries and 16 were countries in transition.[30] The study reveals that some developing countries have faced

[26] Harten, '*Investment Treaty Arbitration and Public Law* (n 1) 32-33.
[27] Gallagher and Shrestha (n 19) 925.
[28] Gallagher and Shrestha (n 19) 927.
[29] UNCTAD, Latest Developments in Investor-State Dispute Settlement (n 23) 1.
[30] Ibid 4.

multiple disputes; Argentina has responded to the most (52 cases), followed by Venezuela (34), Ecuador (23) and Mexico (21).[31]

The US based NGO Food and Water Watch has expressed concern on the increasing number of cases initiated against developing countries and their outcomes.[32] As it stated, of disputes against national governments in 2007,

> '93 percent of the cases involve low- or middle-income developing countries…. ICSID tribunals have ruled in favor of the investor and ordered the government to pay compensation in nearly 70 percent of cases.'[33]

These statistics call attention to the importance of the treatment host developing countries receive from investment tribunals.[34] Withdrawal from the ICSID system by some developing countries, including Venezuela[35] and Ecuador,[36] is also suggestive of serious problems.

1.2.3 FET Standard in International Investment Treaties

The FET standard is perhaps the most popular standard for the investors in international law in bringing a claim in an investment dispute.[37] Foreign investors

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[31] Ibid.
[32] See e.g. Food and Water Watch, 'World Bank Court Grants Power to Corporations' (n 23).
[33] Ibid. Also see e.g. Anderson and Grusky 'Challenging Corporate Investor Rule' (n 23).
[34] This concern has been expressed by the Bolivian President who stated, "Governments in Latin America and I think all over the world never win the cases. The transnationals always win." See e.g. Jamaica-Gleaner, "Venezuela to Sell Off US Refineries," *Taipei Times*, 1 May 2007 <http://jamaica-gleaner.com/gleaner/20070501/business/business1.html> accessed 27 August 2014; Also see e.g. James M Roberts, 'If the Real Simón Bolívar Met Hugo Chávez, He'd See Red' The Heritage Foundation, August 2007) <http://www.heritage.org/research/reports/2007/08/if-the-real-simoacuten-boliacutevar-met-hugo-chaacutevez-hed-see-red> accessed 27 August 2014.
[35] See e.g. Sergey Ripinsk, 'Venezuela's Withdrawal from ICSID: What it Does and Does Not Achieve' <http://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/ > accessed 20 August 2014.
[36] See e.g. <http://uk.practicallaw.com/2-422-1266?service=arbitration> accessed 20 August 2014.
[37] Subedi, *International Investment Law: Reconciling Policy and Principle* (n1) 168; Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' (n1) 287; Christoph Schreur, 'Fair and Equitable

frequently invoke it in investor-state disputes, with a considerable amount of success. Legal scholars have called it the 'golden rule' of investment treaties,[38] acknowledged its 'almost ubiquitous presence' in investment litigation,[39] and called it the 'alpha and omega' of investor state-arbitration under Chapter 11 of NAFTA.[40] It has a potentially elastic nature that aggrieved foreign investors when seeking compensation for host countries' actions favor. Dolzer and Schreur call attention to this elasticity, saying the standard's purpose is to fill the gap other treaty standards may leave.[41] An UNCTAD study says almost every current investment dispute uses the FET standard, and that unfair administrative or governmental conduct that falls under no specific treaty obligation and the FET standard fills this gap.[42] The majority of disputes this thesis will discuss included a claim of breach of FET standard. As a 'catch-all',[43] FET is the most important and far-reaching standard among the international investment treaties. Sornarajah has raised concerns over the frequent use of the standard.[44] Likewise UNCTAD observed in a study that,

> 'There is a great deal of uncertainty concerning the precise meaning of the concept, because the notions of "fairness" and "equity" do not connote a clear set of legal prescriptions in international investment law and allow for a significant degree of subjective judgment. Some tribunals have read an extensive list of disciplines into the FET clause, which are taxing on any State, but *especially*

Treatment in Arbitral Practice' (2005) 6 Journal of World Investment and Trade 357; Harten, *International Treaty Arbitration and Public Law* (n 1) 87.

[38] Jeswald W Salacuse, *The Law f Investment Treaties* (Oxford University Press 2010) 218.

[39] Rudlof Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (2005) 39 International Lawyer 87.

[40] Charles Brower, 'Fair and Equitable Treatment under NAFTA's Investment Chapter' (2002) 96 American Society of International Law Proceedings 9.

[41] Dolzer and Schreuer, *Principles of International Investment Law* (n 3) 122.

[42] Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II (UNCTAD 2012) 7 <http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf> accessed 20 May 2014.

[43] Subedi, *International Investment Law: Reconciling Policy and Principle* (n 1) 168.

[44] Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' (n 1) 287.

on developing and least-developed countries; lack of clarity persists regarding the appropriate threshold of liability."[45] [Emphasis added]

Therefore although the standard is the most important standard in investment treaties, the frequent use of the standard by foreign investors has nevertheless created a risk for the developing countries. The expansive interpretation of the FET standard by investment tribunals was one of the reasons for Bolivia withdrawing from ICSID in 2007, following an allegation that the ICSID tribunals have tailored the standard in favour of the foreign investors.[46]

1.2.4 Scholarship on the FET standard

There are a wide range of scholarly writings on the FET standard, and considerable controversy about it.[47] This section will discuss some of this literature in order to

[45]Investment Policy Framework for Sustainable Development (UNCTAD 2012) 43< http://unctad.org/en/PublicationsLibrary/webdiaepcb2012d6_en.pdf > accessed 2 September 2014.

[46] Subedi, *International Investment Law: Reconciling Policy and Principle* (n1) 170. Also see e.g. Fernando Cabrera Diaz, 'Bolivia Expounds on Reasons for Withdrawing from ICSID Arbitration System' Investment Treaty News, 27 May 2007; Gabriela Molina, 'Ecuador Wary of World Bank Arbitration in Occidental Case' The Washington Post, 11 May 2008.

[47] For an account of scholarly writings on the standard see, e.g. Stephen Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) 70 British Yearbook of International Law 99; Dolzer, 'Fair And Equitable Treatment: A Key Standard In Investment Treaties' (n 39); Brower, 'Fair And Equitable Treatment Under NAFTA's Investment Chapter' (n 40); Katia Yannaca-Small, 'Fair and Equitable Treatment Standard: Recent Developments' in August Reinisch (ed), *Standards of Investment Protection* (Oxford University Press 2008) 111; Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford University Press 2008); Francis A Mann, 'British Treaties For The Promotion And Protection of Investments' (1999) 52 The British Year Book of International Law 242; Hussein Haeri, 'A Tale Of Two Standards: 'Fair And Equitable Treatment' and The Minimum Standard In International Law' (2011) 27(1) Arbitration International 27; Graham Mayeda, 'Playing Fair: The Meaning of Fair And Equitable Treatment In Bilateral Investment Treaties' (2007) 41(3) Journal of World Trade 273; Roland Kläger, 'Fair And Equitable Treatment: A Look at The Theoretical Underpinnings of Legitimacy And Fairness' (2010) 11(3) Journal of World Investment and Trade 435; Roland Kläger, *Fair and Equitable Treatment in International Investment Law* (Cambridge University Press 2011); Stephen W. Schill, 'Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law' (2006) 3(5) Transnational Dispute Management; Peter Muchlinski, 'Caveat Investor? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard' (2006) 55 International and Comparative Law Quarterly 527; Thomas Westcott, 'Recent Practice on Fair and Equitable Treatment" (2007)8 Journal of World Investment and Trade 409; Alexander Orakhelashvili, 'The Normative Basis of "Fair and Equitable Treatment" in Bilateral Investment Treaties' (2008)46 *Archiv des Völkerrechts* 74; Christoph Schreur, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 Journal of World Investment and Trade 357; Patrick G Foy and

explain the common elements in approaches to interpretation, although a majority of scholars do not significantly define the term. They have placed emphasis upon the summarisation of the case law and discussed the contents of the standard identified by the arbitral jurisprudence. The inherent vagueness of the standard is a key element that scholars invariably identify.

A number of scholars argue the essence of the FET standard is fairness and equity. While this leaves these concepts open to interpretation, it is also the case that some argue fairness and equity do not play such clear roles in the standard. Kläger, for example, called the concept indeterminate, stating, 'the underlying rationale of fairness and equity guiding the application of the standard is still very much an enigma which has yet to be properly addressed.'[48] Muchlinski asserts that in this context the concepts of 'fair' and 'equitable' are to a large extent interchangeable.[49] This understanding

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Robert JC Deane, 'Foreign Investment Protection Under Investment Treaties: Recent Developments Under Chapter 11 Of North American Free Trade Agreement' (2001)16(2) ICSID Review- Foreign Investment Law Journal 299; J Christopher Thomas, 'Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators' (2002)17(1) ICSID Review-Foreign Investment Law Journal 21; Patrick Dumberry, 'The Quest To Define "Fair And Equitable Treatment" For Investors Under International Law-The Case of The NAFTA Chapter 11 Pope And Talbot Awards' (2002)3 Journal of World Investment 657; Barnali Choudhury, 'Evolution or Devolution? Defining Fair and Equitable Treatment in International Investment Law' (2005) 6 Journal of World Investment and Trade 287; Christoph H Shcreuer, 'Fair and Equitable Treatment (FET): Interaction with other Standards' (2007) 4(5) Transnational Dispute Management; RH Kreindler, 'Fair and Equitable Treatment-A Comparative International Law Approach' (2006) 3(3) Transnational Dispute Management; Theodore Kill, 'Don't Cross the Streams: Past and Present Overstatement of Customary International law in Connection with Conventional Fair and Equitable Treatment Obligations' (2008) 106 Michigan Law Review 853; Sornarajah, 'The Fair and Equitable Standard of Treatment: Whose Fairness? Whose Equity' (n1)167; Kenneth J Vandevelde, 'A Unified Theory of Fair and Equitable Treatment' (2010) 43 New York University Journal of International Law and Politics 43; J Roman Picherack, 'The Expanding Scope of the Fair and Equitable Treatment Standard: Have Recent Tribunals Gone Too Far? (2008) 9 Journal of World Investment and Trade 255; M Klein Bronfman, 'Fair and Equitable Treatment: An Evolving Standard' in Armin von Bogdany and Rüdiger Wolfrum (eds) Max Planck Year Book of United Nations Law Vol. 10 (Martinus Nijhoff Publishers 2006) 610; Jeand Kalicki and Suzana Medeiros, 'Fair, Equitable and Ambiguous: What is Fair and Equitable Treatment in International Investment Law? (2007) 22(1) ICSID Review-Foreign Investment Law Journal 24; Courtney C Kirkman, 'Fair and Equitable Treatment: Methanex v. United States and the Narrowing Scope of NAFTA Article 1105' (2003) 34 Law and Policy in International Business 343; Ignaciopinto-León, 'Fair and Equitable Treatment under International Law: Analysing the Interpretation of the NAFTA Article 1105 by NAFTA Chapter 11 Tribunals' (2006) 15 Currents International Trade Law Journal 3.

[48] Kläger, 'Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness' (n 47) 435.

[49] Muchlinski, 'Caveat Investor?' (n 47) 531

therefore suggests that fairness implies, among other things, equity. Muchlinski also opines that 'equity' itself is defined not only as synonymous with 'fairness' but 'also the application of the principles of justice to correct or supplement the law.'[50]

Therefore, there is an explicit connection between FET and notions of equity.[51] Nevertheless, Muchlinski thinks that the standard remains considerably uncertain.[52] Similarly Dolzer described 'fair and equitable' as 'open-ended language' that may amount to a 'catch-all' provision which embraces a very broad number of governmental acts.[53] Haeri also asserts that, even though the arbitral tribunals have 'etched out recognisable, if evolving, parameters' of the standard in investment disputes in the last decade, its ambit and threshold nevertheless remained largely indeterminate.[54] Schreuer also thinks that the FET standard is 'relatively imprecise' and that its meaning 'will often depend on the specific circumstances of the case at issue.'[55] Choudhury thinks that this 'amorphous' standard has created misunderstandings among the academics, governments, and investors regarding its scope.[56] Picherack expressed concern over the fact that, since the scope of the FET standard in different international investment treaties largely remains unresolved, the 'differences in the interpretation and application of the standard may translate into differences of hundreds of millions of dollars in tribunal awards.'[57] Similarly, Kalick and Medeiros also think that, despite the growing importance of the standard, its 'content and parameters remain ambiguous, uncertain and subject to debate.'[58] Dolzer and Stevens in their book assert that, 'nearly all recent

[50] Ibid 532; Also see e.g. HW Fowler, FG Fowler and RE Allen (eds), Concise Oxford Dictionary (8th edn, Claredon Press) 396.
[51] See e.g., Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 129-132.
[52] Peter T Muchlinski, *Multinational Enterprise and the Law* (2nd edn, Oxford University Press 2007) 635.
[53] Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (n 39) 87-88.
[54] Haeri (n 47) 27.
[55] Schreuer, 'Fair and Equitable Treatment in Arbitral Practice' (n 37) 364.
[56] Choudhury (n 47) 297.
[57] Picherack (n 47) 255.
[58] Kalicki and Medeiros (n 47) 25.

BITs require that investments and investors covered under the treaty receive "fair and equitable treatment," in spite of the fact that there is no general agreement on the precise meaning of this phrase.'[59]

Kläger considers FET a sophist norm (a flexible norm) as suggested by Franck.[60] On that basis he thinks that it allows the production of more reasonable and just answers by directly invoking equitable standards.[61] In his words,

> '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. The tension between legitimacy and equity appears, therefore, to be an element that is inherent in the very nature of fair and equitable treatment."[62]

He further opines that '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.'[63] Vasciannie describes the vague nature of FET as follows:

> 'Notwithstanding its currency in investment instruments, however, the fair and equitable standard still prompts a number of difficult questions in international law. So, for example, the precise meaning of the concept is sometimes open to enquiry, not least because the notions of 'fairness' and 'equity' do not automatically connote a clear set of legal prescriptions in some situations. Broadly speaking, most legal systems strive to achieve

[59] Rudlof Dolzer and Margrete Stevent, *Bilateral Investment Treaties* (Martinus Nijhoff 1995) 58.
[60] Thomas M Franck, *The Power of Legitimacy Among Nations* (Oxford University Press 1990) 74-75.
[61] Kläger, *Fair and Equitable Treatment in International Investment Law* (n 47) 143.
[62] Ibid.
[63] Ibid 315.

> fairness and equity as a matter of course; however, when parties to a treaty agree, as a matter of positive law, that fair and equitable treatment must be granted to foreign investors, it may be presumed that the parties accept a common standard of treatment. One of the challenges in this area of law is to identify the main elements of this common standard, if indeed they exist.'[64]

Kläger in his seminal work on the standard finds that FET 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.'[65] He argues that the arbitrators do not want to engage in such a 'shaky and controversial area as the doctrinal concept of the fair and equitable treatment.'[66] Kläger claims, however, that certain patterns of arguments have emerged within the arbitral jurisprudence to fill in the gap of the concept of the standard 'with a sense of content.'[67] He terms such patterns of arguments as the *'topoi'*, as a source of those arguments upon which the arbitrators decide a case.[68] These *topoi* are legitimate expectations, non-discrimination, fair-procedure, transparency, and proportionality.[69]

Tudor's extensive work construes FET as a 'standard' which represents a particular type of norm.[70] She emphasises its nature as a broad and indeterminate concept, a discretionary power of the arbitrator/judge, the flexible nature which allows the investor to adapt to new situations, a link between law and society, a reference point of

[64] Vasciannie (n 47) 101.
[65] Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 115. Also see Kläger, 'Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness' (n 47).
[66] Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 116.
[67] Ibid.
[68] Ibid.
[69] Ibid.
[70] Tudor (n 47) 114-115.

which is average social conduct, and a reference to conformity of national law with international law.[71] But none of these elements clearly defines what the standard entails.

Schill suggests that the concept of FET is an embodiment of the rule of law.[72] Therefore he suggests applying a comparative law methodology to identify the common features of the two doctrines. He refers to the object and purpose of the investment treaties, which aims to protect and promote foreign investment flows and economic growth in the host country, to provide a normative justification of this approach.[73] However due to indeterminacy of the concept of rule of law in international law, other scholars contest his view.[74]

Different scholars have emphasised different elements and principles as vital to explain the FET standard. Dolzer makes an argument that the FET standard is closely tied with the protection of foreign investor's legitimate expectations.[75] Others describe these expectations as a major component of the standard.[76] Schreur, for example, thinks that, although FET 'may be reminiscent of the extralegal concepts of fairness and equity', it should not be confused with the concept of *ex aequo et bono*.[77] He further opines that FET 'is a legal concept that is susceptible to interpretation and application by a tribunal without an authorization by the parties to go beyond the law and to apply equitable principles.'[78] Vasciennie explains the two approaches to the meaning of the standard.[79]

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[71] Ibid 115.
[72] See e.g. Schill 'Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law' (n 47).
[73] Ibid. 30-31.
[74] See e.g. Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 127-128.
[75] Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (n 39) 100-106.
[76] Dolzer and Schreuer, *Principles of International Investment Law* (n 3) 135; Abhijit PG Pandya and Andy Moody, 'Legitimate Expectations in Investment Treaty Arbitration: An Unclear Future' (2011) 15 Tilburg Law Review 93, 105; Vasciannie (n 47) 99.
[77] Schreur, 'Fair and Equitable Treatment in Arbitral Practice' (n 37) 365.
[78] Ibid.
[79] Vasciennie (n 47) 102-105.

The first approach is the plain meaning approach based on Article 31 of the Vienna Convention of the Law of the Treaties, 1969: where a straightforward assessment to be made whether the particular treatment in question was fair and equitable to the investor.[80] The second approach is the 'equating approach' where the standard is explained with reference to minimum standard under international law.[81] However he also describes the difficulties of these two approaches to explaining the term. The inherent vagueness makes it difficult to explain the standard using the plain meaning approach as the term in itself is subjective and that there is no body of law or existing legal precedents as to what is 'fair and equitable'. It is also complicated to explain it on the basis of the 'equating' approach as the principles which form the basis of the minimum standard under international law are themselves very contentious. There is considerable debate between the developed and developing countries over whether this has become part of customary international law. [82] Vandevelde in the title of his article suggests that he is proposing 'a unified theory' of the FET standard.[83] However he actually explicates four principles—reasonableness, consistency, non-discrimination, and transparency—and attempts to categorise all past arbitral awards using the FET into either one or more of these categories. Muchlinski in his thought-provoking article suggests that investor conduct should shape the application of the FET standard as well.[84]

[80] Ibid 103.
[81] Ibid 104.
[82] Ibid 102-105.
[83] See e.g., Vandevelde 'A Unified Theory of Fair and Equitable Treatment' (n 47).
[84] Muchlinski, 'Caveat Investor' (n 47).

Overall, while scholars have tried to identify certain elements or contents of the FET standard to explain its meaning, none of these elements amount to an exhaustive list of contents, and all commentators agree on the standard's inherent vagueness. Rather, each author has made an empirical study of past awards to define the standard. It is to be noted that, no scholar has applied this concept in any depth from the perspective of the host developing countries. Those very few who have touched on the issue have discussed the matter in terms of the role of investment treaties and FDI on development in host developing countries or from the view point of investor's responsibility for the risk in investing in developing countries or with reference to investment treaty standards of protection in general.[85] These commentaries do not particularly focus their discussion on the FET standard. These also do not comprehensively discuss and analyse how the tribunals have treated the development issues of the host developing countries. However there is a wide range of scholarship and commentary on the arbitrator's scope to apply discretionary powers in the interpretation of the FET standard. These discretionary powers provide enough space for the overarching argument of this thesis; that the arbitrators need to reconceptualise the FET standard to address the host developing countries perspectives. The following section will focus on the scholarship which discusses the importance of the arbitrators' discretionary powers in interpretation of the standard from the perspectives of the host developing countries.

[85] See e.g., Mayeda (n 47); Muchlinski, 'Caveat Investor?' (n 47); Andrew Newcombe, 'Sustainable Development and Investment Treaty Law' (2007)8 Journal of World Investment and Trade 357; Maria Gritsenko, 'Relevance of the Host State's Development Status in Investment Treaty Arbitration' in Freya Baetens (ed), *Investment Law within International Law: Integrationist Perspectives* (Cambridge University Press 2013) 346; Ursula Kriebaum, 'Are Investment Treaty Standards Flexible Enough to Meet the Needs of Developing Countries' in Freya Baetens (ed), *Investment Law within International Law*: *Integrationist Perspectives* (Cambridge University Press 2013) 337.

1.2.5 The Importance of the Arbitrators' Discretionary Powers in Interpreting FET

An OECD report describes the vagueness of the FET standard as an intentional measure to give arbitrators scope to articulate the necessary principles.[86] Similarly, Tudor identifies FET as a standard representing particular types of norms and including various elements, one of which is 'a large margin of manoeuvre left to the arbitrator/judge and a very flexible character, which allows it to adopt to a variety of circumstances.'[87] Her analysis encompasses the fact that, in contrast to a rule, a standard is a norm that demonstrates a relatively lesser degree of textual precision and therefore allows the decision maker a relatively high degree of discretion.[88] Accordingly she concludes that the standard has no "stable or fixed content"[89] and that it 'allows a continuous adaptation of the law to the changing social and economic circumstances'.[90] Accordingly she thinks that judge and arbitrators have a creative role and that they exercise their discretionary power by taking into account 'the average values and behaviours of a society at a given moment in time'.[91] Accordingly she argues that the FET standard depends on the particular facts of each case, the evolutionary nature of the standard, and arbitrators' appreciation of a country's general situation.[92] In her words, 'The vague and abstract notion of FET becomes concrete and it is the arbitrator

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[86] Fair and Equitable Standard in International Investment Law Working Papers on International Investment Law No. 2004/3 (OECD 2004) 2 <http://www.oecd.org/dataoecd/22/53/33776498.pdf> accessed 12 September 2014. However for a criticism of this view adopted in OECD report see e.g., Sornarajah, 'The Fair and Equitable Standard of Treatment: Whose Fairness? Whose Equity', (n 1) 167-181. On this point Sornarajah argues that the early treaties did not create compulsory arbitration. Therefore in his view at least as far as the older treaties are concerned, this reason for inclusion of the FET standard may be doubted. He further goes on with more extreme views that, this explanation assumes that in a document that contains limitations on their sovereignty, the state parties agreed that a casually appointed arbitrator should have the capricious discretion as to show their sovereignty and should be limited in the future.

[87] Tudor (n 47) 115.

[88] Kathleen M Sullivan, 'Forward: The Justice of Rules and Standards' (1992) 106 Harvard Law Review 22, 58-59.

[89] Tudor (n 47) 133.

[90] Ibid 121.

[91] Ibid.

[92] Ibid 129-133.

who—in the case of FET—breathes life into the standard.'[93] She describes the arbitrators as having discretionary powers to consider the circumstances of the host countries surrounding the investment disputes without facing allegation of deciding the matter *ex aequo et bono*.

Harten's commentary on the international investment law regime also supports Tudor's view of arbitrators' powers: 'Under the investment Treaties, it is clear that the scope and the substance of the adjudicative role is expressed at a high level of generality and that this allocates considerable discretion to arbitrators.'[94] He considers an element of discretion and policy choice to be inherent and reasonable in any adjudicative process and notes that people may differ on how much discretion is appropriate.[95] Harten further opines that '…behind the investor rights approach is a normative construction of investor protection as something so vital, so dominant, as to be treated [as] an end in itself.'[96] In the context of FET, Harten's view is useful to understand the scope of the arbitrators to accommodate the perspectives of the host developing countries. As Harten opines, '..where a dispute tests the limits of the adjudicative process in general, because of its complexity or the treaty's ambiguity, adjudicators should afford a margin of appreciation to the discretionary policy choices of domestic institutions.'[97] Accordingly Harten asserts, 'It is true that most of the treaties favour the historical position of capital-exporting states, and as such, investor protection, but there remains room for discretion.'[98]

[93] Ibid 132.
[94] Harten, *Investment Treaty Arbitration and Public Law* (n 1) 122.
[95] Ibid 123.
[96] Ibid 139.
[97] Ibid 145.
[98] Ibid 132.

Muchlinski also opines that the element of equity inherent in the standard in the legal sense refers to a degree of flexibility arising out of sensitivity with the need to apply rules with discretion implying that equity as an aspect of international law.[99] Therefore this gives the scope for the arbitrators to consider the particular circumstances of the host country and make a proper balance between the host countries' interest and the investors' interests in light of equity. Emphasising the importance of considering the context of the standard, Muchlinski states,

> 'A purely literal approach to the interpretation of legal terms is often very incomplete. The term(s) in question must be reviewed in the light of the context and policy behind their use. In this connection, it should be recalled that the fair and equitable treatment standard, as part of the wider international minimum standard of treatment for aliens, has been described as an evolving one that is not 'frozen in time' and that it is a constant process of development. Accordingly, the meaning of the standard should be determined in the context of the value system that underlines the international investment protection treaties in which these terms can be found.'[100]

Accordingly Muchlinski raises the concern that too much investor protection will create an impression that the 'national sovereignty has been given up to control by faceless international tribunals, whose decisions may restrict the regulatory powers of host countries.'

Hart's statement that, where the meaning of law is doubtful, the judges have the discretion to 'make a choice' by way of weighting and balancing extra-legal interests and

[99] Muchlinski, *Multinational Enterprise and the Law* (n 52) 636.
[100] Muchlinski, 'Caveat Investor?' (n 47) 533. Also see Muchlinski, *Multinational Enterprise and the Law* (n 52) 636.

the moral values, provides a response to such concerns.[101] The advocates of legal positivism suggest that the free and creative activity of the judges or arbitrators should decide complicated cases.[102] By contrast Kläger argues that the vagueness of a norm like FET could reveal a 'penumbra of uncertainty,' as Hart describes, by giving the decision maker 'a certain leeway'.[103] Accordingly, Kläger asserts, 'fairness discourse on fair and equitable treatment' needs to 'accommodate the inevitable tension between the political pull to change and the economic rationale for stability.'[104] He calls on arbitral tribunals to justify why they give particular weight to the facts of the disputes and to explain why one argument has more success than another.[105]

Thomas Franck's seminal theory on fairness in international law,[106] although he does not discuss it in relation to the FET standard, makes a valuable contribution in relation to concepts of fairness in international investment law.[107] He suggests that fairness discourse can balance the tension between stability and change inherent in foreign investment.[108] He stated, 'the 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.'[109] Referencing this, Kläger argues 'Fair and equitable treatment invites arbitrators '…to do justice', but thereby also discloses the tension that relates to the legitimacy of their decisions.[110] According to Franck, such

[101] H.L.A. Hart, *The Concept of Law* (2nd edn., Claredon Press 1997) 132 and 200.
[102]Kläger, '*Fair and Equitable Treatment' in International Investment* Law (n 47) 120. On legal positivism in international law see e.g. Malcolm N Shaw, International Law, (6th edn, Cambridge University Press 2008) 49 et seq
[103] Kläger, '*Fair and Equitable Treatment' in International Investment* Law (n 47) 148; Hart, *Concept of Law* (n 101) 12.
[104] Kläger, '*Fair and Equitable Treatment' in International Investment* Law (n 47) 150. Such balancing function also has been pronounced in Saluka Tribunal. See e.g. Saluka vs. Czech Republic, Partial Award, 17 March 2006 Para 300.
[105] Kläger, '*Fair and Equitable Treatment' in International Investment* Law (n 47) 152.
[106] See e.g., Thomas Franck, *Fairness in International Law and Institutions* (Oxford University Press 2008).
[107] Ibid 'Chapter 14: Fairness in International Investment Law' 438-478
[108] Ibid 438-441.
[109] Ibid 34.
[110] Kläger, *Fair and Equitable Treatment in International Investment Law* (n 47) 144.

tension is to be managed within a fairness discourse.[111] He describes important features of such 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 redistribute 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 economic rationale for stability.'[112]

In the international investment dispute context, the fact that the majority of the disputes concerning breach of the FET standard arise due to some regulatory actions taken by the host country produces this tension between change and stability. This produces inherent tension when the host country seeks, in response to, for instance, a crisis situation or for an important public interest, to change the regulatory policy that is likely to affect the foreign investment. On the other side, the investors seek the stability to ensure that the legal environment under which they invested should remain stable so that their investment is unaffected. As this thesis will show, the facts of disputes make

[111] Ibid 144.
[112] Franck, *Fairness in International Law and Institutions* (n 106) 441.

the tensions between political needs for change and the economic rationale for stability Franck describes evident.

In sum, a number of scholars have identified the tension between foreign investors and host countries regarding the scope of the FET standard, but no clear way to mitigate this tension emerges. As Kriebaum states there is enough inherent flexibility in the FET standard to consider the perspectives of the host developing countries; in her words:

> 'It is generally acknowledged that the standard of fair and equitable treatment is relatively broad and that its application depends on the precise facts of each case. The investor's legitimate expectations at the time of the investment are frequently considered by tribunals when violations of the fair and equitable treatment standard are at stake. It stands to reason that the level of development as well as the economic, social and political circumstances prevailing in a particular country at the time of the investment are relevant to the reasonableness of an investor's expectations.'[113][footnotes in the original text omitted]

Accordingly she further argues that 'there is flexibility in the legal standards in investment law to take account of the different stages of development across nations'.[114]The question therefore arises: do arbitrators in fact adequately consider the perspectives of host developing countries in their interpretation of the FET standard? Of equal importance, do they demonstrate explicitly that they have done so in their decisions? As Kläger states,

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[113] Ursula Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (2011) 10 The Law and Practice of International Courts and Tribunals 383, 384.
[114] Ibid 384.

> '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.'[115]

This thesis examines whether the arbitrators have appropriately taken into account the perspectives of host developing countries and whether they have adequately articulated them in their judgements; have they taken into account developing countries perspectives in a manner which sufficiently addresses the developmental challenges of these host countries relevant to the particular investment dispute? Kläger's view accurately describes the approaches of the current investment tribunals, particularly with reference to difficult cases. Despite the lack of a precise meaning of the standard, the arbitral tribunals have developed some broad principles for the application of the FET standard. These broad principles include good faith, obligation of full protection and security,[116] freedom from coercion and harassment,[117] denial of justice and due process,[118] lack of arbitrariness and non-discrimination,[119] transparency and stability,[120]

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[115] Kläger, '*Fair and Equitable Treatment in International' in International Investment Law* (n 47) 121.

[116] See e.g. Occidental Exploration and Production Company vs. Republic of Ecuador, LCIA No. UN 3467, Award 1 July 2004 Paras 180-192; Azurix vs. Argentine Republic, ICSID Case No. ARB/01/12, Award 14 July 2006 Para 408; For a comprehensive discussion on the standard of full protection and security see e.g. Giuditta Cordero Moss, ' Full Protection and Security' in August Reinisch (ed) *'Standards of Investment Protection'* (Oxford University Press 2008) 131-150.

[117] Pope & Talbot vs. Canada, Award 10 April 2001, 7 ICSID Reports 102. For a detailed discussion on *Pope & Talbot* see e.g. Dumberry (n 47)

[118] See e.g. Metaclad Corporation vs. Mexico, ICSID Case No. ARB (AF)/97/1, Award 30 August 2000, 5 ICSID Reports 212 Para 91; Middle East Cement Shipping and Handling Co. S.A. vs. Arab Republic of Egypt, Award 12 April 2002, 7 ICSID Reports 178 Para 143; Técnicas Medioambientales Tecmed, S.A vs. United Mexican States, ICSID Case No. ARB(AF)/00/02, Award 29 May 2000, 43 International Legal

legitimate expectations of the investor,[121] and the principle of proportionality.[122] However, the tribunals have discussed the FET standard according to these principles, but more from the perspective of investors rather than host countries. They have not come up with any concrete list of elements relevant to developing countries in order to interpret the standard appropriately in each and every case and in complicated situations. Thus Small has rightly said:

> 'It is too early to say whether we are witnessing a sign of evolution of the international custom as it is also too early to establish a definitive list of elements for the interpretation of the 'fair and equitable treatment' standard since the jurisprudence is still constantly evolving.'[123]

These ever expanding interpretations rendered by the tribunals are not sufficient to address the difficult issues, as Kläger rightly points out. Therefore this thesis identifies some of the difficult cases that demand a reconceptualised interpretation of the FET standard, which would accommodate the challenges and difficulties of the host developing countries in difficult situations that this thesis identifies. Thereby it seeks to suggest how future tribunals might reconceptualise the FET standard with a view to accommodate the needs of host developing countries.

Materials (2004) 133 Para 162; Mondev International Ltd vs. United States of America, ICSID Case No. ARB (AF)/99/2, Award 11 October 2002, 6 ICSID Reports 192 Para 96.

[119] CMS Gas Transmission Company vs. The Argentine Republic, ICSID Case No. ARB/01/8, Award 12 May 2005 44 International Legal Materials (2005) 1205 Para 290; MTD Equity Sdn. Bhd. And MTD Chile S.A vs. Republic of Chile, ICSID Case No. ARB/01/7, Award 25 May 2004, 12 ICSID Reports 6; PSEG Global vs. Republic of Turkey, ICSID Case No. ARB/02/5, Award 19 January 2007.

[120] Tecmed (n 118) Paras 167, 172 and 173; Emilio Agustín Maffezini vs. The Kingdom of Spain, Award 13 November 2000, 5 ICSID Report 419 Para 83.

[121] CMS (n 119) Para 284; Saluka (n 104) Para 302; LG & E Energy Corp, LG & E Capital Corp and LG &E International Inc. vs. Argentina Republic, ICSID Case No. ARB/02/1, Decision on Liability Award 3 October 2006, 46 International Legal Materials (2007) 36.

[122] SD Myers vs. Government of Canada, Partial Award, 12 November 2000, 40 International Legal Materials 1408 Paras 263-264; Duke Energy Electroquil Partners and Electroquil SA vs. Republic of Ecuador, ICSID Case No. ARB/04/19, Award 18 August, 2008 Para 320.

[123] Yannaca-Small, 'Fair and Equitable Treatment Standard: Recent Development' (n 47) 130.

1.3 Contribution of the Study

Very few theoretical and even fewer in-depth case studies look at the issues host developing countries face and the economic and socio-political contextual background of these countries in relation to investment disputes. A number of scholars have argued in favour of taking a host developing country's level of development before rendering any awards against them,[124] without comprehensively covering the full range of issues host developing countries incur. Existent scholarship has to date only engaged with a few selected awards which have been broadly criticized for unfairly affecting specific host countries.[125] These studies have also offered a broader discussion in relation to all investment protection standards and have not focused specifically on the FET standard. The large volume of investment disputes against developing countries and the constant presence of the FET standard in all these disputes makes an in-depth study of the FET standard necessary from a development perspective. This thesis aims to examine the full range of approaches to determine how the tribunals might adequately address the socio-political and economic contextual background of each host developing country. It will examine how the FET standard can be reconceptualised from the perspectives of host developing countries. It aims to make a significant contribution to the literature in the following ways.

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[124] See e.g. Nick Gallus, 'The Influence of the Host State's Level of Development on International Investment Treaty Standards of Protection' (2005) 6 Journal of World Investment and Trade 711; Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (n 113); Kriebaum, 'Are Investment Treaty Standards Flexible Enough to Meet the Needs of Developing Countries' (n 85) ; Gritsenko (n 85) 341; Muchlinski discusses the relevance of investor's conduct in investment disputes, suggesting the term 'caveat investor' which implies that the investors have a responsibility to know the risk of investing in developing countries and needs to considered keeping in mind that risk when taking any decision against the host developing countries. See e.g. Muchlinski, 'Caveat Investor?' (n 47). This phrase has also been used by another author, see e.g. L Yves Fortier and Stephen L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know it When I see it, or Caveat Investor' (2004) 19 ICSID Review- Foreign Investment Law Journal 293.

[125]For example the Awards against Argentina in the event of their economic crisis. See e.g. Amin George Forji, 'Drawing the Right Lessons from ICSID Jurisprudence on the Doctrine of Necessity' (2010) 76 Arbitration: The International Journal of Arbitration, Mediation and Dispute Management 44; Michael Waibel, 'Two Words of Necessity in ICSID Arbitration*: CMS* and *LG&E*' (2007) 20 Leiden Journal of International Law 637; LF Castillo Argañarás, 'CMS Gas Transmission Company vs. The Republic of Argentina-The Defense Raised by Argentina' (2004) 1 Transnational Dispute Management (2004).

First, this thesis provides a detailed analysis of the historical development of the FET standard, with particular reference to the role developed and developing countries have played and their conflicting interests over investor protection standards. To understand the debates and controversies surrounding the scope of the standard and its relation to the minimum standard of treatment under international law and customary international law, this thesis adopts a unique classification of the construction of the FET standard that exists across different investment treaties.

Second, this thesis identifies the complexity of classification of countries put forward by different international organisations based on economic and social criteria of development and the diversity that exists across these countries. But the thesis argues that these different classifications by different international organisations do not provide much useful guidance in understanding the issues relevant to host developing countries in an investment dispute context. The thesis identifies a series of developmental issues which are relevant to the investment disputes. It calls for the particular challenges of the host developing countries due to those issues to be taken into account by the investment tribunals in order to deal with these large group of host countries more appropriately.

Third, this thesis provides an elaborate and detailed examination of the interpretation of the FET standard of key arbitral awards affecting host developing countries to demonstrate the full range of different approaches of the interpretation adopted by the current investment tribunals. Such approaches will also demonstrate how the tribunals have addressed (for the most part, inadequately) the host developing countries perspectives in the investment disputes.

Fourth, this thesis identifies the key problems of such interpretation of the FET standard rendered by the current investment tribunals. It points out the inadequacy of such approaches towards the issues faced by developing countries and in some instances the inconsistencies on substantive issues where, in the majority of the cases, tribunals have failed to adequately address key developmental challenges.

Fifth, this thesis argues that it is possible to reconceptualise the FET standard to consider the perspectives of host developing countries, accommodating the challenges that these host developing countries face due to their particular circumstances to reflect better the notions of fairness and equity inherent in the standard.

1.4 Research Questions

The primary research questions that this thesis examines are as follows:

(i) What are the different constructions of the FET standard in different investment treaties and how do those different constructions affect the arbitral tribunals' interpretation of the scope of the standard? Despite these various constructions, is there an overarching and singular concept of the FET standard that this thesis can examine in detail?

(ii) Are the different classifications of countries adopted by different international organisations useful to understand the developmental issues of the host developing countries in an investment dispute context?

(iii) How might the tribunals might identify a concept of development and host developing countries that is appropriate to the investment dispute context?

(iv) What are the different approaches the current investment tribunals have adopted to interpret the FET standard in the disputes against developing

countries? To what extent have they taken into account the particular developmental issues and the contextual background of those countries relevant to the investment dispute (i.e. their socio-political and economic conditions or their transitory status)?

(v) What are the key problems of such interpretation of the FET standard by the current arbitral tribunals and why are these significant for the host developing countries?

(vi) How might the FET standard encompass the perspectives of host developing countries, and thereby accommodate productively the developmental issues, challenges and other circumstances of the host developing countries relevant to investment disputes?

1.5 Methodology

This thesis uses a qualitative method of research to suit its interpretative approach, analysis, and character. Based upon evaluating the literature and scholarship on the issues, debates, commentaries, and controversies surrounding the research theme, it focuses on materials available in libraries. The method includes an in-depth investigation from the historical point of view to describe the development of the concept of the FET standard and various constructions of the standard in the current BITs and other investment treaties; a critical analysis and examination of selected arbitral awards to demonstrate the full range of approaches adopted by the current tribunals to address the developmental issues and the economic and socio-political contextual background of the host developing countries on an alleged breach of the FET standard. The arbitral awards, various international investment treaties (including BITs, regional and multilateral treaties), and Conventions on international investments

provide the primary sources. The secondary sources include reference books, research journals, working papers, websites, and other relevant publications by international organisations.

1.6 Structure of the Thesis

This thesis is composed of eight chapters.

Chapter 1, the present chapter, provides an introduction to the thesis by providing a brief background of the issues and framework of the research topic, the existing scholarship on the standard, presenting the research questions, its contribution to existing knowledge, and the methodology used to conduct the research.

Chapter 2 provides an account of the historical development of the FET standard; showing that it emerged under the auspices of multinational treaties which never came into force. But the standard survived because developed countries pushed it forward in numerous BITs. The chapter also discusses the various events that have contributed to the development of the standard in various investment treaties, with particular reference to the role developed and developing countries have played in the process of drafting and adoption of such treaties.

Chapter 3 provides an elaborate account of different constructions of the FET standard in various investment treaties. It discusses the significance of different constructions for the interpretation of the standard by investment tribunals. Ultimately it concludes that despite the differences in different constructions, there is sufficient

similarity across different treaties to support the claim that an all-embracing concept of the FET standard can be the subject of detailed analysis within this thesis.

Chapter 4 provides a discussion of the complexity of classification of developing countries by different international organisations and scholars who have written on this issue. The chapter concludes by suggesting the need for a concept of developing countries that is appropriate for the investment dispute context.

Chapter 5 makes an in-depth analysis of selected arbitral awards to demonstrate the wide range of approaches current arbitral tribunals have adopted to address the developmental issues of the host developing countries relevant to their socio-political circumstances. This includes consideration of developing countries who are facing political crises or other serious socio-political issues, which are a significant factor for these countries and form an important contextual background to the disputes. It argues that the tribunals in some instances have been inconsistent in their approach to this issue and in many instances have inadequately addressed the socio-political context of the host developing country.

Chapter 6 provides a discussion on some selected arbitral awards to demonstrate the various approaches the current tribunals have adopted in relation to countries in transition. These countries have become the centre of attention after the collapse of the former Soviet Union. This chapter argues that, in addressing the particular transitory status of these countries, the tribunals have inadequately addressed the particular issues and challenges of these countries relevant to the investment dispute in question and also in some instances have been inconsistent.

Chapter 7 provides a detailed discussion of arbitral awards in cases where the dispute arose out of the economic crisis of the host developing countries. This chapter argues that in the majority of the cases the tribunals dealing with the issue have done so inadequately and in some instances have come up with inconsistent decisions about the substantive issues relating to the state of necessity which is pivotal for a host country in the event of such a national crisis.

Chapter 8 identifies the key cross-cutting problems of the current investment tribunals' interpretations of the FET standard discussed in the preceding three chapters and the significance and impact of such interpretations for host developing countries. It concludes the thesis by discussing how the FET standard can be reconceptualised from the perspectives of the host developing countries, taking into account the countries' developmental issues and the socio-political and economic conditions that form a contextual background to the dispute. It also summarises the arguments the thesis has made and its overarching argument.

1.7 Conclusion

This introductory chapter has established a foundation and overview for the thesis. Crucially, it explains the FET standard's status as the most popular investment protection standard and its frequent use by foreign investors against host developing countries. It has also explained that, due to the high volume of disputes against developing countries and the significant economic impact of these disputes upon these countries, it is necessary to revisit the current approaches of the investment tribunals in their interpretation of the FET standard. It has also demonstrated that the existing

scholarship on the standard has universally agreed that vagueness is a core feature of the standard and that this provides arbitrators with leeway to exercise discretionary powers in their interpretation of it. It points outs that there is minimal scholarship investigating the interpretation of the FET standard from host developing countries' perspectives in investment disputes.

With these premises, this thesis aims to provide an in-depth analysis of the current arbitral awards demonstrating the inadequate and inconsistent approaches tribunals have adopted in their interpretation of the standard against host developing countries. It will argue how the FET standard can be reconceptualised from the perspectives of host developing countries.

Chapter 2

The Historical Development of the FET Standard in International Investment Treaties

2.1 Introduction

This chapter will provide a detailed discussion of the historical development of the FET standard in different international investment treaties over the years. It discusses, in chronological order, selected events that have influenced the inclusion of the FET standard as well as its language in different investment agreements and treaties at the regional, multilateral, or bilateral level. Contextualising these developments in the context of the socio-economic-political events in world history over the relevant period of time, it makes particular reference to the role played by the capital exporting developed countries and capital importing developing countries, as well as their conflicting interests in relation to the substantive issues those treaties address. This chapter will demonstrate that capital exporting developed countries advanced the development of the FET standard in multilateral agreements, and then more successfully in bilateral settings. Initially, many developing countries, particularly those from Latin America, appeared hostile to these developments, but developing countries increasingly have acquiesced to the inclusion of the FET standard; it has become an almost ever-present feature of international investment law.

2.1.a Treaties of Friendship, Commerce, and Navigation (FCNs) During the Eighteenth Century – The Starting Point of Investment Agreements

The FCNs are the forerunners of modern BITs. In the late eighteenth century the United States initiated certain treaties to establish commercial relations with a number of leading European economic powers, including France, the Netherlands, Sweden, the United Kingdom, and Spain containing rules on investment protection.[126] These US FCNs did not contain any reference to terms like 'fair' or 'equitable' prior to the Havana Charter of 1948. However they provided a certain degree of protection to foreign investors through other investment protection standards.

2.1. b The First Appearance of the FET Standard– The Havana Charter 1948

The Havana Charter was a multilateral text prepared to establish an International Trade Organisation (ITO) of 1948.[127] Article 11(2) empowered the ITO to make recommendations 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.'[128] While this use of 'just

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[126] See Kenneth J Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (1993) 14 Michigan Journal of International Law 621, 624; Kenneth J. Vandevelde, 'A Brief History of International Investment Agreements' (2005) 12 U.C. Davis Journals of International Law and Policy 157, 158. See e.g. US–Spain Treaty of Friendship, Limits and Navigation, 27 October 1795; US–Great Britain Treaty of Amity, Commerce and Navigation, 19 November 1794; US–Morocco Treaty of Peace and Friendship, January 1787; US–Prussia Treaty of Amity and Commerce, July 1785; US–Sweden Treaty of Amity and Commerce, 3 April 1783; US–The Netherlands Treaty of Amity and Commerce, 8 October 1782; US–France Treaty of Amity and Commerce, 6 February 1778.

[127] Full text of the charter can be found at <http://www.worldtradelaw.net/misc/havana.pdf> accessed 30 August 2014. Post-WWII, the United States first proposed establishing an international organisation with the aim of focusing primarily on trade matters in its Proposals for Expansion of World Trade and Employment of 1945. Along with the focus on international trade, an important objective of the Charter was to encourage economic development, especially in developing countries and to foster 'the international flow of capital for productive investment' (Article I). As a result the Havana Charter contained a number of provisions concerning foreign investment, and on the relationship between the State and foreign investor.

[128] International Investment Instruments: A Compendium, Vol. I (UNCTAD 1996) 4, <http://unctad.org/en/Docs/dtci30vol1_en.pdf> accessed 30 August 2014

and equitable' established the precedent, the charter itself did not seek to guarantee this standard of treatment for investors; it merely authorised the ITO to recommend the inclusion of this standard in future agreements.[129] Thus Vasciannie opines that Article 11(2) was even less than a '*pactum de contrahendo*'[130]— less than an agreement to conclude a treaty or to include certain clauses in future treaties.[131] This first post-war multilateral effort on trade and investment came to an unsuccessful conclusion and hence the Charter never came into force due *inter alia* to the US decision to abandon it in 1950.[132] However, the concept of FET it had introduced survived and found its place with a stronger position in the subsequent investment agreements, particularly in BITs.

2.1.c The Bogota Agreement 1948

During the same period, at the regional level, the Ninth International Conference of American States in 1948 adopted the Economic Agreement of Bogota, an agreement covering, among other things the provision of adequate safeguards for foreign investors.[133] Article 22 of the draft agreement stated,

> 'Foreign capital shall receive equitable treatment. The States therefore agree not to take unjustified, unreasonable or discriminatory measures that would impair the legally acquired rights or interests of nationals of other countries in the enterprises, capital, skills, arts or technology they have supplied.'

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[129] From the investors' and capital exporting countries' point of view, the fact charter's inability to guarantee any protection of the standard, together with the fact that other provisions in the text only provided qualified protection in matters concerning expropriation and currency restrictions, paved the way for limiting the usefulness of the Charter.

[130] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and (n 47) 110.

[131] Anthony Aust, *Modern Treaty Law and Practice* (2nd edn, Cambridge University Press 2007) 31.

[132] On the discussion on politics behind the Havana Charter see e.g. Subedi, 'International Investment Law' (n 3) 732–733.

[133] Text of the agreement can be found at <http://www.oas.org/juridico/english/sigs/a-43.html> accessed 22 August 2014.

In addition to this, under Article 22 the states agreed not to set up 'unreasonable or unjustified impediments that would prevent other states from obtaining on equitable terms the capital, skills, and technology needed for their economic development.' The Bogota Agreement implies that all foreign capital, not simply the capital held by nationals of contracting states, should benefit from the standard.[134] However like the Havana Charter, the Bogota Agreement failed to come into force for lack of support.[135]

2.1.d Introducing FET in US FCN Treaties after the Havana Charter

US FCN treaties began to use the terms 'equitable' and 'fair and equitable' treatment after the Havana Charter of 1948.[136] For example, Article I (1) of the 1954 Treaty between Germany and the United States reads, 'Each Party shall at all times accord fair and equitable treatment to the nationals and companies of the other Party and to their property, enterprises and other interests.'[137] But the FET standard did not appear in every US FCN treaty. For instance, the US FCN Treaty with China did not contain any reference to the FET standard. [138]

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[134] A significant majority of the multilateral and regional treaties and draft treaties are articulated in a different manner, clearly stating that the host country is liable only to the investors of other contracting parties, e.g., Article 1(a), Draft OECD Convention; Article 1, Draft Multilateral Agreement on Investment (MAI); Article 1105, NAFTA; Article 10, Energy Charter Treaty; Article IV (2), ASEAN Treaty.

[135] For discussion on the draft Bogota Agreement see, e.g. Raymond Dennett and Robert K Turner (eds), *Documents on American Foreign Relations,* Vol. X, (Princeton University Press, 1948) 515–527; Seymour J Rubin, *Private Foreign Investment—Legal and Economic Realities* (John Hopkins Press, 1956) 82; EI Nwogugu, *The Legal Problems of Foreign Investment in Developing Countries* (Manchester University Press, 1965) 141.

[136] US FCN treaties with Ireland (1950), Greece (1954), Israel (1954), France (1960), Pakistan (1961), Belgium (1963) and Luxembourg (1963) contained the express assurance that foreign persons, properties, enterprises, and other interests would receive 'equitable treatment' while others, including those with the Federal Republic of Germany, Ethiopia, and the Netherlands used the terms 'fair and equitable treatment' for a similar set of items involved in the foreign investment process. See e.g. Tudor (n 47) 19.

[137] Treaty of Friendship, Commerce and Navigation, 29 October 1954, US-Federal Republic of Germany, 273 UNTS 4.

[138] Treaty of Friendship and Commerce and Navigation between the United States of America and the Republic of China, signed at Nanking, 4 November 1946; came into force on 30 November 1948; for text see, (1949) 43(1) The American Journal of International Law 27.

2.1.e The Abs-Shawcross Draft Convention 1959

The next major development concerning the standard was the Abs-Shawcross Draft Convention on Investment Abroad of 1959.[139] In Article I it stated that

> 'Each party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties. Such property shall be accorded the most constant protection and security within the territories shall not in any way be impaired by unreasonable or discriminatory measures.'

While these words resembled those in most US FCN treaties, the Draft lacked the right of establishment for investors the US FCN treaties had established. However, due to its origin and because of its emphasis on investor protection, a number of scholars have described the Abs-Shawcross Draft Convention as favouring the interests of capital exporting countries.[140]

2.1.f The first BIT in 1959 and subsequent wave of BITs

Pakistan and Germany signed the world's first BIT in 1959,[141] and it made no reference to the FET standard or to phrases like 'fairness' or 'equity', but as BITs have proliferated in the 1960s, FET clauses became almost a common feature in BIT

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[139] The Draft Convention represented a private initiative by a number of European businessmen and lawyers and headed by Hermann Abs and Lord Shawcross. Text can be found at <http://unctad.org/Sections/dite_tobedeleted/iia/docs/compendium/en/137%20volume%205.pdf> accessed 22 August 2014.

[140] See, e.g. Arthur Larson, 'Recipients' Rights Under and International Investment Code' (1960) 9 *Journal of Public Law* 172, especially see at 172–175; at 172 he states, 'The principal flaw in the Draft Convention is its one sidedness. In form it is even-handed. That is, at every point the rights it confers and duties it exacts apply identically to "each party". In same way, as Anatole France pointed out, the law forbids both the rich man and the poor man to sleep in the park. In substance, however, the entire concern of the Convention is the protection of the rights of the investor. There are no provisions motivated by concern for the rights of the host country.'

[141] Pakistan–Germany BIT, signed on 25 November 1959 and entered into force on 28 November, 1962 <http://www.iisd.org/pdf/2006/investment_pakistan_germany.pdf> accessed on 22 August 2014.

programmes.[142] The international community's failure to reach a consensus on a multilateral treaty has, in part, prompted the profusion of BITs since the 1950s; in effect, the major capital exporting countries have used BITs as a means of achieving their expectations, which were difficult to achieve at the multilateral level.[143] European countries started the proliferation of BITs when they started enjoying considerable success in negotiating BITs, which fundamentally differed from the US FCNs in that they were devoted exclusively to investment protection.[144]

For many developing countries BITs were a tangible way of indicating their receptivity to foreign investments and inviting the developed countries to invest. This trend has influenced the bargaining power of developed countries. BITs have become a popular and accepted instrument to promote and protect the inflow of foreign investment. However, the acceptance of BITs in Latin America is particularly noteworthy,[145] since these countries have relied for decades on the *Calvo* doctrine in their foreign relations practice.[146] The doctrine suggested that it would be inappropriate to offer higher

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[142] For a listing of several countries that entered into BITs in the 1960s see Vandevelde, 'A Brief History of International Investment Agreements' (n 126) 169–170. Also for a brief account of the development of the American BIT program see Kenneth J Vandevelde, 'The Bilateral Investment Treaty Program of the United States' (1988) 21 Cornell International Law Journal 201, 209.

[143] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 125 citing Eileen Denza and Shelagh Brooks, 'Investment Protection Treaties: United Kingdom Experience' (1987) 36 International and Comparative Law Quarterly 908; Also see e.g., Salacuse *The Law of Investment Treaties* (n 38) 88–90.

[144] By 1967 it appeared that no country was willing any longer to conclude a US FCN treaty, and thereby the FCN programme in the US expired in that year. See e.g. Kenneth J Vandevelde, *United States Investment Treaties: Policy and Practice* (Kluwer Law and Taxation 1992) 19–20, See Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (n 126) 624–625.

[145] Latin American countries were the first group to gain independence from the European colonial powers. After independence these countries decreed that foreign investors were not entitled to any greater protection than that offered to their own domestic investors. They also deemed that sovereign governments could expropriate foreign investors' properties with compensation. See e.g. Subedi, 'International Investment Law' (n 3) 729. Historically these developing countries favoured the *Calvo* doctrine while developed countries suggested state responsibility should protect the foreign investors. See e.g. Subedi, *International Investment Law : Reconciling Policy and Principle* (n 1) 72.

[146] The Argentinean jurist and diplomat Carlos Calvo established the principle that foreigners' are entitled to no better treatment than nationals of a host state and that the exclusive jurisdiction of the host state's courts should establish the rights of foreigners. Thus the doctrine stated that customary international law did not require that the expropriation undertaken by the host country should be accompanied by 'prompt, adequate and effective compensation'. The popular '*Calvo Doctrine*' gained huge popularity

standard of protection to foreign investors than to locals, as some countries might not have attained the level of economic development required or have not acquired a developed legal system to offer such protection.[147] The acceptance of international law standards in BITs and opening recourse to investor state dispute settlement represented a fundamental change in Latin American foreign policy in the 1960s.[148]

2.1. g FCNs in the 1960s

Investment protection became the primary purpose of the US FCNs after World War II (WWII).[149] Originally the FCNs focused on provisions to protect the property of US nationals in the territory of the treaty partner.[150] The United States signed FCN treaties with a number of Latin American and Asian countries between 1948 and 1966.[151] By 1967 there appeared to be no other countries willing to conclude a US FCN treaty.[152]

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among the Latin American states in relation to treatment of aliens. The doctrine also later found its apogee in the UN General Assembly resolutions relating to the New International Economic Order in the 1970s. See e.g. Article 2(2) (c) of the Charter of Economic Rights and Duties of States. On the *Calvo* doctrine see generally e.g. Donald Shea, *The Calvo Clause* (Minnesota University Press, 1955); Wenhua Shan, 'Calvo Doctrine, State Sovereignty and The Changing Landscape of International Investment Law' in Wenhua Shan, Penelope Simons and Dalvinder Singh (ed), *Redefining Sovereignty in International Economic Law* (Hart Publishing 2008) 247; Kurt Lipstein, 'The Place of the Calvo Clause in International Law' (1945) 22 British Year Book of International Law 130; Rudolf Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 The American Journal of International Law 553; Burns H Weston, 'The Charter of Economic Rights and Duties and Deprivation of Foreign Owned Wealth' (1981) 75 The American Journal of International Law 437.

147 Subedi, 'International Investment Law' (n 3) 730.

148 Stephen W. Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009) 42.

149 Herman Walker, Jr, 'Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice' (1956) 5 The American Journal of Comparative Law 229, 230.

150 Vandevelde, *United States Investment Treaties: Policy and Practice* (n 144) 14–19.

151 For a detailed discussion see e.g. Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (n 126) 624–625. For a detail discussion on later US FCN treaties see e.g. Harry C Hawkins, *Commercial Treaties and Agreements* (Rinehart 1951); Herman Walker, Jr, 'Modern Treaties of Friendship, Commerce and Navigation' (1958) 42 Minnesota Law Review 805; Walker, 'Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice' (n 149) 229; Robert R Wilson, 'A Decade of Commercial Treaties' (1956) 50 The American Journal of International Law 927; Robert R Wilson, 'Post-war Commercial Treaties of the United States' (1949) 43 The American Journal of International Law 262; Robert R Wilson, 'Property Protection Provisions in United States Commercial Treaties', (1951) 45 The American Journal of International Law 83; Robert R Wilson, *The International Law Standards in Treaties of the United States* (Harvard University Press 1953).

152 Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (n 126) 624; Vandevelde, *United States Investment Treaties: Policy and Practice* (n 150) 19.

They generally targeted developed countries, particularly European countries.[153] The US FCN programme expired in 1966,[154] and the FCN treaties it created contained very similar investment protection clauses, including the FET standard as well as other clauses like protection against expropriation, and full protection and security, though they varied on particular points of substance.[155] Their main purpose was to promote international trade by establishing closer commercial and political relations between the contracting parties, especially in the aftermath of WWII.[156]

2.1.h OECD Draft Convention of the Protection of Foreign Property, 1963 and 1967 and its influence

The Draft Convention of the Protection of Foreign Property developed by the Organisation for Economic Co-operation and Development (OECD) was first published in 1963[157] and revised in 1967.[158] As the most influential of early post-war drafts on investment, it contained in Article 1, entitled 'Treatment of Foreign Property' which closely followed the Abs-Shawcross Draft but carries more weight as precedent. It stated:

> '(a) Each Party shall at all times ensure fair and equitable treatment to the property the nationals of the other Parties. It shall accord within its territory the most constant protection and security to such property and shall not in

[153] In contrast the first wave of US BITs mostly existed between the United States and developing countries that had not necessarily been associated with the economic policy of Western Europe or the United States. See e.g. Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (n 126) 627.
[154] The last two FCNs were signed in 1966. See e.g. US–Togo Treaty of Amity and Economic Relations, 8 February 1966; and US–Thailand Treaty of Amity and Economic Relations and Exchange of Notes, 27 May 1966.
[155] See, e.g. Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 109–112.
[156] See e.g. Walker, 'Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice' (n 149) 229, 231.
[157] For the text of the 1963 Draft Convention, see (1963) 2 International Legal Materials 211–267.
[158] OECD Draft Convention on the Protection of Foreign Property 1967, OECD Publication No. 23081, reprinted in (1968) 7 International Legal Materials 117–143.

any way impair the management, maintenance, use, enjoyment or disposal thereof by unreasonable or discriminatory measure.'[159]

The Draft OECD Convention was never opened for signature. As a non-ratified treaty its importance lies mainly in the fact that it emphasised the protection of foreign investors at a time when developing countries and some developed countries generally favoured national control over FDI.[160] It also excluded reference to the national standard of treatment at that time but required states to ensure 'fair and equitable treatment' 'at all times', an approach which placed higher emphasis on the FET standard than most earlier instruments. Given the economic and political influence the OECD acting as a group wielded, the Draft Convention represented the dominant trends and perspectives among capital exporting countries in investment matters.[161]

These two drafts conventions, i.e. the Abs-Shawcross Draft Convention on Investment Abroad, 1959 and the Draft Convention on the Protection of Foreign Property proposed by the OECD in 1967, which generally reflect the perspective of capital exporting countries, adopted the language of 'just and equitable treatment' in setting out basic protections for foreign investors. Therefore a primary study shows that the multilateral treaty efforts among the capital exporting countries share their tendency to favour the FET standard (or close equivalents). This became a common feature of BITs. BITs between capital exporting and capital importing countries, which began to proliferate after the early 1960s, have generally included the FET standard.[162] Most

[159] OECD Draft Convention on the Protection of Foreign Property, 1967 reprinted in (1968) 7 International Legal Materials 117, 119.
[160] International Investment Instruments: A Compendium (n 128) xxi.
<http://unctad.org/en/Docs/dtci30vol1_en.pdf> accessed 1 September 2014
[161] See, e.g. Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 112.
[162] This tendency to use the term in the early 1960s and particularly a flow in the 1970s onwards to a greater extent also reflects the general movement at the global level towards more liberalized economic

OECD countries used the Draft OECD Convention as a basis for their investment agreement negotiations. Thereby the OECD model and its systematic use also refers to this standard as defined by the Draft Convention.[163]

When the OECD initiated its Draft Convention, the international climate could hardly have been less favourable to multilateral protection for foreign investment. A coalition of developing countries, as well as socialist and communist countries, had made an open attempt to challenge the customary international law rules on property protection in the UN General Assembly. They opposed the protection of foreign investment by customary international law because they perceived this as either an obstacle to their political independence or as an impairment to the organisation of their economy.[164] Both of these groups aimed at abolishing the customary international law requirement to provide compensation for the expropriation of foreigners, a position that the UN General Assembly Resolution 1803 reflected in 1962 when it established 'Permanent Sovereignty over Natural Resources', relying on one of the most powerful doctrines of international law – the sovereignty of states. Subedi argues that this was not an attempt to rewrite the existing law completely, but rather to provide a new direction to the law on foreign investment that would accommodate the needs for economic sovereignty

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relations between the States. Due to the eventual demise of Cold War antagonism resulting in an opening up of former communist States to Western capital, and particularly due to the strong encouragement and support from the Western countries and its allies of various multinational financial institutions and also to encourage the flow of capital in their own territory, there has been an inclination of the capital importing countries to adopt a *laissez-faire* economic policy to encourage foreign investment. This aperture has been accompanied by greater safeguards for foreign investors, which encompasses inclusion of FET clauses in the BITs. See generally e.g., Kenneth J Vandevelde, 'Sustainable Liberalism and International Investment Regime' (1997-98) 19 Michigan Journal of International Law 373; Stephen Vasciannie, 'The Namibian Foreign Investments Act: Balancing Interests in the New Concessionary Era' (1992) 7 ICSID Review — Foreign Investments Law Journal 114.

[163] See e.g., Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements (n 42).

[164] Schill, *The Multilateralization of International Investment Law* (n 148) 37.

and states' rights of self-determination, recognising economic sovereignty as an intrinsic part of the state's sovereignty.[165]

The UN General Assembly Resolution 3201 of 1974, which contained the 'Declaration on the Establishment of a New International Economic Order' (NIEO), also characteristic of the international climate at the time. The resolution declared 'the right of nationalization or transfer of ownership to its nationals', encompassing 'an expression of the full permanent sovereignty of the State.'[166] Since developing countries favoured NIEO, one major concern was regulating the foreign investment in a manner more favourable to developing countries.[167]

The development leading up to the proclamation of NIEO in the 1970s also illustrates why developing countries almost unanimously opposed the protection of international property and consequently would not support the OECD Draft Convention of 1967. Even some of the OECD member states were reluctant to support it. In particular Greece, Portugal, and Turkey considered certain provisions of the 1967 Draft to be too favourable to capital exporting countries and foreign investors.[168] The United States did not actively push for the conclusion of a multilateral convention within the OECD and this led to the failure of the 1967 OECD Draft Convention. In recognition of the ideological divide between capital exporting and capital importing countries on the appropriate level of foreign investment protection, the Draft Convention was never

[165] Subedi, 'International Investment Law' (n 3) 733.
[166] On the politics and economics connected with the NIEO, see e.g. Jagdish N Bhagwati, *The New International Economic Order* (MIT Press 1978); Jeffery A Hart, *The New International Economic Order: Conflict and Co-operation in North-South Economic Relations* (Palgrave Macmillan 1983).
[167] Subedi 'International Investment Law' (n 3) 735; generally see e.g. Kamal Hossain (ed) *Legal Aspects of the New International Economic Order* (Frances Pinter 1980.
[168] Anthony C Sinclair, 'The Origins of the Umbrella Clause in the International Law of Investment Protection' (2004) 20 Arbitration International 411, 432.

opened for signature.[169] Walker opines that the necessary 'consensus concerning the sanctity of private property, the advantages of private enterprises, and the acceptability of alien participation in the country's economy' simply did not exist at the time.[170]

Despite the fact that it was not opened for signature, the 1967 Draft Convention was recommended to OECD members as a model for the conclusion of BITs with developing countries.[171] The Draft Convention demonstrably influenced the Model BITs of France, the United Kingdom,[172] and the United States.[173] The pedigree of many BITs is, therefore, linked to the efforts within the OECD in the 1960s to establish an investment framework on a multilateral basis. The multilateral effort within the OECD also largely explains the reasons for the homogeneity of many BITs.[174]

2.1.i World Politics in the 1970s and its Influence on Investment Treaties and the FET Standard

It is interesting to see that, bilateral efforts at investment agreements would succeed where their multilateral counterparts had failed. The early proponents of BITs had a number of purposes in their minds for these treaties. One reason was that capital exporting countries favoured BITs as a response to the claims made by many developing countries during the 1970s to enforce the *Calvo* doctrine. This doctrine

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[169] Dolzer and Stevens, *Bilateral Investment Treaties* (n 59) 2; stating that 'the reason for this was in part due to the fact that the Convention was originally intended to be a multilateral instrument applicable to all countries, not only to OECD members….The controversy surrounding other well-known multilateral instruments of that period, however, reflected more accurately the deep divisions in the international community on what in fact constituted "recognized principles" in the area of foreign investment law'.

[170] Walker 'Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice' (n 149) 229, 241.

[171] Schill, *The Multilateralization of International Investment Law* (n 148) 39.

[172] See e.g. Denza and Brooks (n 143) 910.

[173] K Scott Gudgeon, 'United States Bilateral Investment Treaties' (1986) 4 International Tax and Business Lawyer 105, 111.

[174] Dolzer and Stevens, *Bilateral Investment Treaties* (n 59)2 *et seq.* pointing out that, 'OECD countries have continued to review their policies in this respect within the OECD Committee on International Investment and Multinational Enterprises'.

rejected the idea that expropriation needs to be accompanied by 'prompt, adequate and effective compensation.'

The *Calvo* doctrine dominated for a century in foreign relations in Latin America, as well as in the Soviet bloc, as these countries became fierce opponents of international protection of property.[175] A group of developing countries advanced this opposition in the UN General Assembly's Resolution 3281, the Charter of Economic Rights and Duties of States (CERDS) in 1974. CERDS provided that the law of expropriating states would measure compensation for expropriation.[176] CERDS seemed to challenge the standard of prompt, adequate, and effective compensation as well as asserting that there was no international minimum standard at all.

Developed countries sought the network of BITs, embracing the standard of 'prompt, adequate and effective compensation', to counter the assertions made by the developing countries' that customary international law no longer required expropriation to that standard.[177] Though direct expropriations are now rare, the introduction of the FET standard in BITs gave the capital exporting countries recourse to a remedy against a broad range of actions that might amount to indirect expropriation of foreign investors in the host developing countries.[178]

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[175] See e.g. Report of the Centre on Transnational Corporations on Work on the Formulation of the United Nations Code of Conduct on Transnational Corporations, U.N. Doc E/C. 10/1985/s/2 Excerpted in Louis Henkin, *International Law* : *Cases and Materials* (2nd edn, West Group 1987) 1049–1051.

[176] Article 2. 2(c) of CERDS provided that ' Each State has the right to nationalize, 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 State considered pertinent'.

[177] Vandevelde, *United States Investment Treaties: Policy and Practice* (n 152) 21; Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (n 126) 625.

[178] Vandevelde, 'US Bilateral Investment Treaties: The Second Wave' (n 126) 625. Another reason for the popularity of BITs was to depoliticise the investment disputes. Traditionally the remedies available to foreign investors whose investment was expropriated or otherwise affected by some actions of the host state was subject to the involvement of the investor's government in the dispute. The BITs established the legal remedies for investment disputes which do not require the involvement of the investor's own government. See e.g. Vandevelde, *United States Investment Treaties: Policy and Practice* (n 152) 29–31.

It appears that at the multilateral and regional level many of the investment agreements did include reference to the FET standard, but not with a directly binding obligation. Any stipulation of the standard appeared only in a preamble or was demonstrated in other ways with an intent that such foreign investors should be subject to such treatment. The hortatory approach in those agreements only created an incentive, rather than a binding obligation, for the signatory states to treat the foreign investors fairly and equitably.[179] However the BITs were different in their construction as they included the FET standard as a binding obligation rather than merely being non-binding aspiration.

2.1.j UN Documents 1983

The UN made an effort to recognise the FET standard in dealing with transnational corporations, as the Draft UN Code of Conduct on Transnational Corporations (CTC) exemplifies. Its 1983 version in Article 48, it contained that 'Transnational corporations should receive [fair and] equitable [and non-discriminatory] treatment [under] [in accordance with] the laws, regulations, and administrative practices of the countries in which they operate [as well as intergovernmental obligations to which the Governments of these countries have freely subscribed] [consistent with their international obligations] [consistent with international law].'[180] In 1988 when the CTC finally formulated a draft code of conduct, it became clear that states have so many areas of

[179] Bronfman (n 47) 625.
[180] International Investment Instruments: A Compendium (n 128) 172. The brackets are original and reflect the provisional stage of the drafting. < http://unctad.org/en/Docs/dtci30vol1_en.pdf> accessed 1 September 2014.

major disagreement that the UN Commission on the CTC itself seemed acquiescent with the possibility of the states adopting an internationally agreed upon code.[181]

2.1.k The MIGA Convention 1985

The Convention Establishing the Multilateral Investment Agency of 1985 (the MIGA Convention)[182] requires the availability of FET as a precondition for extending insurance cover. The OECD originated the Multilateral Agreement on Investment (MAI),[183] which places emphasis on fairness in the investment process. The draft preamble indicates that 'fair, transparent and predictable investment regimes complement and benefit the world trading system.' Under the heading 'General Treatment', it specifies that,

> 'Each Contracting Party shall accord to investments in its territory of investors of another Contracting Party fair and equitable treatment and full and constant protection and security. In no case shall a Contracting Party accord treatment less favourable than that required by international law.'[184]

However, MIGA does not seek to create a direct obligation on countries to provide such treatment to investors.[185] Again this represents the non-binding nature of the

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[181] Subedi, 'International Investment Law' (n 3) 736.
[182] MIGA Convention reprinted in International Investment Instruments: A Compendium (n 128) 202, 219.
[183] Draft text can be found at <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf> accessed 22 August 2014.
[184] Section IV, Article 1.1, MAI. In contrast to the OECD Draft, the Draft MAI provides for national treatment and most favoured nation standards in addition to the fair and equitable treatment. Section III, Articles 1 and 2, respectively.
[185]Article 12 of MIGA dealing with 'Eligible Investments' provides in part: '(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.' Article 12(d) rather stipulates that, in order to guarantee an investment, MIGA must satisfy itself fair and equitable treatment and legal protection for the investment exist in the host country concerned. Although this provision does not create liability on a host State where there has been a breach of the FET standard, it is designed to create an incentive for the foreign investors to favour locating their investment in

standard at the multilateral level. Significantly, the developed countries supported MIGA as a means to an international system of investment guarantee for investing in developing countries.[186] However, some OECD member states and civil society objected that the document did not ensure a proper balance between the interests of foreign investors and host countries.[187]

2.1.l The ASEAN Treaty 1987

Sections a–k have described the historical development of the treaties. Sections l–t describe more recent events as developing countries' attitude towards the FET standard have shifted. In an early sign of the shift, the Association of Southeast Asian Nations (ASEAN) adopted the Agreement for Promotion and Protection of Investments in 1987 (the ASEAN Treaty),[188] which supports the promotion of private investment among treaty parties in order to promote development and economic cooperation. Its Article IV (2) references the FET standard:

> 'All investments made by investors of any Contracting Party shall enjoy fair and equitable treatment in the territory of any other Contracting Party. This treatment shall be no less favourable than that granted to investor of the most-favoured-nation.'

This shift of attitude of some developing countries demonstrates how they begin to accept FET as an integral standard in investment treaties.

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countries which offer that standard of treatment. MIGA Convention in International Investment Instruments; A Compendium (n 128) 219.

[186] For a brief discussion on MIGA see e.g. Subedi, 'International Investment Law' (n 3) 737.

[187] Ibid.

[188] This is an Agreement among Governments of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand. Text can be found at <http://www.aseansec.org/12812.htm> accessed 22 August 2014.

2.1.m The Lomé IV 1990

Lomé IV, 1990[189] reflects the perspective of a significant cross section of both capital exporting and capital importing countries. Article 258(b) of Lomé IV binds the African, Caribbean and the Pacific (ACP)[190] Group of States and members of the European Union to the FET standard in relation to nationals of each state party to the Convention. This acknowledges the importance of private investment in promoting development and cooperation, and reflects the growing acceptance of the standard among mainly capital importing developing countries.

2.1. n The World Bank Guidelines 1992

The Guidelines on the Treatment of Foreign Direct Investment,[191] adopted by the Development Committee of the Board of Governors of the International Monetary Fund (IMF) and the World Bank (WB) in 1992, in their section III dealing with 'Treatment' called for FET:

> '2. Each State will extend to the investments established in its territory by nationals of any other State fair and equitable treatment according to the standards recommended in these Guidelines.'[192]

These guidelines are non-binding, but Article III (2)–Article III (3) states,

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[189] An unofficial text can be found at <www.crnm.org/index.php?option=com_docman&task=doc_download&gid=379> accessed 22 August 2014. Lomé IV was ratified by 12 developed European countries on the one part and 68 developing countries from Africa, the Caribbean and the Pacific.

[190] The ACP was created by the Georgetown Agreement in 1975.

[191] World Bank—Legal Framework for the Treatment of Foreign Investment (1992) 31 International Legal Materials 1366.

[192] World Bank—Guidelines on the Treatment of Foreign Direct Investment, 7 ICSID Review, (1992) Foreign Investment Law Journal 297, 300.

> '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….
>
> (a) With respect to the protection and security of their person, property rights and interests, and to the granting of permits, import and export licenses and the authorization to employ, and the issuance of the necessary entry and stay visas to their foreign personnel, and other legal matters relevant to the treatment of foreign investors as described in Section 1 above, *such treatment will, subject to the requirement of fair and equitable treatment mentioned above,* be as favourable as that accorded by the State to national investors in similar circumstances. In all cases, full protection and security will be accorded to the investor's rights regarding ownership, control and substantial benefits over his property, including intellectual property.' [Emphasis added]

This approach suggests that when treatment of a foreign investor falls short of any of the recommended standards, a country has failed to satisfy the overreaching requirement of FET. Vasciannie opines that, in this respect, the Guidelines are likely to provide a convenient reference point for assessing the content of the FET standard in the future, bearing in mind the limitations of placing reliance on an instrument not prepared with the direct input of developing and developed countries.[193] Similarly, Rubin argues that, although the guidelines may be credible, the process involved in their preparation left the overall document 'somewhat short of "soft law."'[194]

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[193] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 119.

[194] Seymour J Rubin, 'Introductory Note on "'World Bank: Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment", (1992) 31 International Legal Materials 1363.

2.1.o NAFTA 1992

The North American Free Trade Agreement (NAFTA) Treaty of 1992 contains the FET standard in its Article 1105 under the rubric 'Minimum Standard of Treatment'. It reads 'Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable and full protection and security.'[195]

A number of BITs between developed countries and their developing counterparts use similar language. Prince argues that this provision of NAFTA indicates that the Agreement incorporates 'customary international law principles obligating the host country to accord fair and equitable treatment and full protection and security to investments in its territory'.[196] However, Vasciannie, whilst acknowledging that this view is plausible, expresses a different opinion. Vasciannie argues that the particular formulation in Article 1105 allows for an alternative view:

> 'NAFTA incorporates international law, and contemplates that international law *allows* States to provide fair and equitable treatment and full protection and security. On the latter interpretation, Article 1105 implies no judgment on whether States are obliged to provide fair and equitable treatment in customary international law.'[197]

Chapter 3 provides a detailed discussion of the debates and controversies on NAFTA Article 1105.

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[195] NAFTA 1994, (1993) 32 International Legal Materials 639.
[196] Daniel M Prince, 'An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement' (1993) 27 International Lawyer 727, 727–728.
[197] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 117.

2.1.p The Energy Charter Treaty 1994

At the regional level, the Energy Charter Treaty (ECT) of 1994, reflecting the perspectives of capital exporting countries, contains elaborate language around the requirement of FET, with specific reference to stable and transparent conditions. Article 10 Para 1 of the Charter provides:

> 'Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment.'[198]

This language reflects the influence of the OECD Draft of 1967, since both instruments pledge to ensure FET 'at all times'. While ECT is sector specific and its scope is limited to the European continent, its parties include several countries which are currently reliant on capital importation as part of their basic strategy for economic development, i.e. the countries in transition, which gives the FET provision particular weight.[199]

2.1.q MERCOSUR

MERCOSUR member countries signed the Colonial Protocol on Reciprocal Promotion and Protection of Investments within MERCOSUR, 1994.[200] Article 3, under the

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[198] ECT 1994, (1995) 34 International Legal Materials 381, 389.
[199] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 117.
[200] The MERCOSUR in English means the Southern Common Market. This is an economic and political agreement among some Latin American countries. The member states of MERCOSUR are Argentina, Brazil, Paraguay, Uruguay, Venezuela and Bolivia. The official website of MERCOSUR is available only

heading 'Treatment', expressly grants investors from other MERCOSUR country 'at all times a fair and equitable treatment'. More generally, the Protocol on Promotion and Protection of Investments coming from states, not parties to MERCOSUR signed in August 1994, in Article 2(C) under the heading 'Investment Protection', extends 'fair and equitable treatment' to investments of investors from third states. These treaties have not yet to come into force, but considering the conventional attitude of the Latin American states, they reflect a notable change in MERCOSUR member countries.[201]

2.1.r The Pacific Basin Charter on International Investments 1995

The Pacific Basin Economic Council approved the Pacific Basin Charter on International Investments, 1995[202] through its Committee on Foreign Investments. The Council comprises representatives of the international business community from over twenty countries including both capital importing and capital exporting countries. This Charter also shows high regard for the principles of fairness, by stating that domestic legislation affecting foreign investment should be 'fair and reasonable among all types of investors' and also that government policies on investment should be applied on a fair basis.[203]

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in Spanish and Portuguese see e.g. <http://www.mercosur.int/msweb/portal%20intermediario/> accessed 22 August 2014.

[201] For text in Spanish see, respectively International Investment Instruments: A Compendium, Vol. II (UNCTAD 1996) 513 <http://unctad.org/en/Docs/dtci30vol2_en.pdf> accessed 30 August 2014. An unofficial translated version of the January, 1994 text can be found at <http://www.cvm.gov.br/ingl/inter/mercosul/coloni-e.asp> accessed 30 August 2014.

[202] For text see International Investment Instruments: A Compendium, Vol. III (UNCTAD 1996) 375 <http://unctad.org/en/Docs/dtci30vol3_en.pdf> accessed 1 September 2014.

[203] Ibid.

2.1.s OECD Draft Negotiating Text for MAI 1998

The OECD Draft Negotiating Text for a Multilateral Agreement on Investment of 1998 provided for FET and the standard of constant protection and security.[204] At the same time international law was preserved as a residual standard: '1.1. Each Contracting Party shall accord to investments in its territory of investors of another Contracting Party fair and equitable treatment and full and constant protection and security required by international law.'[205]

2.1.t Treaties with No FET

Today few BITs or IIAs lack the FET standard. The IIAs that do not contain an FET clause include Australia–Singapore FTA (2003),[206] New Zealand–Singapore FTA (2001),[207] the New Zealand–Thailand Closer Economic Partnership Agreement (EPA) (2005),[208] India–Singapore Comprehensive Economic Cooperation Agreement (2005),[209] Albania–Croatia BIT (1993),[210] the Croatia–Ukraine BIT (1997),[211] and a number of BITs concluded by Turkey. This exclusion reflects unwillingness on the part of parties

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[204] The Multilateral Agreement on Investment, the main negotiating text can be found at <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf> accessed 30 August 2014. From the outset of the deliberations on this draft agreement, it was agreed that the fair and equitable standard would be included in the text; see, e.g. OECD, 'A Multilateral Agreement on Investment: Report by the Committee on International Investment and Multinational Enterprise (CIME) and the Committee on Capital Movement and Invisible Transactions (CMIT)', Doc. OECD/GD(95) 65, (1995) <http://www.oecd.org/daf/mai/htm/cmitcime95.htm> 30 August 2014.

[205] MAI negotiating text at p. 56 <http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf> accessed 30 August 2014

[206] <http://www.customs.gov.au/webdata/resources/files/PS200913-ig-SAFTA.pdf> accessed 1 September 2014.

[207] <http://wits.worldbank.org/GPTAD/PDF/archive/NewZealand-Singapore.pdf> accessed 1 September 2014.

[208] <http://www.mfat.govt.nz/downloads/trade-agreement/thailand/thainzcep-december2004.pdf> accessed 1 September 2014.

[209] <http://wits.worldbank.org/GPTAD/PDF/archive/India-singapore.pdf> accessed 1September 2014.

[210] <http://investmentpolicyhub.unctad.org/Download/TreatyFile/9> accessed 1 September 2014.

[211] <http://investmentpolicyhub.unctad.org/Download/TreatyFile/895> accessed 1 September 2014.

to the agreement to subject their regulatory measures to review under this standard.[212] The fact that the vast majority of investment treaties have included the standard, suggests that countries that have excluded the FET standard have done so with particular purpose. The avoidance of the standard reflects the fear of being exposed to this standard of protection and the fear of the 'catch all' power of the standard.[213] However these are isolated exceptions among almost three thousand BITs that are in existence.[214]

2.2 The FET Standard in International Investment Treaties as It Stands Today

As this chapter has described, the FET clause does not convey the same legal result in every multilateral or regional instrument. More particularly, the meaning varies from one treaty to another depending on the context. Consequently, the type of protection offered will also not be constant[215] and also sometimes does not have a binding effect.[216] However, although many of these multilateral efforts did not ultimately result in enforceable treaties, what Salacuse calls the 'epistemic community of international lawyers and negotiators' adopted it and this would become a principle channel for its diffusion and development among countries.[217] The soft formulation of the FET standard at a multilateral and regional level reflects the fact that, at the multilateral level, it has been extremely difficult for the parties to negotiate multilateral investment rules as

[212] Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II (n 42) 18.
[213] Subedi, *International Investment Law Reconciling Policy and Principle* (n 1) 2.
[214] See, e.g. Jack Coe, 'Fair and Equitable Treatment under NAFTA's Investment Chapter' (2002) 96 American Society of International Law Proceedings 9, 18; Mohamed I Khalil, 'Treatment of Foreign Investment in Bilateral Investment Treaties' (1992) 8 ICSID Review—Foreign Investment Law Journal 339.
[215] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 122.
[216] See, e.g., The Havana Charter and MIGA Treaty discussed above.
[217] Salacuse *The Law of Investment Treaties* (n 38) 219.

it remains unfeasible for them to come to a unanimous consensus on an all-embracing multilateral investment regime.[218]

The FET standard emerged as a core investment protection standard in international investment law during the post-WWII era. Although different developing countries opposed investment agreements at the multilateral level, and the efforts to create those treaties generally failed, a number of resistant countries gradually signed BITs encompassing the FET standard in the 1950s and early 1960s.

Still, some countries, particularly Latin American countries, determinedly avoided FET throughout the greater part of the post-WWII period.[219] These countries preferred to maintain national control over their foreign investments and thus adopted national treatment provisions in their BITs rather than FET due to the influence of the famous *Calvo* doctrine.[220] Therefore we see that, post-WWII, the influence of a new economic order era, unity of developing countries on sovereignty over their natural resources in the 1970s and the dominance of the *Calvo* doctrine among the Latin American and other developing countries did still influence the shape of investment treaties as well as the FET standard. However, since the 1980s even these Latin American countries have begun to incorporate the FET standard into their trade agreements.[221] BITs which omit reference to FET standard are quite exceptional.[222] Ever since then, the standard has become an indispensable element for international investment treaties and consequently

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[218] Kläger, *Fair and Equitable Treatment in International Investment Law* (n 47) 13.
[219] See, e.g., Decision 24 on 'Common Regime of Treatment of Foreign Capital and of Trademarks, Patents, Licenses and Royalties' dated 1977 and Decision 291 on 'Common Code for the Treatment of Foreign Capital and on Trademarks, Patents, Licenses and Royalties' dated 1991 both adopted by the Commission of the Cartagena Agreement; for text see respectively (1977) 16 International Legal Materials 138 and (1991) 30 International Legal Materials 1288.
[220] See discussion above in 2.1.i World Politics in the 1970s and its Influence on Investment Treaties and the FET Standard 45 .
[221] See the discussion above in 2.1.q MERCOSUR 53.
[222]See, e.g., Coe (n 214); Khalil (n 214).

in investment dispute arbitration.[223] To emphasise its importance in international investment law, Salacuse describes the concept as follows: 'Indeed, one would say that fair and equitable treatment is, to employ Hans Kelsen's concept from his *Pure Theory of Law (1934),* the *grundnorm* or basic norm of the investment treaty system.'[224] With very few exceptions, the FET standard has developed over the course of time into a common clause in most investment treaties. It has become one of the core features of modern investment treaties. A survey of over 500 BITs in 2002 found that approximately 90 per cent of them had FET clauses.[225] The concept of FET standard originally created in multilateral treaties has therefore become a key element in BITs, and through this process the standard has become a principle of international law and a 'fundamental norm of the emerging global regime for international investment.'[226]

However, these BITs do not reflect a single formulation of the FET standard.[227] Thus Dolzer has rightly observed that, after a close scrutiny of the text of the BITs, it appears that the drafters of those treaties considered it desirable to include a general standard, in addition to the specific rules, which would cover such issues and matters relevant for the desirable extent of protection, which did not fall under the specific rules.[228] Chapter 3 explores these various constructions of the standard in different BITs.

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[223] Harten, 'Investment Treaties as a Constraining Framework' (n 24) 164.
[224] Salacuse, *The Law of Investment Treaties* (n 38) 219.
[225] See, e.g. Coe (n 214). Also see e.g. Khalil (n 214)— In his study Khalil examines 335 BITs from the early 1960s to the 1990s and found that only 28 did not expressly include the standard, and that in 1996 cases, the FET standard was combined with the national and most favoured nation standards.
[226] Salacuse, *The Law of Investment Treaties* (n 38) 219.
[227]Discussed in Chapter 3
[228] Dolzer, 'Fair and Equitable Treatment: A Key Standard in Investment Treaties' (n 39) 89.

2.3 Conclusion

This chapter has described the FET standard from the orientation of its genealogy and its historical development in international investment law, with particular focus on the role developed and developing countries has played. It has traced the standard from its initial stage of development, when international economic agreements at the multilateral and regional levels mostly employed a hortatory reference to the standard, rather than making it a binding obligation. Although most of the post-WWII multilateral efforts on trade and investment did not come to a successful conclusion, the concept of FET survived as a binding obligation in the vast majority of BITs in force today. While some international agreements omit the standard, it has become a fundamental principle of international investment law, and the vast majority of investment treaties and agreements contain it.

Chapter 3

Different Constructions of the FET Standard in Investment Treaties

3.1 Introduction

The preceding chapter has demonstrated that over time the concept of FET has become a common feature in BITs. The scope of FET has been hotly debated, not least by host countries fearing that it might become a 'catch all' provision that foreign investors can invoke against virtually any adverse treatment.[229] The different wording used in different treaties in relation to FET has complicated the issue, and the tribunals have varied their interpretation in accordance with the construction of the treaty language. This impacts the outcome of particular disputes.

This chapter will discuss the different constructions of FET in different investment treaties and the associated issues and controversies surrounding the standard depending on the particular construction. It will argue that, despite differences in construction, there remains sufficient similarity across different treaties to support the claim that there is an overarching and singular concept of FET that can be the subject of detailed analysis. It will also argue that connecting the standard with other standards within the text of each treaty can productively limit the ambit of the FET standard. However, the most common form of limitation, by connecting FET to key principles of international law, does not clearly limit the scope of the FET standard. This is because the relevant international legal principles are not well defined, nor is their applicability in the context of international investment law well understood.

[229] Subedi, *International Investment Law: Reconciling Law and Principle* (n1) 168.

3.2 Different Construction of FET in Investment Treaties

Investment treaties do not adopt a uniform approach to the standard and the tribunals have not adopted a uniform approach to its interpretation. Scholars have categorised the different constructions of the FET standard in existing international investment treaties[230]; this thesis builds on this work to adopt three broad categories. These are

(A) FET *minus* - which refers to those treaties where treaty framers have connected the definition of the standard to other concepts that define, and appear to limit its scope.

(B) *Simple* FET where the FET clause is formulated without any reference to international law, customary international law, or any other limitation,

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[230] Salacuse had divided them under two headings, namely (a) that FET merely reflects the *international minimum standard* requirement by customary international law; or (b) that the standard is *autonomous and additional* to general international law, see e.g. Salacuse, *The Law of Investment Treaties* (n 38) 222–227. Laird has depicted three variations of the standard, i.e. (a) the additive provision, indicating that the provision would appear to consider the FET standard is in addition to whatever treatment international law requires; (b) the inclusive provision, meaning that the FET standard is subsumed under international law, not a separate or autonomous standard of treatment; and (c) the customary international law provision, meaning that the FET standard is customary international law. He also opines that arbitral tribunals have not applied these three variations differently when a claim is made solely under the FET standard. He also argues that, whether one characterizes the FET standard as being customary international law or not, as additive to or included in international law, the question remains, what is the substantive content of FET standard? See e.g. Ian A Laird, 'Betrayal, Shock and Outrage—Recent Developments in NAFTA Article 1105' in Todd Weiler (ed), *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Transnational Publisher, Inc, New York 2004) 49, 51–54. In 2007 UNCTAD grouped the various formulations into seven categories, see e.g. Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking, UNCTAD (2007) 30–33 <http://www.unctad.org/en/docs/iteiia20065_en.pdf> accessed 22 August 2014. Marshall summarises the different constructions of the standard as '(a) Treaties that grant investments fair and equitable treatment without making any reference to international law or to any other criteria to determine the content of the standard; (b) Treaties that state that investments will receive fair and equitable treatment no less favourable than accorded to its own investors or to investors of any third State; (c)Treaties that couple the fair and equitable treatment standard with an obligation to abstain from impairing the investment through unreasonable or discriminatory measures; (d) Treaties that require investments to be granted "fair and equitable treatment in accordance with the principles of international law"; (e) Treaties that similarly require fair and equitable treatment in accordance with the principles of international law, but that in addition expressly identify some requirements of the standard. These specific inclusions may broaden the scope of the standard; (f) Treaties that make the fair and equitable treatment standard contingent on the domestic legislation of the host country; (g) Finally, some recent BITs and free trade agreements provide a more precisely defined scope of the fair and equitable treatment standard. They oblige the contracting parties to accord covered investments treatment in accordance with the minimum standard of treatment under customary international law. Some also make it express that fair and equitable treatment is part of the minimum standard and does not create additional substantive rights.' See e.g. Fiona Marshall, '*Fair and Equitable Treatment in International Investment Agreements'* Issues in International Investment Law, Background Papers for the Developing Country Investment Negotiators' Forum Singapore, 1–2 October 2007, International Institute for Sustainable Development, 4–5 <http://www.iisd.org/pdf/2007/inv_fair_treatment.pdf> accessed 1 September 2014.

(C) FET *plus* – which refers to treaties which combine the FET standard with an additional substantive obligation, such as full protection and security, prohibition of denial of justice, prohibition of arbitrary or discriminatory measures, obligations of MFN, or guarantee of protection and security.

It is suggested that this novel categorisation of FET is an important mechanism for understanding the differentiation in construction of the clause across different investment treaties, and the implications of that differentiation for how different versions of the FET clause will be interpreted by tribunals. Each of these three categories are explained in detail below.

3.2.A FET *Minus*

FET *minus* refers to those treaties where treaty framers have connected the definition of the standard to other concepts that define, and appear to limit, its scope. This category includes treaties which have combined the FET clause either as a standard with the minimum standard under international law generally or under customary international law. A considerable volume of sources have drawn on the perspective of capital exporting countries.[231] This is the most controversial formulation of the FET standard. The minimum standard here largely refers to the treatment of aliens. The FET standard then simply means the standard which international law or customary international law guarantees for aliens. A number of other regional and bilateral treaties have also limited the scope of the FET standard by combining it with other principles, which will be discussed below. But before going into discussion of different FET minus provisions, it

[231] See e.g. Pamela B Gann, 'The US Bilateral Investment Treaty Program' (1985) 21 Stanford Journal of International law 373; Muchlinski, *Multinational Enterprises and the Law* (n 52) 636–639.

is also necessary to shed some light on the notion of the minimum standard under international law generally or under customary international law.

3.2.A.a Minimum Standard under International Law or Customary International Law

In the twentieth century the colonial powers envisaged the notion of the 'international minimum standard' to protect their nationals and property.[232] This evolved into a concept of international law and customary international law[233] as a shield to protect foreign nationals from all kinds of violations, regardless of their identity as investors.[234] Roth supplied the classical definition of the international minimum standard: 'the international standard is nothing else but a set of rules, correlated to each other and deriving from one particular norm of general international law namely, that the treatment of an alien is regulated by the law of nations.'[235] The landmark decision of the US–Mexico General Claims Commission in the *Neer* claim Award (1926) provided the foundational understanding of the international minimum standard for the protection of aliens. [236] The classical *dictum* states:

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[232] For general discussion on the minimum standard as developed under international law as a response to protect property of the investors from a post-colonial perspective, see generally Pahuja (n1) Chapter 4. Also see e.g. M Sornarajah, *The International Law on Foreign Investment* (3rd, edn, Cambridge 2010) 8–20, 27–37.

[233] The 'general and consistent practice of states' that they follow out a sense of legal obligation (*opinion juris)* forms customary international law. See e.g. Continental Shelf Case (Libya vs. Malta) ICJ, Judgment dated 3 June 1985, Para 27.

[234] See e.g. Elihu Root, 'The Basis of Protection to Citizens Residing Abroad' (1910) 4(3) American Journal of International Law Proceedings 517; Edwin M. Borchard, *The Diplomatic Protection of the Citizens Abroad*' (The Banks Law Publishing Co. 1915) 177; The American Law Institute's Restatement (Second) of Foreign Relations Law of the United States, 1965 Para 165.2.

[235] See Andreas H Roth, *The Minimum Standard of International Law Applied to Aliens* (A.W. Sijthoff, 1949) 127.

[236] The United States presented this claim to the US–Mexico Claim Commission on behalf of the family of Mr. Paul Neer, who was killed in Mexico under obscure circumstances. The claim stated that the Mexican government had shown a lack of diligence in prosecuting those responsible and that it ought to reimburse the family. The Commission found that the Mexican authorities' failure to apprehend or punish those guilty of the murder of the American citizen did not *per se* violate the international minimum standard on the treatment of aliens. See e.g. Neer Claim (US vs. Mexico Opinion) US–Mexico General Claims Commission, 15 October 1926, Reports of International Arbitral Awards, Vol. 4, 60–66.

> 'the propriety of governmental acts should be put to the rest of international standards…the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether the insufficiency proceeds from the deficient execution of a reasonable law or from the fact that the laws of the country do not empower the authorities to measure up to international standard is immaterial.'[237]

The assumption that a standing body of customary rules as agreed by the nations protecting an alien in another country,[238] which a host country must fulfill,[239] characterises this interpretation. It presumes a host country may be responsible under international law[240] and the violation of this norm may open the way for international action on behalf of the injured alien against the host country, provided that the alien has exhausted local remedies.[241]

The scope of the standard has been debated from its very inception, although it aims to reflect a common standard of conduct which the majority of the nations have accepted. Scholars such as Roy questioned it as early as 1961;[242] Roth critiques the assumption

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[237] Neer Claim Award (n 236) 61–62.
[238] See e.g. Marcos Orellana, 'International Law on Investment: the Minimum Standard of Treatment' (2004) 1(3) Transnational Dispute Management.
[239] Shaw (n 102) 824.
[240] Over time, treaties began to tie the minimum standard to the doctrine of state responsibility in international law for injuries to aliens. See generally e.g. Mavrommatis Palestine Concessions Case (Greece vs. UK) (1924) PCIJ, Judgment dated 30 August 1924; Panevexys-Saldututiskis Railway Case (Estonia vs. Lithuania) (1938) PCIJ, Judgment dated 28 February 1938; Charzow Factory Case (Germany vs. Poland) (1928) PCIJ, Judgment dated 17 September 1928.
[241] Ian Brownlie, *Principles of Public International Law* (6th edn, Oxford University Press 2003) 502.
[242] See generally, SN Guha Roy, 'Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?' (1961) 55 American Journal of International Law 863.

that a common standard exists: 'The law of treatment of aliens, as part of international law, lacks uniformity, not only with regard to rules of positive law but still to a greater extent as regards the fundamental concepts underlying its structure.'[243] Nations continue to debate the concept of this 'minimum standard' in international law;[244] while protection of aliens in foreign lands prevailed in international law in the late nineteenth and first half of the twentieth century, the atrocities of WWII increasingly focused judicial and academic commentary on universal human rights. Therefore there was a shift in the discourse from the rights of a particular group like 'foreigners' or 'aliens' in international law to the rights of 'all' as human beings.[245] Opposition to the standard was influenced by the *Calvo* doctrine[246] of equal rights for locals and foreigners, and the applicability of domestic legislation and local courts for the settlement of investment disputes, largely came from Latin America.

Therefore from the above discussion it is clear that the standard developed under international law and customary international law is one of the main standards to protect aliens in international law. But the scope of the standard is uncertain and very much contested. In various investment treaties, the minimum standard under international Law or customary international law is combined with the FET standard. The implications of this form of 'FET *minus'* are discussed below.

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[243] Roth (n 235) 61 and 87.

[244] Sornarajah, *The International Law on Foreign Investment* (n 232) 140–141 and 328; AO 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* (Oxford University Press 1983) 1001; Matthew C Porterfield, 'An International Common Law of Investor Rights?" (2006) 27 University of Pennsylvania International Journal of Economic Law 79, 81–84.

[245] Tolga Yalkin, 'The International Minimum Standard and Investment Law: The Proof is in the Pudding' EJIL: Talk! (Blog of European Journal of International Law) <http://www.ejiltalk.org/international-minimum-standard/> accessed 30 August 2014.

[246] See Chapter 2 for discussion of the *Calvo* doctrine in 2.1.i World Politics in the 1970s and its Influence on Investment Treaties and the FET Standard 45.

3.2.A.b FET as a Standard Combined with International Law Generally

The first group of treaties discussed here combine FET with a reference to international law in general, thereby appearing to subsume it under international law.[247] For example multilateral treaties such as the ECT[248] and bilateral treaty such as the Croatia–Oman BIT (2004).[249] Article 4(1) of the France–Mexico BIT (1998) provides one form of wording:

> '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.'[250]

By describing FET as an obligation 'in accordance' with international law, treaties with this wording call on the tribunals to limit the scope of FET to within the sources of international law.[251] This creates an obligation for the tribunals to review the sources of international law to judge an alleged breach of conduct. An UNCTAD study suggests that the divergent scope of international law makes the process of discerning all these divergent principles of international law a daunting task for the Tribunals.[252]

By contrast, the Croatia–Oman BIT states, 'Investments or returns of investors of either Contracting Party in the territory of the other Contracting Party shall be accorded

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[247] Laird (n 230) 52.
[248] Article 10(1) of the ECT; Chapter IV, Article 1.1 of the 1998 OECD Draft MAI also falls into this category.
[249] Croatia–Oman BIT (2004) <http://unctad.org/sections/dite/iia/docs/bits/croatia_oman.pdf> accessed 1 September 2014.
[250] France–Mexico BIT (1998) <http://unctad.org/sections/dite/iia/docs/bits/mexico_france.pdf> accessed 1 September 2014.
[251] The sources of international law derive from Article 38 of the Statute of International Court of Justice.
[252] Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements (n 42) 23.

fair and equitable treatment in accordance with international law and provisions of this Agreement.' [253] Article 2(3) (a) of the Bahrain–United States BIT (1999) states, 'Each Party shall at all times accord to covered investments fair and equitable treatment and full protection and security; and shall in no case accord treatment less favourable than that required by international law.'[254] By referring to the FET obligation as being 'no less' than that of international law, treaties such as these imply that FET is not strictly linked to principles of international law. Rather international law here sets the floor of protection an investor can claim, and the standard may accommodate other requirements of the treaty itself. This construction of FET is effectively closer to the autonomous standing of the FET standard, thereby giving the arbitrators more freedom to interpret the standard[255] (see discussion on *Simple* FET below).

An UNCTAD study shows that this construction of FET with reference to international law prevents the use of a 'purely semantic approach'[256] to the standard and a literal interpretation of it. Reference to international law in general implies that FET is a body of standards of principles civilised nations have recognised as the proper due of foreign investors. This does not limit FET to being part of customary international law. Kläger argues that the FET standard is not expressly limited to the minimum standard as contained in international customary law, but takes into account the full range of international law sources, including general principles and modern treaties and other conventional obligations.[257] Laird believes that this reflects the 'inclusive provision approach' which is less narrow and allows one to conclude that the FET standard is

[253] Croatia–Oman BIT (2004) <http://unctad.org/sections/dite/iia/docs/bits/croatia_oman.pdf> accessed 1 September 2014.
[254] Bahrain–United States BIT (1999) <http://unctad.org/sections/dite/iia/docs/bits/us_bahrein.pdf> accessed 30 September 2014.
[255] Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements (n 42) 23.
[256] Ibid 22.
[257] Kläger, '*Fair and Equitable Treatment' in International Investment Law* (n 47) 271–280.

included under the sources of international law, or as part of customary international law or both.[258] To date judicial and academic jurisprudence has not considered this approach. One good reason for this is that if FET truly means the existent international minimum standard, there is no need to create a BIT to invoke it.[259]

3.2.A.c FET as a Standard Combined with Customary International Law

Treaties that combine FET with the minimum standard of treatment under customary international law invoke the most controversy. This restrictive approach attempts to limit the scope of FET to the extent of protection accorded to aliens under customary international law. Examples include NAFTA Article 1105[260] and the US and Canada model BITs. The US Model BIT 2012 in Article 5 (1) states that, 'Each party shall accord to covered investments treatments in accordance with customary international law, including fair and equitable treatment and full protection and security.'[261] As a further clarification, the next paragraph states,

> 'For greater certainty…the customary international law minimum standard of treatment of aliens [is] 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.'

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[258] Laird (n 230) 53.
[259] See e.g. Fair and Equitable Treatment, Series on the Issues in International Investment Agreements UNCTAD /ITE/IIT/11 (Vol. III) (UNCTAD 1999) 37–42. <http://www.unctad.org/en/docs/psiteiitd11v3.en.pdf> accessed 20 August 2014.
[260] See Chapter 2, 2.1.o NAFTA 1992 51.
[261] See e.g. Article 5 of US model BIT 2012. <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf> accessed 30 August 2014.

Article 5(2) of Canada Model BIT 2004 similarly states that the concepts of FET do not require treatment in addition to or beyond that which the customary international law minimum standard of treatment of aliens requires.[262]

Although only the US Model BIT prescribes in detailed terms the customary rules that apply, both of these examples show the clear intention of the drafters to limit FET to the rules of the customary international law minimum standard of treatment.[263] The elaboration of FET construction and NAFTA's precedent provide further clarification. Some non-NAFTA investment agreements, which the NAFTA model influences, include US FTAs[264] and other international investment agreements.

3.2.A.d FET and Customary International Law: The NAFTA Saga

The most intensive discussion in the existing scholarship on the relationship of FET to the minimum standard under customary international law has taken place in the context of NAFTA Article 1105.[265] The centre of controversy has been the NAFTA parties' attempt to re-write NAFTA Article 1105 through the mechanism of an all-party interpretation.[266] NAFTA references FET under the rubric, 'Minimum Standard of Treatment'. Schreur cites that the combination of these two features of the text as

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[262] See e.g. Article 5 of Canada Model BIT 2004 <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf> accessed 30 September 2014.

[263] Kläger, '*Fair and Equitable Treatment' in International Investment Law* (n 47) 20.

[264] See e.g. Article 10.5 of the Central America-Dominican Republic–United States Free Trade Agreements (DR–CAFTA) (2004) <http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text> accessed 22 August 2014.

[265] See e.g. Dumberry (n 47); Patrick G Foy and Robert JC Deane, 'Foreign Investment under Investment Treaties: Recent Developments under Chapter 11 of the North American Free Trade Agreement' (2001) 16 ICSID Review – Foreign Investment Law Journal 299; J Christopher Thomas, 'Reflections on Article 1105 of NAFTA: History, State Practice and Influence of Commentators' (2002) 17 ICSID Review – Foreign Investment Law Journal 21.

[266] See e.g. Fourth Opinion of Sir Robert Jennings, 'The Meaning of Article 1105(1) of the NAFTA Agreement', 6 September 2001 4–5 in Methanex Corporation vs. United States of America, Preliminary Award on Jurisdiction and Admissibility, 7 August 2002, cited in Laird (n 230) 49–50.

'conspicuous'.[267] Certainly the heading is a manifest reference to customary international law. Schreur argues that the inclusion of the FET standard in the reference to international law makes FET part of international law, and particularly incorporates its rules on the minimum standard of treatment.[268]

However, despite this clear articulation of NAFTA Article 1105 some of the arbitral tribunals have not restricted the FET standard to customary international law.[269] The Partial Award in *S.D. Myers vs. Canada*[270] stated that a breach of a rule of international law may not be decisive in determining whether a denial of FET had occurred.[271] In *Pope and Talbot vs. Canada*[272] the tribunal even more explicitly, and controversially, attempted a shift away from strictly attaching the FET clause to customary international law. The tribunal adopted an idiosyncratic concept of FET that could have far reaching impact. The Tribunal in its second award in *Pope and Talbot* concluded that both the 'language and the evident intention' of the BITs supported the 'additive character' interpretation under which the 'fairness elements' are distinct from customary international law standards.[273] It followed that 'compliance with fairness elements must be ascertained free of any threshold that might be applicable to the evaluation of measures under the minimum standard of international law.'[274] Reflecting an analogy with the language of the BITs, the tribunal found that the fairness elements were 'additive' to the

[267] Schreur, 'Fair and Equitable Treatment in Arbitral Practice' (n 37) 362.
[268] Ibid.
[269] Laird however argues that all the NAFTA parties employed a strained and torturous strategy in the early NAFTA Chapter 11 cases to limit NAFTA Article 1105 and the FET standard to the minimum standard of treatment as construed in the *Neer* Claim case. Not surprisingly, NAFTA parties have consistently opposed the plain meaning approach as an overly expansive interpretation of NAFTA Article 1105. Laird further opines that the NAFTA parties have relied upon the *Neer* case as the 'seminal' case on the international minimum standard since it carried a low threshold standard of conduct easily reached by any government. *See* e.g. Laird (n 230) 57.
[270] SD Myers (n 122).
[271] Ibid Para 264.
[272] Pope & Talbot (n 117) Paras 105–118.
[273] Ibid Para 113.
[274] Ibid Para 111.

requirements of international law[275] and therefore the investor was 'entitled to the international law minimum plus the fairness elements'.[276]

Based on the presumed intentions of the NAFTA parties, the tribunal stated that the NAFTA parties would not have provided investors of NAFTA states with a lower level of protection than it offered to third parties.[277] Basing its conclusion on the strong relationship between the NAFTA parties in comparison to other third party states, it argued that any other construction would assign Article 1105 a lower level of protection than the BIT provisions and would therefore violate NAFTA's national treatment and MFN obligations.[278]

Laird suggests that this decision was controversial not only because it adopted a subjective plain meaning interpretative approach in complete denial of the submissions of NAFTA parties, but also that it attempted to reinterpret Article 1105 as providing obligations equivalent to an additive provision based on an application of the MFN principle.[279] The NAFTA parties reacted forcefully to this outcome, arguing that the award rendered by the tribunal was poorly reasoned and unpersuasive.[280]

This extensive interpretation evoked the fear among the NAFTA parties that FET would threaten economically related regulative measures in their national laws, even if they otherwise complied fully with NAFTA.[281] Kläger argues this prompted the

[275] Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 68.
[276] Pope & Talbot (n 117) Para 110.
[277] Ibid Para 115.
[278] Ibid Para 117.
[279] See e.g. Laird (n 230) 64–65.
[280] See e.g. J Christopher Thomas, 'Reflections on Art.1105 of NAFTA' (2002) 17 ICSID Review—Foreign Investment Law Journal 21, 80; David A Gantz, 'Pope & Talbot, Inc vs. Government of Canada – Case Report' (2003) 97 American Journal of International Law 937, 944; Kläger *'Fair and Equitable Treatment' in International Investment Law* (n) 69–70.
[281] Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 70.

NAFTA member states to seek a political move to put an embargo on future NAFTA arbitration proceedings so as to prevent them from becoming irrepressible.[282] The NAFTA Free Trade Commission (FTC)[283] therefore unexpectedly issued a Note of Interpretation,[284] clearly stating that the concept of FET does not require treatment in 'addition to or beyond that which is required by the customary international law minimum standard of treatment to aliens.'[285] This note effectively ended the debate surrounding the relationship between FET and customary international law in the context of NAFTA, making it clear that the member states intended to adopt an FET standard that is as narrow as possible, by considering only the customary international law sources pertaining to the classical minimum standard of treatment of aliens.[286] Nonetheless, the formulation invented in the 1920s *Neer* case will likely fail to serve the purpose of a modern day complicated investor–state relationship.[287]

The tribunal's award, in dealing with the issue of damages in *Pope & Talbot vs. Canada*[288] reflected this tension, expressing considerable reservations concerning the FTC's power to issue the Note of Interpretation[289] as well as a critique of the soundness of the

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[282] Ibid.

[283] A body composed of representatives of the three state parties with the power to adopt binding interpretations under Article 1131(2).

[284] The NAFTA Free Trade Commission (FTC) issued its Note of Interpretation dated 31 July 2001 <http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/nafta-interpr.aspx?lang=en> accessed 30 August 2014.

[285] No public consultation preceded the announcement of the Note of Interpretation, and the public had no knowledge of the deliberations. Thus Laird opines that the irony of the FTC Note of Interpretation is that, in addition to the interpretation of NAFTA Article 1105, it sought to provide more transparency to the NAFTA Chapter 11 process. He further argues that following frequent citation by Canada in its NAFTA arbitration submissions, this standard 'minimum standard of treatment' has become known as the 'egregious' standard of treatment and that these arguments foreshadowed the FTC Note of Interpretation which subsequently clarified the meaning of NAFTA Article 1105. See Laird (n 230) 55–57.

[286] Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 71.

[287] Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 71–72; Sornarajah, *The International Law on Foreign Investment* (n 232) 329–330.

[288] Pope & Talbot vs. Canada, Award in Respect of Damages, 31 May 2002, (2002) 41 International Legal Materials 1347.

[289] The Tribunal providing *obiter dicta* in its decision that the FTC Note of Interpretation was in form and substance an amendment of Article 1105, rather than a proper interpretation. See Pope & Talbot (n 288) Paras 17–24.

interpretation itself,[290] but reluctantly accepted the interpretation in its award.[291] Subsequent NAFTA Tribunals dealing with the issue have accepted the FTC's interpretation without objection.[292] Future NAFTA tribunals may not accept the Note,[293] but at present the equivalence of FET articulated in the context of NAFTA Article 1105 to the minimum standard of treatment under customary international law is established fact.[294]

Schreur has opined that the FTC note does not mean that other investment treaties, particularly in BITs, should incur the same consequence, despite the fact that international standard of treatment clauses in other BITs use similar wording to Article 1105's. He argues that the special features of NAFTA Article 1105—the heading's reference to the 'Minimum Standard of Treatment', the wording 'international law including fair and equitable treatment', and the use of a binding interpretation by an authorised treaty body, which other BITs do not establish—differentiate NAFTA.[295]

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[290] Pope & Talbot (n 288) Paras 25–47.

[291] Pope & Talbot (n 288) Paras 48–69. Laird opines that the tribunal in *Pope and Talbot* (Merits Award) had no need to conflate the additive provision with a plain meaning interpretive approach, particularly in the context of a fairly flexible inclusive construction of NAFTA Article 1105 and therefore by adopting this plain meaning approach the tribunal was inviting controversy. The Note of Interpretation likely reflects a reaction to this, as does the Canadian authorities' decision to demand the Pope Tribunal reconsider the merits rather than leaving the matter for future cases. Thus the issue of retroactivity was clearly on the stage when the tribunal on damages hearing was rendered. See Laird (n 230) 55.

[292] None of the subsequent Tribunals have followed the lead of the *Pope & Talbot* tribunal in questioning the legitimacy of the FTC Note of Interpretation. Since the announcement of the FTC Note of Interpretation, NAFTA Chapter 11 Tribunals have adjusted to the shifting of NAFTA Article 1105 from an inclusive provision to one explicitly based on the customary international minimum standard of treatment. See e.g. Mondev (n 118) Para 100; ADF Group, Inc vs. United States of America, ICSID Case No. ARB(AF)/00/1, Award, 9 January 2003, 18 ICSID Review—Foreign Investment Law Journal (2003) 195 Paras 175–178; Lowen Group Inc, and Raymond L. Lowen vs. United States of America, Award, 26 June 2003, 7 ICSID Reports 442 Paras 124–128; Waste Management Inc. vs. United Mexican States (No.2) ICSID Case No. ARB(AF)/00/3, Award April 30 2004, 43 International Legal Materials (2004) 967 Paras 90–91.

[293] Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 72–74.

[294] Laird (n 230) 56.

[295] See e.g., Schreur 'Fair and Equitable Treatment in Arbitral Practice' (n 37) 364; Laird (n 230) 49–75.

Tribunals operating outside NAFTA have not adopted any fixed approach on the issue, but have employed individualized interpretations of the respective BITs.[296]

An UNCTAD (2012) study concluded that the treaties which limit FET to customary international law indicate that FET cannot go beyond what customary international law declares to be the content of the minimum standard of treatment of aliens.[297] Further, it argues that from the host country's perspective, combining FET with customary international law may be a progressive step, given that the tribunals will likely interpret the standard as a higher threshold for finding a breach of the standard as compared to unqualified FET clauses.[298] However, this view fails to reflect the drawback of such a construction, which is that no clear set of principles constitutes the minimum standard under customary international law. Given that customary international law is itself highly indeterminate[299] and its evolutionary nature contentious,[300] and that establishing the precise obligations to which it gives rise, tribunals will be unlikely to adhere to this view. The UNCTAD study's argument is therefore unconvincing.

3.2.A.e Minimum Standard under International Law/Customary International Law in Investment Law Context

The international minimum standard does not encompass any particular focus on 'investor'; it only refers to aliens and their property. This restrictive approach is no longer sufficient to address the complexity of today's foreign investment disputes.

[296] See e.g. Tecmed (n 118) Paras 155 and 156; MTD Equity (n 119) Paras 110–112; Occidental (n 116) Paras 188–190. Also see e.g., Schreur, 'Fair and Equitable Treatment in Arbitral Practice' (n 37) 368–385.
[297] Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements Vol. II (n 42) 28.
[298] Ibid 29.
[299] Porterfield (n 244) 88.
[300] Also see e.g. Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 74–76.

Accordingly investment tribunals have not addressed the standard with respect to an investor's investment. Considering the established components of the international minimum standard, which offers little in terms of substantive investor protection, most investor protections cannot constitute a violation of customary international law even in the absence of a treaty obligation.[301]

Interpretation suffers from confusion as to whether the *Neer* claim and ensuing contexts have created the minimum standard or whether evolving customary law, which the extensive network of BITs has influenced, provides the standard. In this context, developing countries (particularly Latin American countries) have questioned the existence of a minimum standard of treatment and its inclusion in customary international law.[302] BITs have not provided a comprehensive definition of such a standard, an ironic result given nations enter into them to clarify vagueness on customary international law as it applies to investment protection.

Thus no body of minimum standard of international law or customary international law that directly speaks to rapidly evolving standards like FET, and the present modern, highly intricate, and complicated investor–state relationship therefore exists without such a standard. Therefore combining the FET standard with the minimum standard does not create any secure guarantee for developing countries that the ambit of the FET obligation will be significantly restricted. As a result, it is clear that, in the vast majority of investment treaties, the host developing countries need to assume that a tribunal will interpret the FET standard as an independent and autonomous standard.

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[301] See e.g. Yalkin (n 245).

[302] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and (n 47) 144.

3.2.A.f Other FET Minus Provisions Which Limit The Scope of the Standard

In this discussion it is pertinent to point out that, some investment agreements tend to narrow down the scope of the standard in an alternative way, apart from combining it with customary international law. They limit the scope of FET by specifically defining it in the text of the treaty. For instance some regional treaties have done so by expressly referring to denial of justice in the FET clause. For example, Article 11 of the ASEAN Comprehensive Investment Agreement (2009) states,

> " 1. Each Member State shall accord to covered investments of investors of any other Member State, fair and equitable treatment and full protection and security.
>
> 2. *For greater certainty*:
>
> (a) fair and equitable treatment requires each Member State *not to deny* justice in any legal or administrative proceedings in accordance with the principle of due process; and……."[303] [emphasis added]

The text of the ASEAN Comprehensive Investment Agreement (2009) here may suggest that the FET standard should be understood to be limited to denial of justice since it uses the term 'requires' rather than 'includes.'[304] Similarly Article 10.10 of the Malaysia-New Zealand FTA (2009) also used the word 'requires' and stated that,

> ' 1. Each Party shall accord to covered investments fair and equitable treatment and full protection and security.
>
> 2. For greater certainty:

[303] ASEAN Comprehensive Investment Agreement (2009) <http://www.unescap.org/tid/projects/tisiln-investagreement.pdf > accessed 23 September 2014.
[304] Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements Vol. II (n 42) 30.

(a) fair and equitable treatment requires each Party not to deny justice in any legal or administrative proceedings;

(b) full protection and security requires each Party to take such measures as may be reasonably necessary to ensure the protection and security of the covered investment; and

(c) 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 under customary international law, and do not create additional substantive rights.'[305]

This appears to be a clear way of limiting the scope of the FET. The denial of justice in administrative or legal proceedings is clearly narrowing the obligation. The FET clause then only relates to judicial or quasi-judicial processes. Clauses like this therefore can potentially provide much clearer limits to the scope of the FET than invocation of international law or customary international law. But the vast majority of the investment treaties do not contain these kind of definitional limitations.

3.2.B *Simple* FET

The second category of treaties stipulate FET without any reference to international law, customary international law, or any other limitation, thereby implying that FET in these treaties is an unqualified, autonomous, and separate standard. These treaties rely on the simple construction, which does no more than to assert that the states have the obligation to accord the FET standard to the investors of the other contracting party.

[305] Malaysia-New Zealand FTA (2009) <http://www.mfat.govt.nz/downloads/trade-agreement/malaysia/mnzfta-text-of-agreement.pdf> accessed 6 October 2014.

For example Article 3 of the Belgium–Luxembourg Economic Union–Tajikistan BIT, 2009 states that, 'All investments made by investors of one Contracting Party shall enjoy a fair and equitable treatment in the territory of the other Contracting Party.'[306]

Now this potentially suggests that general notions of fairness and equity should guide interpretation of the clause on a case by case basis. Alternatively suggestions have been made that even if FET is stipulated as unqualified, the FET obligation should be equated with the minimum standard of treatment under customary international law. For example the Draft OECD 1967 Convention on Protection of Foreign Property included an unqualified FET obligation equated to the minimum standard—'the standard required conforms in effect to the "minimum standard" which forms part of customary international law,'[307]—a notion the OECD Committee on International Investment and Multinational Enterprises reaffirmed in 1984 when it reported, 'according to all Member countries which have commented on this point, fair and equitable treatment introduced a substantive legal standard referring to general principles of international law even if this is not explicitly stated.'[308] The Draft OECD Convention never came into force,[309] nor does the OECD Report of 1984 have any binding effect. In spite of the Draft's influence on later BITs, this effectively leaves the tribunals to interpret an unqualified FET standard and to adopt their own

[306]Belgium–Luxembourg Economic Union–Tajikistan BIT, 2009. <http://unctad.org/sections/dite/iia/docs/bits/Belgium_Tajikistan.PDF> accessed 22 August 2014.

[307] See e.g. Notes and Comments to Article 1(a) of Draft OECD Convention, 1967 by the Drafting Committee, OECD, Draft Convention on the Protection of Foreign Property, 1967, (1968) 7 International Legal Materials 117, 120. Also a comment by the Swiss Foreign Office of 1979 in the context of discussion of FET supports this view, which states, 'Thus, it refers to the classical principle of international public law according to which States must give foreigners found within their territories, and their properties, the benefit of the international "minimum standard", that is to say to accord them a minimum of personal, procedural and economic rights" translated and cited in Schreur, 'Fair and Equitable Treatment in Arbitral Practice' (n 37) 361.

[308] OECD, 1984, 12 Para 36.

[309] See discussion on Draft OECD Convention in Chapter 2: 2.1.h OECD Draft Convention of the Protection of Foreign Property, 1963 and 1967 and its influence 41.

interpretations for the terms 'fair' and 'equitable' rather than linking it to the minimum standard under customary international law.

However an UNCTAD 2012 study on FET critiqued this in relation to unqualified FET clauses in BITs. The report states,

> 'such an interpretation leaves a wide margin of discretion to arbitrators and may lead to an overbroad and surprising extension of the FET standard toward the review of the wide categories of governmental action previously regarded as being outside the remit of international law review. The simple unqualified formulation may result in a low liability threshold and brings with it a risk for State regulatory action to be found in breach of it.'[310]

Therefore the UNCTAD 2012 study expressed a caution that the unqualified FET would give the Tribunals a very wide discretionary power of interpretation and bring some unwanted results.

It is important to note that UNCTAD also carried out a detailed study on the issue in 1999.[311] The earlier report stated, 'if States and investors believe that the fair and equitable standard is entirely interchangeable with the international minimum standard, they could indicate this clearly in their investment instruments.'[312] After a detailed examination[313] the 1999 study concludes,

> 'These considerations point ultimately towards fair and equitable treatment *not being synonymous* with the international minimum standard. Both standards may

[310] Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements Vol. II (n 42) 22.
[311] Fair and Equitable Treatment, Series on the Issues in International Investment Agreements Vo. III (n 259).
[312] Ibid 13.
[313] Ibid 17, 23, 37–40, 53 and 61.

> overlap significantly with respect to issues such as arbitrary treatment, discrimination and unreasonableness, *but the presence of a provision assuring fair and equitable treatment in an investment instrument does not automatically incorporate the international minimum standard for foreign investors. Where the fair and equitable standard is invoked, the central issues remain simply whether the actions in question are in all circumstances fair and equitable or unfair or inequitable.*'[314] [Emphasis added]

Therefore the UNCTAD 1999 study also points towards an independent and autonomous FET standard. The findings of the UNCTAD study of 1999 are plausible since it provides a clear picture in relation to the interpretation of an FET clause in an investment dispute, emphasising the fact that the standard needs to be interpreted independently. Vasciannie also supports this view and opines that this standard is autonomous.[315] He concludes,

> 'bearing in mind that the international minimum standard has itself been an issue of controversy between developed and developing countries for a considerable period, it is unlikely that a majority of States would have accepted the idea that this standard is fully reflected in fair and equitable standard without clear discussion'.[316][Footnotes in the original text omitted]

Presciently, Mann argued in 1981 for the autonomous standard of the FET clause. At the time judicial authorities and scholars alike continued to seek to tie the FET to the minimum standard. He wrote:

> 'It is submitted that nothing is gained by introducing the conception of a minimum standard and, more than this, it is positively misleading to

[314] Ibid 40. Also see e.g. Muchlinski, *Multinational Enterprises and the Law* (n 52) 637–638.
[315] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 104–105 and 139–144.
[316] Ibid 144.

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 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*.'[317] [Emphasis added]

Fourteen years later Dolzer and Stevens expressed similar views, saying that stipulation of the standard as an express obligation rather than relying on the international law or minimum standard is probably 'evidence of a self-contained standard.'[318]

3.2.B.a The Role of the Minimum Standard in Interpreting *Simple* FET

Controversy about the existence of an international minimum standard in customary international law predates its appearance in investment treaties. Thus Vasciannie argues, if the FET and the minimum standard are equivalent, acceptance of the FET standard would obviously have committed the Latin American states[319] and some other

[317] Francis A Mann, 'British Treaties for the Promotion and Protection of Investments' (n 47) 244. Repeated in Francis A Mann, *Further Studies in International Law* (Oxford University Press 1990) 238; similar but more restrictive is Francis A Mann, *The Legal Aspect of Money* (5th edn, Clarendon Press 1992) 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 Thomas, 'Reflections on Art.1105 of NAFTA' (n 280) 51–58, submitting that the statement was deeply influenced by Belgium's loss in the *Barcelona Traction* Case and the statement was later somewhat blindly introduced as an argument into the NAFTA debate. See e.g., Barcelona Traction, Light and Power Co. Ltd. (Belgium vs. Spain) ICJ Judgment of 5 February 1970.

[318] Dolzer and Stevens, *Bilateral Investment Treaties* (n 59) 60.

[319] See discussion on the *Calvo* doctrine and NIEO, 1970 in Chapter 2: 2.1.i World Politics in the 1970s and its Influence on Investment Treaties and the FET Standard 45; Also see e.g. Article 2(2)(c) of the Charter of Economic Rights and Duties of States, 1974.

developing countries to a level of treatment that they have been reluctant to offer on grounds of 'principle and pragmatism'.[320]

Interpreting the concept of a FET clause autonomously in accordance with its 'ordinary meaning' rather than as a reference to the international minimum standard has significant judicial support, as well.[321] In *Técnicas Medioambientales Tecmed, SA vs. United Mexican States* [322] the tribunal interpreted the FET standard autonomously, according to its ordinary meaning, international law, and the 'good faith' principle. They cited the security and trust of foreign investors, and its role in maximising the use of economic resources, which the preamble of the relevant BIT emphasized, as rationale.[323] The tribunal in *MTD vs. Chile* [324] adopted a similar approach,[325] holding that the BIT framed FET as a 'pro-active statement–"to promote", "to create", "to stimulate" rather than a prescription for passive behaviour of states or the avoidance of prejudicial conduct to the investors.'[326]

The Tribunal in *Enron vs. Argentina*[327] held that,

> 'it might well be that in some circumstances where the international minimum standard is sufficiently elaborate and clear, fair and equitable treatment might be equated with it. But in other more vague circumstances, the fair and equitable treatment standard may be more precise than its

[320] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 162.
[321] See e.g. Azurix (n 116); Rumeli Telekom AS vs. Republic of Kazakhstan, ICSID Case No. ARB/05/16, Award, 29 July 2008.
[322] Tecmed (n 118).
[323] Ibid Paras 155 and 156.
[324] MTD Equity (n 119).
[325]Ibid Paras 112 and 113.
[326] Ibid Para 113. The *ad hoc* Annulment Committee which dismissed Chile's request for annulment held that, 'the extent to which a State is obliged under the fair and equitable treatment standard to be proactive is open to debate, but that is more a question of application of the standard than it is of formulation'. MTD Equity (n 119) Para 71. Also see Saluka (n 104) Paras 292–293.
[327] Enron Corp. vs. Argentine Republic, ICSID Case No. ARB/01/03, Award, 22 May 2007.

> customary international law forefathers. This is why the Tribunal concludes that the fair and equitable treatment standard, at least in the context of the Treaty applicable to this case, can also require a treatment additional to or beyond that of customary law. The very fact that recent FTC interpretations or 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.'[328]

By stating that the FET standard may be 'more precise' than the international minimum standard, this passage suggests that the FET standard may contain specific obligations outside of the international minimum standard.[329] More generally the tribunal in *PSEG Global Inc. vs. Republic of Turkey*[330] stated that the FET standard 'clearly does allow for justice to be done in the absence of more traditional breaches of international law standards.'[331]

As Haeri rightly observed:

> 'Accordingly, in interpreting and applying the fair and equitable treatment standard autonomously, tribunals are not restricted by the methodology (and authoritative sources) for the identification of customary international law. It is not, therefore surprising that the fair and equitable treatment

[328] Ibid Para 258.
[329] Haeri (n 47) 36.
[330] PSEG (n 119).
[331] Ibid Para 239. Recent jurisprudence supports the findings of these tribunals that the FET standard can be broader than the international minimum standard. The tribunal in *Glamis Gold vs. United States* observed correctly with regard to the FET standard, 'there are...numerous BITs that have been interpreted as going beyond customary international law.' See e.g. Glamis Gold vs. United States, UNCITRAL (NAFTA) Award, 8 June 2009 Para 609. Similarly the tribunal in *Cargill vs. Mexico* held that the international minimum standard is significantly narrower than the [autonomous fair and equitable treatment standard] present in the *Tecmed* award where the same requirement of severity is not present. See e.g. Cargill vs. United Mexican States, ICSID Case No. ARB(AF)/05/02 (NAFTA), Award, 18 September 2009 Para 285.

> standard has been interpreted autonomously as a broader standard than the international minimum standard, nor that it has been subjected to more varied applications.'[332]

Haeri argues that the development of the FET standard as a broader standard than the international minimum standard may reflect different purposes and the methodologies for determining the FET standard and the international minimum standard.[333]

Consequently the discussions made above suggests that in the absence of a clear indication to the contrary, when a treaty constructs FET in its simple formulation it has to be understood as an independent, autonomous, and standard.[334] Any attempt to equate such a simply constructed FET standard with any other standards is rather a futile attempt to distort its meaning and the intentions of the parties to the treaty.

3.2.C FET *Plus*

FET *Plus* refers to treaties which combine the FET standard with an additional substantive obligation, such as full protection and security, prohibition of denial of justice, prohibition of arbitrary or discriminatory measures, obligations of MFN, or guarantee of protection and security. For example Article II (2) of the Cambodia–Cuba BIT, 2001 states, 'Investments of investors of either contracting party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and

[332] Haeri (n 47) 41.
[333] Ibid 38.
[334] Ibid 28; Schreur 'Fair and Equitable Treatment in Arbitral Practice' (n 47) 364.

security in the territory of the other contracting party.'[335] Similarly Article 3 of the Netherlands–Philippines BIT, 1985 in Article 3(2) states that,

> 'Investments of nationals of either Contracting Party shall, in their entry, operation, management, maintenance, use, enjoyment or disposal, be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party.'[336]

Some BITs have combined FET with the MFN standard. For example Article 3(2) of the Switzerland Model BIT, 1986 states

> '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.'[337]

Some treaties combine FET with an additional duty not to take any unreasonable or discriminatory measure. For example Article 2(2) of the Lebanon–Hungary BIT, 2001 states

> 'Investments and returns of investors of either contracting party shall at all times be accorded fair and equitable treatment and shall enjoy full

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[335] Cambodia–Cuba BIT, 2001.
< http://unctad.org/sections/dite/iia/docs/bits/cuba_cambodia.pdf> accessed 30 August 2014.
[336]Netherlands–Philippines BIT,
1985<http://investmentpolicyhub.unctad.org/Download/TreatyFile/2073> accessed 22 August 2014.
[337] Switzerland Model BIT, 1986. Also see Article 4(2) of Switzerland–Chile BIT, 1999. A similar kind of reference with MFN has been made in Article 4 of the Bangladesh–Iran BIT, 2001 which states,
'Investments of natural and legal persons of either Contracting Party effected within the territory of the other Contracting Party, shall receive the host Contracting Party's full legal protection and fair treatment not less favourable than that accorded to its own investors or investors of any third state, whichever is more favourable'. See e.g. Bangladesh–Iran BIT, 2001
<http://unctad.org/Sections/dite/iia/docs/bits/bangladesh_iran.pdf> accessed 22 August 2014.

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.'[338]

These treaties imply that the FET standard is separate from the other substantive obligations listed alongside it. The notions of arbitrariness, unreasonableness, and discrimination are understood as inherent to the FET standard. Therefore it appears that such clauses give further substance to the otherwise general wording of the standard.[339] However, prohibiting arbitrary or unreasonable measures while also establishing the FET standard does not help to shape the scope of the FET standard. Rather it implies the prohibition of unreasonable, arbitrary, and discriminatory measures are consonant with the FET standard, but the sphere of the standard itself goes beyond these prohibitions.[340] For example the tribunal in *LG&E vs. Argentina* found a state measure to be not unreasonable or arbitrary or discriminatory but nevertheless found a violation of the FET standard.[341]

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[338] Lebanon–Hungary BIT, 2001 <http://unctad.org/Sections/dite/iia/docs/bits/hungary_lebanon.pdf> accessed 22 August 2014. In the like manner Article 2(2) of The Netherlands–Oman BIT, 2009 states,
'Each Contracting Party shall ensure fair and equitable treatment to the investments or nationals or persons of the other Contracting Party and shall not impair, by unjustified or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals or persons'. See e.g. The Netherlands–Oman BIT, 2009 <http://unctad.org/Sections/dite/iia/docs/bits/netherlands_oman.pdf> accessed 20 August 2014. Also see Article II(2) of Romania–US BIT, 1994 <http://www.state.gov/documents/organization/43584.pdf> accessed 26 August 2014.

[339] Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements Vol. II (n 42) 31.

[340] Ibid 31.

[341] LG& E (n 121) Para 162; Also see e.g. Sempara Energy vs. Argentina, ICSID Case No. ARB/02/16, Award, 28 September 2007 Paras 281–283; PSEG (119) Para 262; Duke Energy (n 122) Paras 380–383.

The articulation of the FET standard in a particular BIT can guide its interpretation. For example in the 1994 US Model Draft Treaty,[342] Article II(3) (a) stipulates,

> 'Each Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favourable than that required by international law.'

This provision reflects one of the United States's basic policy positions, which says that BITs should combine the FET standard with full protection and security and the requirements of international law. This differs significantly from the approach other capital exporting countries have taken to the relationship between the FET standard and other treatment standards.[343] The Federal Republic of Germany's Model BIT offers [344] investments, nationals, and companies of each contracting party both national treatment and MFN treatment, as well as full protection and security respectively under its Article 3. Unlike the US Model BIT, the German Model BIT separates the FET standard by stating that while each contracting party shall promote investments and admit those investments in accordance with its legislation, the host country shall 'in any case accord such investments fair and equitable treatment.'[345] However, a close examination reveals the effective similarities, since both model BITs afford investors a combination of national and MFN treatment, together with a general assurance of

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[342] Treaty between Government of United States of America and Government of ------ concerning the Encouragement and Reciprocal Protection of Investment, reprinted in UNCTAD, *International Investment Instruments,* vol. III, 195–205. Also can be found at <http://www.bilaterals.org/spip.php?article137>

[343] In the US Draft Model BIT, 1994, Article II(1) and (2) calls for national and MFN treatment with respect to, 'the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition' of investments, and provides certain exceptions. Thus while Article II guarantees the provision for FET and full protection and security, Article III reiterates that the FET/full protection and security standard shall apply along with other rules, to matters concerning expropriation. Therefore the US Draft Model BIT, 1994 stipulates the FET standard is one of a number of general standards applicable to investments, and implies that the standards apply concurrently.

[344] Treaty between the Federal Republic of Germany and ----- concerning the Encouragement and Reciprocal Protection of Investments, reprinted in International Investment Instruments: A Compendium, Vol. III (n 202) 167–176.

[345] Article 2 of German Model BIT.

fairness and equity. The Model BITs prepared by the United Kingdom,[346] France,[347] conform to this model, and many other BITs signed by capital exporting countries do as well. These Model BITs stipulate the FET standard from the outset as a general standard in a manner which permits tribunals to interpret whether the other standards included in each treaty are specific applications of the general standard.[348]

Some treaties use the unqualified form of the FET standard and link it with the standard of full protection and security in the same clause. For example, the China–Switzerland BIT, 2009, [349] in its Article 4 states, '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.' However this language does not modify the interpretation of the standard; it merely incorporates both treatments in the same provision.[350]

Kläger argues that combining FET with other investment protection standards might give the impression that the scope of different standards overlap at least to some extent.[351] The UNCTAD study (2012) states that treaties use this combination to be more precise about the content of the FET standard and to be more predictable in its implementation and subsequent interpretation.[352] But combining FET with additional

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[346] Agreement between Government of United Kingdom of Great Britain and Northern Ireland and the Government of ------ for the Promotion and Protection of Investments, 2005 reprinted International Investment Instruments: A Compendium, Vol. III (n 202)185–194.
[347] Project d'Accord entre le Gouvernment de la Republique Francaise et le Gouvernment ---- sur l' Encouragement et la Protection Reciproques des Investissements, 2006 reprinted International Investment Instruments: A Compendium, Vol. III (n 202) 159–166.
[348] Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 129.
[349]China–Switzerland BIT, 2009
<http://unctad.org/sections/dite/iia/docs/bits/Switzerland_China_new.pdf> accessed 20 August 2014.
[350] Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements Vol. II (n 42) 21.
[351] Kläger, '*Fair and Equitable Treatment' in International Investment Law* (n 47)17.
[352] Fair and Equitable Treatment, UNCTAD Series on Issues in International Investment Agreements Vol. II (n 42) 29.

substantive standards does not make any difference to the substance of the standard; it is still autonomous and self-standing. As Kläger rightly states, the issue of these obligations combined in one clause or stipulated in distinct clauses is a stylistic question rather than one of substance.[353]

3.3 Conclusion

This chapter has described the different variations of the FET standard as articulated in various investment treaties and shed light on the different issues and controversies surrounding the standard in the context of an individual treaty's particular construction. It reveals that sufficient similarity of construction across different treaties exists to support the claim that an overarching and singular concept of FET can be the subject of detailed analysis. It also has argued that no body of a minimum standard of international law or customary international law can be clearly and predictably applied to a modern and rapidly evolving standard like FET. Apart from NAFTA Article 1105 it is clear that even treaties that construct the FET standard in combination with international law or the minimum standard under customary international law, may not be clearly limiting the scope of the standard. This chapter has also explained how, in some treaties, the parties have attempted to more precisely limit the FET standard with a specific interpretation of the clause in the treaty. This creates a more precise form of FET *minus*. But these kind of clauses are not common.

Therefore, it is clear that the host developing countries in the vast majority of investment treaties should assume that tribunals will interpret the FET standard as an independent and autonomous standard. The remaining part of this thesis will argue that

[353] Kläger, '*Fair and Equitable Treatment' in International Investment Law* (n 47) 17.

in the absence of clear indications to the contrary, FET has to be understood as an independent and autonomous standard and that this approach is appropriate to the vast majority of investment treaties signed by developing countries.

Chapter 4

Country Classification and Developing Countries in International Investment Disputes

4.1 Introduction

A key phrase that runs through this thesis is 'developing countries'. Cognisant of a diverse understanding of the term, this chapter aims to contextualise the discussion by familiarising the reader with classifications of countries different international organisations have adopted. It will review the most common justifications for such classifications in the present literature, without offering a detailed discussion of the historical aspect of this issue, which is beyond the scope of this thesis. Rather, it will focus on the classifications different international organisations and academic scholarship have produced in relation to the concept of development. It will examine whether these conceptions can provide useful guidance to the international investment tribunals to consider the developmental issues and challenges of the host developing countries in their interpretation of the FET standard. On the basis of this analysis, this chapter argues for the need to identify a concept of development which is relevant in the investment law context. It will be argued that this can be done by identifying the conditions and prevailing circumstances of developing countries, which form a relevant contextual background in the particular context of investment disputes.

Part 4.2.A will provide a detailed discussion of the different classifications of countries that international organisations have adopted. Part 4.2.B will discuss the fact that, despite adopting the popular term 'developing countries' to describe a large number of

countries, there exist large differences between these countries. This part will also discuss, in brief, the concept of development. Finally, Part 4.2.C will explore whether the country classifications different international organisations have adopted and the concepts of development scholars have adopted can provide useful guidance to international investment tribunals. It will conclude by arguing that, for the purposes of international investment disputes, the tribunals need to adopt a concept of developing countries which takes into account the development factors that exist in these countries relevant to international investment law in their interpretation of the FET standard.

4.2. A Classification of Countries by Different International Organisations

The existing country classification systems by different organisations are termed as the 'development taxonomy' and the associated criteria are called the 'development threshold'.[354] Classifying countries according to their level of development is controversial. No universally accepted criteria, either based on theory or an objective yardstick, exists to classify all countries according to their level of development.[355] In the 1960s, a significant number of new countries emerged following decolonisation after WWII.[356] Academics and researchers became interested in understanding, not only the large income differences but also the diversity across these newly emerged countries in terms of issues such as social outcomes, culture, human development, and industrialisation.[357] International organisations classify countries in order to describe their social and economic differences in relation to the organisation's functions and

[354] . See e.g. Lynge Nielsen, *Classification of Countries Based On Their Level of Development: How it is Done and How it Could Be Done* (International Monetary Fund 2011) 4 <http://www.imf.org/external/pubs/ft/wp/2011/wp1131.pdf> accessed 7 July 2014.

[355] Others have argued that development is not a concept upon which countries can be classified and also that the inherent normative nature of the system does not allow for having a generally accepted classification system. See e.g. Ibid 3–5.

[356] When new states emerged after decolonisation around the globe the former empires started to invest and transfer resources to their former colonies. This paved the way for a new branch of economics known as development economics.

[357] Nielsen (n 354) 5.

goals. The terms developed and developing, have emerged as the preferred choice since the 1960s. These two words have been the focus of policy discussions on transferring resources from richer (developed) to poorer (developing) countries.[358] Organizations also refer to countries across the globe as poor/rich, backward/advanced, North/South, First World/Third World, and developing/industrialized countries.[359] Developing countries are further divided into poor, under-developed and less developed.[360]

Some international organisations classify countries based on economic criteria, while others classify them on social criteria. Different organisations use different terminology. Some use the term 'indicators of development', while others use 'index'. This thesis uses 'criteria' to refer to the classification of countries in lieu of technical terminology. Starting with the classification the World Bank (WB) employs, this part discusses the country classifications international organisations have favoured which are most dominant in the existing literature and most used in theory and practice in any discussion and commentary on country classification.

4.2.A.a The World Bank

The WB's[361] strategy to classify the countries uses the gross national income (GNI) of the countries using the WB Atlas Method.[362] This classification answers both the

[358] See e.g. Lester Pearson, *Partners in Development: Report of Commission on International Development* (Praeger Publishers 1969).
[359] See e.g. Nielsen (n 354) 4.
[360] Kathryn Morton and Peter Tulloch, *Trade and Developing Countries* (Routledge 2011) 14.
[361] The term 'World Bank' refers to the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). See e.g. <http://web.worldbank.org/WBSITE/EXTERNAL/EXTSITETOOLS/0,,contentMDK:20147466~menuPK:344189~pagePK:98400~piPK:98424~theSitePK:95474,00.html> accessed 7 July 2014.
[362] See e.g. <http://data.worldbank.org/about/country-classifications/world-bank-atlas-method> accessed 7 July 2014.

WB's[363] operational purposes and its analytical purposes.[364] At present they have classified the countries into four groups.[365] These include all the WB member states (currently 188 countries) and all other economies with populations of more than 30,000 (in total 214 countries). It sets the GNI of each category every year on 1 July. As of 1 July 2014, the WB income classifications by GNI per capita are: low income countries (GNI of US dollars 1,045 or less in 2013); lower middle income economies (GNI per capita of more than US dollars 1,045 but less than US dollars 4,125); upper middle income economies (GNI per capita of more than US dollars 4,125 but less than US dollars 12,746); and high income countries (GNI of US dollars 12,746 or higher). [366]

The WB began providing an analytical country classification in 1978. The World Development Indicators (WDI) appeared for the first time in the World Development Report,[367] in an appendix, which provided the statistical basis for the analysis. This first country classification listed three categories: developing,[368] industrialized, and capital surplus oil exporting countries. The report included summary data on eleven countries with centrally planned economies (CPEs).[369] Significantly, developing and industrialised countries the Bank did not resort to income as a threshold. Rather the Bank used

[363] The operation classification system of the WB preceded the analytical classification system. See e.g. Nielsen (n 354) 9.
[364] For information on the operational and analytical purpose of the WB see <http://blogs.worldbank.org/opendata/lics-lmics-umics-and-hics-classifying-economies-analytical-purposes> accessed 7 July 2014.
[365] See e.g. <http://data.worldbank.org/about/country-classifications> accessed 7 July 2014.
[366] <http://data.worldbank.org/about/country-and-lending-groups> accessed 7 July 2014.
[367] World Development Report, 1978 <http://wdronline.worldbank.org/worldbank/bookpdfdownload/3> accessed 20 July 2014. Also see e.g. <http://wdronline.worldbank.org/> accessed 21 July 2014. For a discussion on the issue see e.g. Norman Hicks and Paul Streeten, 'Indicators of Development: The Search for a Basic Needs Yardstick' (1979) 7 World Development 567.
[368] Developing countries were further categorised as low income and middle income countries.
[369] These countries were Albania, Bulgaria, the People's Republic of China, Cuba, Czechoslovakia, the German Democratic Republic, Hungary, the Democratic, Republic of Korea, Mongolia, Poland, Romania, and the USSR.

OECD membership for such classification.[370] In 1989 the WB introduced major reforms to the country classification in the WDI.[371] From 1997 onwards the WDI has been published separately with the Bank's statistical survey of world development across countries.[372]

Though the WB used a per capita income ceiling to designate developing countries, it made further sub-classifications of these countries ranging from low income to upper middle income countries. This sub-classification indicates the existence of complex grey areas. Though the WB classifies all low and middle income countries as 'developing countries', it further clarifies this classification by its note stating that, 'The use of the term is convenient; it is not intended to imply that all economies in the group are experiencing similar development or that other economies have reached a preferred or final stage of development.'[373] The WB acknowledges that it uses the per capita income method for country classification because it's convenient, although it does not necessarily reflect development status. Accordingly the classification does not capture the full scenario of the differences that exist across countries.[374] Despite this shortcoming, the WB classification is an important one given its widespread usage and acceptability.

[370] It is also to be noted that four OECD member states, Greece, Portugal, Spain and Turkey, were in the developing country group. Whereas South Africa which was not an OECD member state was designated as an industrial country.
[371]Nielsen (n 354) 13.
[372] See <http://data.worldbank.org/products/wdi> accessed 30 May 2014.
[373] See e.g. <http://data.worldbank.org/news/new-country-classifications> accessed 30 May 2014.
[374] See e.g. <http://unstats.un.org/unsd/methods/m49/m49.htm> accessed 20 July 2014.

4.2.A.b International Monetary Fund (IMF)

Like its sister Bretton Woods institution, the WB, the IMF uses a classification system for operational and analytical purposes,[375] which it began publishing in its World Economic Outlook (WEO) in 1980.[376] The IMF relies on a wider and more flexible classification of countries than the WB. It classifies countries into three groups, namely advanced economies, emerging markets, and developing economies.[377] The IMF describes the scale as encompassing '(1) per capita income level, (2) export diversification…and (3) degree of integration into the global financial system.'[378] It further clarifies diversification as follows: 'oil exporters that have high per capita GDP would not make the advanced classification because around 70% of [their] exports are oil.' [379] The IMF therefore resorts to a greater range of criteria of development to classify the countries based on per capital income, export diversification, and the degree of integration into the global financial system.

However the IMF also employs other criteria in the classifications of countries.[380] It employs geographical locations as well as economic considerations.[381] Further, in response to the collapse of the Soviet Union, in 1993 the WEO created a new country classification, 'countries in transition' to classify former Soviet states. It described these countries, as well as some eastern and central European states which had made a transition from communist CPEs to market-based economies, as in a process of

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[375] Nielsen (n 354) 14.
[376] For several years the WEO had been produced for internal use in the Fund.
[377] See e.g. <http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/weoselgr.aspx> accessed 20 July 2014.
[378] Ibid.
[379] Ibid.
[380] IMF, Statistical Appendix (2013) 177 <http://www.imf.org/external/pubs/ft/weo/2012/01/pdf/statapp.pdf > accessed 20 July 2014.
[381] See e.g.<http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/weoselagr.aspx> accessed 20 July 2014.

transition from one economic and political system to another.[382] Nevertheless it is to be noted that these countries in transition are now widely regarded as developing countries, albeit they are in a process of transition in their political and economic systems. The 2013 WEO's Statistical Appendix states that 'This classification is not based on strict criteria, economic or otherwise, and it has evolved over time. The objective is to facilitate analysis by providing a reasonably meaningful method of organizing data.'[383] This document classified 188 countries, with some countries appearing in more than one group.[384]

The IMF essentially classifies any country not advanced as emerging and developing, which means that it labels 135 countries, despite their wide range of differences in terms of their economies, as 'developing'. The group includes countries with stable and fast growing economies like Brazil, Qatar, and Malaysia; countries with promising economies like Vietnam, South Africa, and Sri Lanka; countries undergoing a transition like former Soviet states; countries with a high gross domestic product (GDP) like Saudi Arabia, United Arab Emirates, or Brunei Darussalam; countries with strong economies in spite of political instability like Mexico or Chile; and countries like China, which has a very strong economy and a stable political environment and which most scholars and policymakers consider 'super powers'; as well as countries like Congo or South Sudan

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382 See e.g. Ron Hill, 'The Collapse of Soviet Union' (2005) 13 History Ireland 37; Attila Agh, 'The Transition to Democracy in Central Europe: A Comparative View' (1991) 11 Journal of Public Policy 133; Victor Zaslavsky, 'Nationalism and Democratic Transition in Post-communist Societies (1992) Daedalus 97; Martin Sokol, 'Central and Eastern Europe a Decade After the Fall of State-Socialism: Regional Dimensions of Transition Processes' (2001) 35 Regional Studies 645; Ronald Grigor Suny, *The Revenge of the Past: Nationalism, Revolution and the Collapse of the Soviet Union* (Stanford University Press 1993).

383 IMF, Statistical Appendix (n 380) 177.

384 These groups are advanced economies (35 countries), Euro area (17 countries), major advanced economies (G7), other advanced economies (Advanced economies excluding G7 and euro area), European Union (27 countries), emerging markets and developing economies (135 countries), Central and Eastern Europe (14 countries), the Commonwealth of Independent States (12 countries), developing Asia (28 countries), ASEAN-5 (5 countries), Latin America and the Caribbean (32 countries), Middle East, North Africa, Afghanistan and Pakistan (22 countries), Middle East and North Africa (20 countries) and Sub-Sahara Africa (45 countries). See e.g. <http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/weoselagr.aspx> accessed 20 July 2014.

which are deeply troubled by poor economies and political instability. The disparities among these developing countries limits the utility of IMF classification for the purposes of the underlying questions this thesis seeks to address.

4.2.A.c United Nations

The UN General Assembly debated country classification over the years. In the 1970s the General Assembly identified a group of twenty-five countries as Least Developed Countries (LDCs) indicating a lower level of socio-economic development.[385] The General Assembly determined to focus on supporting the development of these countries in its implementation of the second UN Development Decade. Follow-up UN Conferences have monitored these listed countries and updated its list, which presently comprises forty-nine countries.[386]

Unlike the WB or the IMF, which establish development taxonomies for their full membership[387] the UN General Assembly has never done so.[388] Like the WB, however the UN Statistics Division states, 'The designations "developed" and "developing" are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process.'[389]

[385] For details visit <http://www.un.org/wcm/content/site/ldc/home/Background> accessed 25 July 2014.
[386] See <http://www.unohrlls.org/en/ldc/25/> accessed 20 July 2014.
[387] An economic taxonomy is the system by which economic activity is classified.
[388] Nielsen (n 354) 7.
[389] See e.g.< http://unstats.un.org/unsd/methods/m49/m49.htm> accessed 27 July 2014.

4.2.A.d UN Development Programme (UNDP)

The UNDP is the UN's global development network. The current UNDP position on country classification is based on the Human Development Index (HDI).[390] Economists Mahbub ul Haq and Amartya Sen developed the HDI in 1990,[391] and the UNDP began using it in its annual Human Development Report in 1993.[392] This index is a comparative measure comprising different criteria, including poverty, literacy, life expectancy, education, and quality of life.[393] While Haq and Sen acknowledge the significance of political freedom and personal security as measures of development, the lack of sufficient data on these criteria discouraged their inclusion in the HDI.[394] Instead it uses three variables – an index of per capita gross domestic income, life expectancy at birth, and level of education.[395] Therefore a country's ranking based on HDI can substantially differ from its ranking based on per capita income.[396] These social criteria are a valuable addition to per capita national income data, though Szirmai argues that the per capita GNP has never been undermined as a summary criteria of

[390] See e.g.< http://hdr.undp.org/en/statistics/ >accessed 27 July 2014.
[391] See e.g. <http://hdr.undp.org/en/humandev/> accessed 27 July 2014.
[392] See e.g. <http://hdr.undp.org/en/humandev/> accessed 25 July 2014. Also see e.g. Mark McGillivray and Howard White, 'Measuring Development? The UNDP's Human Development Index' (1993) 5 Journal of International Development 183; Mark McGillivray, 'The Human Development Index: Yet Another Redundant Composite Development Indicator?' (1991) 19(10) World Development 1461; Michael Hopkins, 'Human Development Revisited: A New UNDP Report' (1991) 19(10) World Development 1469; Farhad Noorbakhsh, 'A Modified Human Development Index' (1998) 26(3) World Development 517; Farhad Noorbakshi, 'The Human Development Index: Some Technical Issues and Alternative Indices' (1998) 10 Journal of International Development 589.
[393] See <http://hdr.undp.org/en/data> accessed 27 July 2014.
[394] Nielsen (n 354) 8.
[395] The UNDP Human Development Report (1991) states in its explanation to technical notes that in order to represent the declining marginal utility of higher incomes in the income index it gives the income categories above the poverty threshold progressively lower weights. See e.g. UNDP Human Development Report 1991 (Oxford University Press 1991) 88–91. For a general discussion on UNDP, Human Development Report see e.g. Ambuj D Sagar and Adil Najam, 'The Human Development Index: a Critical Review' (1998) 25 Ecological Economies 249; Mark McGillivray, 'The Human Development Index: Yet Another Redundant Composite Development Indicator?' (1991) 19(10) World Development 1461; Meghnad Desai, 'Human Development: Concepts and Measurement' (1991) 35 European Economic Review 350; Harald Trabold-Nübler, 'The Human Development Index – A New Development Indicator?' (1991) 26 Intereconomics 236.
[396] According to the UNDP Human Development Report, 2001, in 1991, 30 countries had an HDI ranking that differed more than 20 points from their ranking according to their per capita income. See e.g. UNDP *Human Development Report 2001: Making New Technologies Work for Human Development* (Oxford University Press 2001) 41.

development.[397] The UNDP HDI classifies countries across the globe into four different groups—very high HDI, high HDI, medium HDI, and low HDI.[398] The 2013 list of very high HDI countries includes all the countries IMF classifies as advanced and some countries it classifies as emerging markets and developing countries.[399] The UNDP classifies some countries with a very high GDP like Saudi Arabia and others with a relatively low GDP like Sri Lanka as high HDI countries. As in the IMF classification, countries with a strong economy like India and South Africa (which the scholars and policy makers describes as the emerging 'super powers') qualify only as medium HDI countries. This visible difference from the HDI classification reflects its humanistic approach to describing a country's level of development.

4.2.A.e World Trade Organisation (WTO)

The WTO system has no classification of 'developed' or 'developing' countries. In effect, unlike other organisations, it uses no established normative standard to designate a developing country.[400] The member states themselves announce whether they are 'developed' or 'developing' countries.[401] If any member states have any objection to any such announcement, they can challenge the decision of that particular member state

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[397] Adam Szirmai, *The Dynamics of Socio-Economic Development: An Introduction* (Cambridge University Press 2005) 15.
[398] See e.g. <http://hdr.undp.org/en/countries > accessed 21 July 2014.
[399] Ibid.
[400] Alex Ansong, *Special and Differential Treatment of Developing Countries in the WTO-GATT – Past, Present, Future* (Law Research Association 2012) 22. Also see e.g. Cui Fan, 'Who Are the Developing Countries in the WTO?' (2008) 1 The Law and Development Review 124.
[401] See e.g. <http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm> accessed 21 July 2014. Also see e.g. R Abbot, 'Are Developing Countries Deterred from Using the WTO Dispute Settlement System? Participation of Developing Countries in the DSM in the Years 1995–2005'. ECIPE Working Paper No. 01/2007, <www.ecipe.org/publications/ecipe-working-papers/are-developing-countries-deterred-from-using-the-wto-settlement-system/PDF > accessed 23 August 2014; and H Horn and P Mavroidis, *The WTO Dispute Settlement 1995–2004: Some Descriptive Statistics* (World Bank 2006); also see e.g. Leah Granger, 'Explaining the Board-Based Support For WTO Adjudication' (2006) 24 Berkeley Journal of International Law 521.

claiming to be a 'developing country'.[402] Given that the WTO system gives 'developing countries' some benefits,[403] including 'special and differentiated' treatment from the organisation,[404] including longer transition periods to implement some WTO agreements, and eligibility for certain technical assistance,[405] such labelling can be controversial. 'Developing countries' in the WTO also benefit from the unilateral preference schemes of some of the developed member states such as the Generalized System of Preference (GSP).[406] However, the GSP is not part of the WTO system and announcing itself as a developing country does not *per se* guarantee that the country will benefit from the GSP. In practice the developed country implementing the GSP decides which countries will receive preference as 'developing countries.'[407] This mitigates the value a country realizes by designating itself 'developing.' However, the countries which have claimed to be developing countries within the WTO system generally have been labelled as developing countries by the WB, or emerging markets and developing economies by the IMF.[408] The list of self-declared 'developing countries' within the WTO system does not provide any useful additional guidance to define a developing country, or provide any information on the level of development of these countries, given the nature of the system.

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[402] <http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm> accessed 25 July 2014.

[403] See e.g. Bernard Hoekman, Constantine Michalopoulos and L Alan Winter, 'Special and Differential Treatment of Developing Countries in the WTO: Moving Forward After Cancun' (2004) 27 The World Economy 481; J Michael Finger and L Alan Winters, 'What Can the WTO Do For Developing Countries?' in Anne O Krueger and Chonira Aturupane (eds), *The WTO as an International Organization* (The University of Chicago Press 1998); Spencer Henson and Rupert Loader, 'Barriers to Agricultural Exports From Developing Countries: The Role of Sanitary and Phytosanitary Requirements' (2001) 29 World Development 85.

[404] See e.g. <http://www.wto.org/english/tratop_e/devel_e/devel_e.htm> accessed 23 August 2014.

[405]<http://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm#legal_provisions> accessed 20 July 2014.

[406] For a general understanding of the GSP see e.g. George D Holliday, *Generalized System of Preferences* (Congressional Research Service, Library of Congress 1996); William H Cooper, *Generalized System of Preferences* (Congressional Research Service, Library of Congress 1999); Bernard M Hoekman and Michael M Kostecki, *The Political Economy of World Trading System: The WTO and Beyond* (Oxford University Press 2009).

[407] For more information on GSP see e.g. <http://unctad.org/en/Pages/DITC/GSP/Generalized-System-of-Preferences.aspx> accessed 23 August 2014.

[408] See e.g. Constantine Michalopoulos, *Developing Countries in the WTO* (Palgrave New York 2011); Chantal Thomas and Joel P Trachtman, *Developing Countries in the WTO Legal System* (Oxford University Press 2009).

4.2.A.f OECD

In the absence of a generally accepted classification of the countries based on their level of development, some international organisations have used OECD membership as the main criteria for developed country status. For example, the WB used OECD membership for country classification rather than an economic threshold in 1978. However, the OECD does not have any criteria like the WB or IMF for country classification. The preamble to the OECD Convention, 1960 identifies the contracting parties with a belief that 'the economically more advanced nations should co-operate in assisting to the best of their ability the countries in process of economic development.'[409] Essentially, like the WTO system, which is a voluntary system of classification, OECD members declare themselves 'developed'.

Only a small of number of countries clearly qualify as 'economically advanced nations' according to this system. At present the OECD has thirty-four member states, up from the original twenty in 1961.[410] OECD member states clearly exist as 'developed'; the remaining countries in the world, according to this system, are 'developing countries'. While the thirty-four member countries of the OECD includes most countries the IMF lists as advanced economies, it also includes Chile, Mexico, Hungary, Turkey, and Poland which the IMF classified as emerging markets and developing economies. This suggests OECD membership may be an imperfect standard. However OECD membership provides a general picture of the more economically advanced nations, subject to some exceptions stated above. Thus a simple understanding of OECD

[409] OECD Convention, signed in Paris, 1960. See e.g. <http://www.oecd.org/general/conventionontheorganisationforeconomicco-operationanddevelopment.htm> accessed 25 July 2014.
[410] For a more information on current members of OECD visit <http://www.oecd.org/about/membersandpartners/> accessed 25 July 2014.

membership gives the impression that outside the OECD member states the rest of the world can be termed as developing countries.

As part 4.2.A has described, country classifications adopted by different international organisations are significant not only for the organisations' policy goals, but also for the countries since such classification based on the level of development affords them certain benefits and exemptions.[411] Scholars therefore hotly debate country classifications as there is an economic interest when resources are transferred to or invested in developing countries.[412] Various complex taxonomies of classification and sub-classifications of countries, like LDCs, 'countries in transition', and classifications based on more technical and complex HDI complicate these debates. None of the classifications forwarded by the WB, IMF, or UNDP provide a complete picture of developing countries. Organisations which use a self-declaration mechanism provide no assurance of accuracy. The same country can fall within different groups based on all of these classification systems.

[411] See e.g. Cartel Exemptions in Developing Countries: Recent Work from the World Bank Group, Competition Policy International (2013) <https://www.competitionpolicyinternational.com/cartel-exemptions-in-developing-countries-recent-work-from-the-world-bank-group/ > accessed 23 July 2014; Ricardo Bitrán and Ursula Giedion, Waivers and Exemptions for Health Services in Developing Countries Social Protection Unit Human Development Network The World Bank (March 2003) < http://siteresources.worldbank.org/SOCIALPROTECTION/Resources/SP-Discussion-papers/Safety-Nets-DP/0308.pdf > accessed 23 July 2014; Jean-Christophe Bureau, Sebastien Jean and Alan Matthews, 'Concessions and Exemptions For Developing Countries in the Agricultural Negotiations: The Role of the Special and Differential Treatment' No. 18858 (2005) Working Papers from TRADEAG – Agricultural Trade Agreements <http://ageconsearch.umn.edu/bitstream/18858/1/wp050006.pdf> accessed 10 September 2014.

[412] Hans-Peter Lankes and Anthony J Venables, 'Foreign Direct Investment in Economic Transition: The Changing Pattern of Investments' (1996) 4 Economics of Transition 331; Luiz R De Mello Jr, 'Foreign Direct Investment in Developing Countries and Growth: A Selective Survey' (1997) 34 The Journal of Development Studies 1; Yuko Kinoshita and Nauro F Campos, *Why Does FDI Go Where it Goes? New Evidence from the Transition Economies* (IMF 2003).

4.2.B Disparities and Differences Across Developing Countries and the Concept of Development

From part 4.2.A, it is clear that it is a difficult task to fit all countries appropriately into the constricting dichotomous classification framework forwarded by these different international organisations. Worsley opines that after WWII existing scholarship designated any country not clearly economically advanced as 'developing countries.'[413] However, even between developing countries there remain a wide range of disparities and differences in terms of their economic and social levels of development. Further, neither of these two criteria can describe a particular country's level of development exactly.

Szirmai identified the disparities and differences across this large group of countries as including their per capita income, their demographic characteristics, natural resources, economic structure and dynamism, and even the difference in their colonial experience and their pre-colonial history and regional characteristics.[414] Similarly the Report of the South Commission lists developing countries' size, natural resources, economies, level of economic and technological development, social and cultural differences, and political ideology and systems as significant differences.[415] It describes widening disparities in the last decade due to economic and technological differences.[416] The WB's classification acknowledges that developing countries range from low income to lower middle income, upper middle income and high income; the IMF classification encompasses special characteristics such as oil exporting, newly industrialised countries, countries in transition, emerging economies.

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[413] See e.g. Peter Worsley, *The Third World* (University of Chicago Press 1970). All these developing countries however had significant differences with developed industrialised countries. Other terms such as 'North' and 'South' were also used to describe these two broad group of countries.
[414] Szirmai (n 397) 26.
[415] Julius Kambarage Nyerere (ed.), *The Challenge to the South: The Report of the South Commission,* Independent Commission of South on Development Issues (Oxford University Press 1990) 1.
[416] Ibid.

Many Middle East countries are developing countries but they are rich, even richer than some developed countries, in their per capita income.[417] Brazil and India have experienced rapid economic growth and have developed a sophisticated industrial sector comparable to the developed world, while countries like South Korea earn most of their foreign exchange through export of manufactured goods.[418] Countries like Nepal or Kenya, readily qualify as developing countries while Japan and Norway are developed countries. But classifying countries like Russia, Malaysia, or Brazil, or UAE with its high GDP and high HDI classification, and Sri Lanka with its low GDP and high HDI, is difficult. India has a much stronger economy than Sri Lanka, but only qualifies for medium HDI. A large number of countries are difficult to classify, which suggest the developed/developing country dichotomy is too restrictive to capture the differences in the level of development of all the countries across the globe.[419] Therefore the classification of developed and developing countries is subject to relative and subjective judgment. It also depends on how one defines the concept of 'development' itself. In the absence of a normative regime as to what a developing country is, it becomes relevant to provide a brief overview of different views in the relevant scholarship surrounding the debate on the concept of development itself.

It is difficult to define the term 'development' in what Szirmai calls an 'objective, abstract and ahistorical manner'.[420] In simple terms, development means progress. At the societal level it is a positive 'progressive social change'.[421] As Aristotle stated, the

[417] Morton and Tulloch (n 360) 15; Also see e.g. Szirmai (n 397) 6.
[418] Szirmai (n 397) 15.
[419] Nielsen (n 354) 3
[420] Szirmai (n 397) 11.
[421] John Henry Merryman, 'Comparative Law and Social Change: On the Origins, Style, Decline & Revival of the Law and Development Movement' (1977) 25 The American Journal of Comparative law 457, 463.

purpose of the state, 'is not merely to provide a living but to make a life that is good'.[422] In modern times social contract theory encapsulates this, saying that a state has a developmental duty towards its citizenry. Therefore development now has become the *raison d'etre* of states. However, scholars are often in conflict as to what constitutes the concept of development.[423] Scholars like Escobar think that development is a historically produced discourse through which the idea of 'third world' was invented and made an object of scholarship meant to serve hegemonic purposes.[424] Baxi views development as a global ritual of the 'periodic reinvention of impoverishment' and that it 'constitutes a mode of legitimate power'.[425] Scholars like Szirmai linked development with westernisation. He argues that the international political and economic balance of power influences and determines the concept and powerful countries set up the model of development.[426] In the last 400 years of human history the 'West' has become the dominant power both in economic and political terms in the globe, and accordingly western societies have become the models of modern and developed societies.[427] Likewise Myrdal argues that the present day idea of development links to westernisation and that scholars have derived it from the historical development experiences of the present Western countries.[428] Szirmai opines that the powers which dominate the world

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422 Aristotle, *The Politics* (Trevor J Saunders, Trevor J Sinclair and Thomas Alan trs, Penguin Books 1992) 196.

423 See e.g. David Colman and Frederick Nixson, *Economics of Change in Less Developed Countries* (3rd edn, Harvester Wheatsheaf 1994)1–5. The views on development are so divergent that some scholars view modern day capitalism as producing a distorted form of development around the globe. For a detailed discussion on capitalism and development in a global perspective see e.g. Leslie Sklair, 'Capitalism and Development in Global Perspective' in Leslie Sklair (ed), *Capitalism and Development* (Routledge 1994) 165.

424 Arturo Escobar, *Encountering Development: The Making and Unmaking of the Third World* (Princeton University Press 1995) 5 and 44–45.

425 Upendra Baxi, *The Future of Human Rights,* (Oxford University Press 2012) 455.

426 Szirmai (n 397) 11.

427 See e.g. Eric Lionel Jones, *Growth Recurring: Economic Change in World History* (University of Michigan Press 1988); David S Landes, *The Wealth and Poverty of Nations: Why Some Countries Are So Rich and Some So Poor* (WW Norton 1998).

428 See e.g. Gunnar Myrdal, *Asian Drama: An Inquiry into the Poverty of Nations* (Penguin Books 1968); Gunner Myrdal, *The Challenge of World Poverty: A World Anti-Poverty Program in Outline* (Pantheon Books 1970). Sen argues that in ancient Asian traditions the so-called modern day Western notions such as tolerance or human rights were very much prominent. But today the spread of these ideas in modern form in this part of the globe is inextricably linked to Western expansion. See e.g. Amartya Sen, *Development as Freedom* (Oxford University Press 1999).

in fact explicitly or implicitly determine the ideas and objectives of development.[429] Esteva has expressed a similar view, calling development a promotional symbol for pursuing and internalising the hegemony of the United States, a tool for transmogrifying 'into an inverted mirror of others' reality: a mirror that belittles them and sends them off to the end of the queue, a mirror that defines their identity, which is really that of a heterogeneous and diverse majority, simply in terms of homogenizing and narrow minority.'[430]

Nobel laureate economist Amartya Sen described development in terms shifted from strictly economic criteria, suggesting a humanistic approach to the concept. He proposed that the value of economic growth, technological advances, and political change all lies in their contribution to human freedoms.[431] Sen even went further to challenge the too narrow focus on economic dimensions of development only, citing many examples of countries, in which growth in social factors such as literacy or life expectancy do not accompany rapid economic growth.[432] Therefore in his view, development reflects the 'acceptable minimum living condition'[433] of the people in a country, rather than the per capita income which may not in all cases reflect the real

[429] Szirmai (n 397) 12. Szirmai also refers to Frank. See e.g. Andre Gunder Franck, *Capitalism and Underdevelopment in Latin America: Historical Studies of Chile and Brazil* (Monthly Review Press 1969).
[430] Gustavo Esteva, 'Development' in Wolfgang Sachs (ed), *The Development Dictionary: A Guide to Knowledge as Power* (Zed Books 1992) 2.
[431] Sen identifies a short list that among these freedoms the most significant are freedom from poverty, malnutrition, premature mortality, and access to health care. In support of his argument Sen shows the empirical evidence of urban African Americans who have lower life expectancies than that of the Chinese person despite the fact that in the United States the per capita income is much higher. For a brief discussion on Sen's ideas of freedom see e.g. Sen (n 428).
[432] Szirmai (n 354) 7.
[433] An acceptable living condition implies that a person is able to consume sufficient nutrients to avoid being malnourished and that his or her dwelling place has certain basics for life such as water, light, size, sanitation, etc. Therefore the minimum income has to afford workers these basic standards of living conditions; the poverty line defines this minimum. The individuals or households who fall below that line are designated as poor. However, as the costs and politically acceptable minimum living standards vary greatly from country to country, the poverty lines are country specific, which has a direct impact on the comparisons of poverty outcomes across the countries. See e.g. Sen (n 428).

living conditions of the citizenry. Scholars like Korten and Seers express similar views.[434]

These different classifications of development can provide useful information on various economic and social indices of the country. But these indices have limited explanatory power in terms of the status and ability of a host developing country in the international investment dispute context. A developing country's particular capability in an investment regime cannot be defined by its GDP, GNI or its HDI. The social and economic criteria different international organisations have advanced can explain a country's level of economic or social development but they cannot explain the particular host country's capability and the challenges of their particular developmental level with regard to investment protection. Understanding this picture requires a different perspective, one that recognises the socio-political and economic conditions prevailing in that country and the challenges they create in an investment law context.

4.2.C Perspectives of Host Developing Countries in Investment Disputes

The discussion in part 4.2.B established that each developing country is unique in terms of its economic and social level of development, and that different international organisations classify them according to different economic and social criteria of development. The country classifications different international organisations have created can help us to understand the wide range of developing countries according to a broader set of perspectives. However such perspectives provide little help when it comes to the particular developmental issues of the host developing countries in the investment dispute context.

[434] See e.g. Dudley Seers, 'What Are We Trying to Measure? (1972) 8 The Journal of Development Studies 21; David C Korten, *When Corporations Rule the World* (Berrett-Koehler Publishers 2001) 165.

As Morton and Tulloch have rightly observed, the phrases used to describe a developing country do not accurately or uniquely describe all the countries in the group; they are merely epithets.[435] However, they have identified a number of features that often developing countries share, including poverty, unemployment, infrastructural capacity, lack of self-sustained economic growth, uneven economic development, significant disparity among citizens in terms of income and wealth, lack of high standards of living, illiteracy, different degrees of corruption, lack of technological support, and political instability.[436] For example, Nepal and Brazil differ widely in terms of economic and technical capability but both countries face challenges like poverty, corruption in public life, and some degree of political instability.[437] The issues identified by Morton and Tulloch represent an important and more inclusive basket of developmental issues that the host developing countries might face to varying degrees. What is important for this thesis is to identify those that are particularly relevant for the investment dispute context. This part of the thesis and the chapters which follow will identify some of those issues which will assist the tribunals in their interpretation of the alleged breach of FET standard by host developing countries. These issues will enable the tribunals to deal with this large group of host countries more appropriately.

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[435] Morton and Tulloch (n 360) 14. Also see e.g. UN Statistics Division Note <http://unstats.un.org/unsd/methods/m49/m49.htm> accessed 30 May 2014.

[436] Morton and Tulloch (n 360) 15. Similarly, Szirmai identifies certain common problems in developing countries, such as a problem of widespread poverty, a dominance of agriculture in national income and employment patterns, widespread corruption, political instability, environmental degradation, and lack of proper technological capacities, see e.g. Szirmai (n 397) 29.

[437] From the historical point of view, most developing countries lack the process of widespread capitalist industrialisation of their developed counterparts. However that does not mean that they were totally untouched by the development of Western capitalism or industrialisation. The majority of developing countries were once colonies of developed industrial states, and Morton and Tulloch argue that exceptions tend to have similar patterns in economic, political, and cultural links with industrial countries. They believe the links with their former colonial powers have an influential role in the economic, political, and social activities of the developing countries, since these influences have dominated their trade and exports with developed countries, in particular their ex-colonial powers and also their reliance on Western capital and technology. See e.g. Morton and Tulloch (n 360) 14.

Thus, this thesis is not concerned with a universally applicable concept of 'development'. Rather it suggests that there is a need to identify a concept of development that is relevant to the investment law context. It focuses on the international investment tribunals' role in considering the developmental issues and challenges host developing countries face when they interpret the FET standard. This investigation requires an understanding of the functions of those tribunals in a dispute. As discussed in brief in Chapter 1, the purpose of international investment tribunals is to adjudicate investment disputes between host countries and foreign investors. Chapter 1 also emphasised the importance of the arbitrators' discretionary powers to interpret the FET standard. From this view point of the arbitrators' discretionary power to interpret the standard, this thesis proposes that international investment tribunals, in their interpretation of the standard, need to accommodate the developmental issues and challenges of the host developing countries which have direct and indirect relevance to the dispute in question instead of those identified by the different classifications by different international organisations in terms of their economic and social level of development. As will be shown in the chapters which follow, elements such as the level of poverty, HDI ranking, or GDP of the host developing countries are not the most relevant factors that the investment tribunals need to be particularly aware of in the investment dispute context. Rather investment tribunals should weigh other issues and factors identified in this thesis in adjudicating disputes against developing countries.

The case studies which Chapters 5-7 will present will identify those issues which, in the investment dispute context, the tribunals need to take into account most in relation to host developing countries. These issues and challenges include many which are identified by those Morton and Tulloch; in particular lack of administrative capacity and sophistication of the governmental bodies, lack of experience in international

investment law, lack of technological support and infrastructure, limited resources, post-conflict vulnerability, social and political transition, political instability, social unrest, and economic crisis. Even the socio-political dimensions of a particular sector or socio-political sensitivity in relation to foreign investment in sectors like public utilities or natural resources bear on investment disputes. The status of being a developing country makes policy changes that might not occur in a developed country both natural and necessary. As Kriebaum argues,

> '[A] raising of domestic law requirements during the lifespan of the investment in fields such as labour law, environmental law etc. within reasonable bounds should not be seen as a violation of legitimate expectations. Investment protection must not stand in the way of States graduating to higher levels of social development.'[438]

Developing countries, intrinsically, are at a level of development different from their developed counter parts. Therefore investment treaties should not obstruct their right to change policies on certain issues to meet their obligations to foreign investors. Given the relationship of legitimate expectations to the FET standard, Kriebaum's argument suggests developing countries should have latitude to change policies that might affect the investment. This thesis will extend this logic to the FET standard; the developmental issues and challenges of host developing countries that should bear on their adherence to the standard would include this right to change policy related to the investment.

Serious situations like civil war and the vulnerability that follows, social unrest, and economic crisis in the context of political instability make host developing countries

[438] Kriebaum, 'The Relevance of Economic and Political Condition for Protection under Investment Treaties' (n 113) 404.

more vulnerable in their relationships with the foreign investors. Investing in developing countries bears inherent risks for foreign investors.

The three chapters that follow this one will describe how these issues and conditions have played a key role in the challenges that the host developing countries face in seeking to meet their investment treaty obligations and particularly their obligation in relation to the FET standard. The case studies will illustrate, investment tribunals have frequently disregarded these factors, when foreign investors claim host developing countries have breached the FET standard. The challenges host developing countries face under current interpretations of their treaty obligations reflect the catalyst role of a lack of resources, experience, sophisticated administrative capacity, and other vulnerabilities in the investment dispute context. This thesis focuses on three types of situations and crises which make these factors more significant; (i) political crises as discussed in Chapter 5 (ii) political and economic transition as discussed in Chapter 6 and (iii) economic crises as discussed in Chapter 7. Each of these chapters describes the influence of these factors in particular circumstances which are common for developing countries, and reveals their impact in host countries' ability to meet their treaty obligations towards foreign investors.

This impact particularly emerges in difficult cases. Kläger has identified the absence of any clear guidance in relation to the difficult cases from the current tribunals.[439] He describes the current tribunals as engaged in categorisation of lines of argument by specification of fact situations to simplify the FET standard,[440] which does not help when it comes to the most difficult situations host developing countries face.

[439] Kläger, '*Fair and Equitable Treatment in International Investment Law*' (n 47) 121.
[440] Ibid.

This thesis argues that if the investment tribunals acknowledge the developmental issues that host countries face in complicated situations, the awards will reflect a sound interpretation of the FET standard. Therefore this thesis argues that the issues, including the need to change policies, which become relevant for host developing countries in complicated situations should be introduced as obligatory factors in investment dispute proceedings and acknowledged as relevant. These factors fuel the challenges that host developing countries face as they seek to ensure investor protection standards under treaty obligations, and particularly in compliance with the FET standard. The flexible and 'catch-all' nature of the FET standard makes this particularly significant. Investment tribunals have interpreted it as license to interpret actions governments undertake to address crises or serve public need as a breach of their FET obligations, imposing high costs on developing countries of accepting foreign investment. If tribunals begin to identify and utilise developmental issues in the context of investment disputes, taking into account the challenges countries face relevant to the investment dispute, they will make possible a concept of development that supports both the continued development of host developing countries and their continued ability to support foreign investment.

4.3 Conclusion

This chapter has discussed the country classifications different international organisations have adopted depending on either economic or social criteria. It has also discussed the wide disparity among developing countries and highlighted that no definitive list of developing countries exists. It also points out the fact that these different classifications, and the concept of development as discussed here, have limited explanatory power in relation to the particular capabilities and challenges of the host

developing countries in an investment dispute context. There is a need to identify a specific concept of development which is particularly applicable to the challenges faced by developing countries in investment law disputes as identified above. This will allow the tribunals to take the contextual background of the disputes into consideration in a way that will provide more appropriate decisions.

The subsequent three chapters will focus on how the tribunals have addressed the issues and challenges of host developing countries in relation to (1) political crises and socio-political conditions, (2) transition from communist centrally planned economies (CPEs) to market based economies, and (3) economic crises in their interpretation of alleged breaches of the FET obligation by host developing countries.

Chapter 5

Current Arbitral Practice Relating to Social and Political Circumstances in Host Developing Countries: FET Standard in Context

5.1 Introduction

This chapter will discuss a selection of arbitral awards against host developing countries in which their particular socio-political circumstances led to alleged breaches of the FET standard. Tribunals in these cases have discussed the different aspects of those socio-political circumstances, the host countries' related ability to provide protection to foreign investors, and the issue of foreign investors' legitimate expectation from these host countries under the FET obligation in a particular case. The arbitral awards discussed in this chapter represent the full range of approaches current tribunals have adopted where these socio-political circumstances were clearly a relevant contextual background to the dispute. Part 5.2.A of the chapter will analyse the awards where political instability was an issue and part 5.2.B will analyse the awards where a broader range of socio-political circumstances were a vital contextual background to the investment disputes.

5.2.A Political instability

Developing countries have unstable political conditions to varying degrees,[441] due to undemocratic military interventions, conflict situations after changes of power, rigged general elections, domination by undemocratic political parties, and conflicts due to mass political intolerance.[442] Political instability often affects foreign investment protection standards;[443] changes of power in government can even lead to changes in policy in relation to foreign investments or benefits particular foreign investors may receive.[444] Thus political instability imposes certain inherent risks on foreign investors in developing countries.[445]

This part will examine arbitral awards against host countries experiencing political turmoil or in a post-war situation, focusing on the impact of these circumstances upon foreign investors and the tribunals' interpretation of whether the host country breached the FET standard. It begins with the

441 See e.g. Taketsugu Tsurutani, 'Stability and Instability: A Note in Comparative Political Analysis' (1968) 30 The Journal of Politics 910.

442 For wide range of such issues see e.g. Adam Przeworski, Michael E. Alvarez, Jose Antonio Cheibub and Fernando Limongi, *Democracy and Development: Political Institutions and Well-being in the World, 1950-1990* (Cambridge University Press 2000); Steven Barracca, 'Military Coups in the Post-cold War Era' (2007) 28 Third World Quarterly 137.

443 See e.g. Mario Levis, 'Does Political Instability in Developing Countries Affect Foreign Investment Flow? An Empirical Examination' (1979)19 Management International Review 59; Alberto Alesina and Roberto Perotti, 'Income Distribution, Political Instability and Investment' (1996) 40 European Economic Review 1203; Kamal Fatehi-Sedeh and M Hossaein Safizadeh, 'The Association between Political Instability and Flow of Foreign Direct Investment' (1989) 29 Management International Review 4.

444 See e.g. Yi Feng, 'Political Freedom, Political Instability and Policy Uncertainty : A Study of Political Institutions and Private Investment in Developing Countries' (2001) 45 International Studies Quarterly 271; Khalid Saeed, 'The Dynamics of Economic Growth and Political Instability in Developing Countries' (1986) 2 System Dynamics Review 20; Friedrich Schneider and Bruno S Frey, 'Economic and Political Determinants of Foreign Direct Investment' (1985) 13 World Development 161; Dani Rodrik, 'Policy Uncertainty and Private Investment in Developing Countries' (1991) 36 Journal of Development Economics 229.

445 See e.g. Levis (n 443); Pietra Rivoli and Thomas L Brewer, 'Political Instability and Country Risk' (1998) 8 Global Financial Journal 309; John A Doces, 'The Dynamics of Democracy and Direct Investment: An Empirical Analysis' (2010) 42 Polity 329.

awards most sympathetic to the problems political situations impose on host developing countries and progresses to the least sympathetic.

5.2.A.a Bayindir Insaat Turizm

Bayindir Insaat Turizm Ticaret ve Sanayi A.S, a Turkish company, entered into a contract with the National Highway Authority (NHA) of Pakistan to build a six-lane motorway in Pakistan in 1993.[446] Various disagreements over delays in the schedule disrupted the project for eight years. When the NHA terminated the contract and the Pakistani army took control of the company's work site in 2001, Bayinder initiated proceedings in ICSID that Pakistan had breached a number of obligations including FET, MFN, and National Treatment.[447] Bayinder also complained that there was adverse impact of change in government during those years over the project and when in 1999 General Musharaf took over power, this new regime conspired to remove them.[448] Bayinder claimed that it had wider expectations of stability and predictability under the FET standard.[449]

In its award in *Bayindir Insaat Turizm Ticaret ve Sanayi A.S vs. Pakistan* on the question of legitimate expectation of the investor under the circumstances the tribunal cited three pre-existing decisions which relied on:

> 'all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State.'[450][Footnotes in the original text omitted]

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[446] Bayindir Insaat Turizm Ticaret ve Sanayi AS vs. Pakistan, ICSID Case No. ARB/03/29 Award, 27 August 2009.
[447] Ibid Paras 96–100.
[448] Ibid Paras 194–195.
[449] Ibid Para 194.
[450] Ibid Para 192. The Tribunal cited Saluka (n 104) and Duke Energy (122).

The tribunal concluded that investors cannot expect stable and predictable decision making on the part of the government when it changes rapidly and successive regimes may have different views on investment projects.[451] It also emphasised the reasonableness of the investor's expectation under such political circumstances and stated that,

> '… the Tribunal is of the view that the Claimant could not reasonably have ignored the volatility of the political conditions prevailing in Pakistan at the time it agreed to the revival of the Contract. Indeed, the Claimant expressly acknowledges that it suffered severely from political changes in Pakistan during the preceding years.'[452]

The tribunal ruled that Bayinder had no legitimate expectation of stability, and therefore the facts were not sufficient to prove that the host country had breached the investor's legitimate expectation as part of its FET obligation.[453] Referring to a decision discussed later in this chapter, *Tecmed*[454] the tribunal observed that the decision,

> '…could not rule out *prima facie* that Pakistan's fair and equitable treatment obligation comprised an obligation to maintain a stable framework for investments and that "a State can breach the 'stability limb' of its [FET] obligation through acts which do not concern the regulatory framework but more generally the State's policy towards investments."'[455] [Footnotes in the original text omitted]

On the basis of the facts of the dispute, the tribunal stated that "…in the light of political changes of the preceding years, the Claimant could not reasonably expect that

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[451] Kriebaum, 'Are Investment Treaty Standards Flexible Enough to Meet the Needs of Developing Countries' (n 85) 337.
[452] Bayinder (n 446) Para 193.
[453]Ibid Paras 177-–179.
[454] Tecmed (n 118) see 5.2.B.c Tecmed 137.
[455] Bayinder (n 446) Para 177.

no further political changes would occur."[456] Accordingly the tribunal held that Bayinder's claim for frustration of legitimate expectation is unsustainable[457] and also that there was no breach of the applicable FET standard.[458]

The tribunal's willingness to take the particular political situation and instability in Pakistan that existed during General Musharaff's regime into account[459] reflected Pakistan's long history of political turmoil and considerable evidence that a lack of democracy, transparency and accountability is endemic to Pakistan's political and social culture and that foreign investors should understand these risks before investing in that country.[460] Others have criticized this reasoning,[461] and, as the balance of this chapter will show, a number of other tribunals have taken a different approach towards such unstable political situations in host states.

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[456] Ibid Para 197.
[457] Ibid Para 199.
[458] See e.g., Ibid Paras 458 and 482.
[459] For an account of Pakistan's political situation during General Mushraff's regime see e.g. Vali Nasr, 'Military Rule, Islamism and Democracy in Pakistan' (2004) 58(2)The Middle East Journal 195; Matthew J Nelson, 'Pakistan in 2008: Moving Beyond Musharraf' (2009) 49 Asian Survey 16; C Christine Fair, 'Why the Pakistan Army is here to Stay: Prospects for Civilian Governance' (2011) 87 International Affairs 571; Iftikhar H Malik, 'Pakistan in 2000: Starting A New Stalemate?' (2001) 41 Asian Survey 104; Shoaib A Ghias, 'Miscarriage of Chief Justice: Judicial Power and the Legal Complex in Pakistan under Musharraf' (2010) 35 Law & Social Inquiry 985.
[460] For a detailed account of Pakistan's political instability see e.g. Ian Talbot, *Pakistan: A Modern History* (Hurst 2009); Khalid Bin Sayeed, 'Collapse of Parliamentary Democracy in Pakistan'(1959) 13(4) The Middle East Journal 389; S Akbar Zaidi, 'State Military and Social Transition: Improbable Future of Democracy of Pakistan' (2005) 40 (49) Economic and Political Weekly 5173; Samina Yasmeen, 'Democracy in Pakistan: The Third Dismissal' (1994) 34(6) Asian Survey 572; Aqil Shah, 'Pakistan's "Armored" Democracy' (2003) 14(4) Journal of Democracy 26; Veena Kukreja, 'Pakistan Since the 1999 Coup: Prospects of Democracy' in Veena Kukreja and MP Sing (eds), *Pakistan: Democracy, Development and Security Issues* (Sage Publications 2005); Iftikhar H Malik, 'Pakistan in 2001: The Afghanistan Crisis and the Rediscovery of the Frontline State' (2002) 42(2) Asian Survey 204; Ameen Jan, 'Pakistan on a Precipice' (1999) 39(5) Asian Survey 699; John Bray, 'Pakistan at 50: a State in Decline?' (1997) 73(2) International Affairs 315.
[461] For a criticism of the Award see e.g., Akin Alcitepe and Ronan J McHugh, 'Bayinder v. Pakistan and the Decline and Fall of Investment Treaty Claims on Construction Projects' (2009) 6(2) Ankara Review 83.

5.2.A.b Toto

Toto Construzioni Generali S.p.A., an Italian construction company, contracted with the state of Lebanon to build a highway in 1997.[462] The Syrian troops occupied at least part of the work site,[463] and a change in the customs and tax regulation affected the project. In *Toto Costruzioni Generali S.p.A. vs. The Republic of Lebanon,*[464] Toto alleged that Lebanon had breached various provisions of the Italy–Lebanon BIT,[465] including FET. Lebanon contended that Toto had visited the site before it entered into the contract and was aware of the presence of the Syrian army, and also that the Syrian Army's presence could not have substantially hindered the project work because it occupied only a small area of the site.[466]

The tribunal found that Lebanon did not breach the FET obligation under the BIT with regard to evacuation of the Syrian troops from the site.[467] Referring to *Parkerings-Compagniet AS vs. Lithunia*[468] the tribunal stressed that investors must consider the business risk as well as the possible legal and economic instability imposes when investing in a country in political transition.[469] Further, it stated, 'the post-civil war situation in Lebanon, with substantial economic challenges and colossal reconstruction efforts, did not justify legal expectations that custom duties would remain unchanged.'[470] The tribunal held on merit that in such a situation a foreign investor in a developing country cannot expect the degree of protection a developed country offers, and thereby

[462] See e.g., Toto Costruzioni Generali S.p.A vs. The Republic of Lebanon, ICSID Case No. ARB/07/12, Award, 7 June 2012.
[463] For an account of the political crisis in Lebanon see e.g. Yair Evron, *War and Intervention in Lebanon: the Israeli-Syrian Deterrence Dialogue* (Routledge 2013); Naomi Joy Weinberger, *Syrian Intervention in Lebanon: The 1975-76 Civil War* (Oxford University Press 1986); Dilip Hiro, *Lebanon: Fire and Embers: A History of the Lebanese Civil War* (Weidenfeld and Nicolson 1993).
[464] Toto (n 462).
[465] Italy–Lebanon BIT, 7 November, 1997.
[466] See e.g. Toto (n 462) Paras 100–102.
[467] Ibid Paras 206, 200.
[468] Parkerings-Compagniet AS vs. Lithunia, ICSID Case No. ARB/05/8, Award, 11 September 2007.
[469] Toto (n 462) Para 245.
[470] Toto (n 462) Para 245. For a summary of the war, see e.g. Edgar O'balance, *Civil War in Lebanon, 1975-92* (Macmillan Press 1998).

took political instability into consideration. Lebanon was a clearer case of a post-war situation than other cases have involved; in other situations tribunals have been less confident that investors should recognise political instability as an underlying condition of their investment.

5.2.A.c AMT

In *American Manufacturing & Trading (AMT) vs. Republic of Zaire*[471] riots and acts of violence by the armed forces in the Republic of Zaire led to looting and destruction of the property of US investors. The claimant company alleged that this failure to protect its property represented a failure by Zaire in its obligation to protect the investor's property under the Zaire-US BIT,[472] particularly Article II paragraph 4 of the BIT which referred to FET.[473] In its rejoinder, Zaire cited political crisis as a ground of its defence:

> 'No one on earth could ignore the fact that for the past four years, the Republic of Zaire has been going through a most painful and unfortunate period in its history.… This requires a benevolent and compassionate attention on the part of all our partners, even those who have encountered unfortunate and disastrous consequences, for there was a time when these same persons were enjoying the benefit of the good situation of the State of Zaire.'[474]

[471] American Manufacturing & Trading vs. Republic of Zaire (AMT), ICSID Case No. ARB/93/1, Award, 21 February 1997.
[472] Ibid Para 1.05. Treaty concerning the Reciprocal Encouragement and Protection of Investment, United States–Zaire, 3 August 1984 <http://www.state.gov/documents/organization/43544.pdf> accessed 4 September 2014.
[473] See AMT (n 471) Paras 6.04 and 6.05.
[474] Ibid Para 7.17.

The tribunal did not consider local conditions in finding that Zaire failed to provide the standard of FET prescribed in the BIT, but did not specifically respond to Zaire's contention that it should.[475] It stated,

> 'The Tribunal does not consider it necessary to insist on this question beyond measure. In effect, [the] relevance [of Zaire's political instability] is not here discussed as a foundation of the responsibility of Zaire. That is why the Tribunal prefers at this stage to concern itself with the method of calculation of the amount of compensation to which AMT is entitled because of injury sustained.'[476]

In other words, the tribunal rejected Zaire's political situation as relevant to liability, but considered it relevant to determine compensation.[477] The tribunal stated that it would, 'take into account the existing conditions of the country.'[478] It further stated that,

> 'AMT would have liked to adopt a method of calculating compensation...practicable in the normal circumstances prevailing in an ideal country where the climate of investment is very stable, such as Switzerland or the Federal Republic of Germany. The Tribunal does not find it possible to accede to this way of evaluating the damages with interests in the circumstances under consideration, in which it is apparent that the situation remains precarious...the Tribunal will opt for a method that is most plausible and realistic in the circumstances of the case, while rejecting all other methods of assessment which would serve unjustly to enrich an investor who, rightly or wrongly, has chosen to invest in a country such as Zaire, believing that by so doing the investor is constructing a castle in Spain or a Swiss Chalet in Germany

[475] Ibid Paras 6.06–6.08.
[476] Ibid Para 7.12.
[477] Ibid Paras 7.14–7.15.
[478] Ibid Para 7.13.

> without any risk, political or even economic or financial or any risk whatsoever.'[479]

The tribunal acknowledged Zaire's distinction from a developed country but did not question the basic obligation in this light, only the compensation for the failure. AMT made a request for compensation in the amount of 14.3 million US dollars plus interests and costs;[480] the final award was 9 million US dollars. The tribunal found that AMT had severely diminished the market value of the property damaged in the events cited in the complaint by sending it to a country in Zaire's precarious situation[481] and that therefore AMT's complaint amounted to an application for an unjust enrichment of the investors.[482]

Arbitrator Mr Kéba Mbaye in a separate individual declaration argued for a smaller award, stating,

> 'Although concurring in the reasoning of the Tribunal, I am still convinced that the sum of US Dollars 9,000,000 (nine million) awarded to the Claimant exceeds by far the injuries actually sustained by the Claimant and the profits including the interests it could have reasonably expected. In my opinion, the total amount of compensation, inclusive of the principal, interests and all other claims, should not exceed US Dollars 4,000,000 (four million).'[483]

[479] See e.g., Ibid Paras 7.14–7.15.
[480] Ibid Para 3.06
[481] Ibid Para 7.13, 7.15.
[482] See e.g., Ibid Paras 7.14–7.15.
[483] See Separate Individual Declaration by Arbitrator Mr Kéba Mbaye in AMT (n 471).

This assertion by Mr Mbaye for reducing the amount of compensation against Zaire is also supported by Gallus who also examines the relevance of host country's level of development on investment protection standards.[484]

Distinct from the tribunal in *Toto* and *Bayindir*, the Tribunal rejected Zaire's politically unstable condition as relevant to a finding of liability. Reducing the amount of damages on the basis of these conditions suggests unsound reasoning; the tribunal does not explain why Zaire's political context related to compensation but not liability. This dubious logic limits the AMT award's appropriateness for future tribunals in relation to unstable political situations of host developing countries.

Zaire, now the Democratic Republic of Congo, faced a momentous political crisis that continues to the present day.[485] Its long history of political turmoil going back to independence in 1960 from Belgium includes ethnic conflict and invasion by Katangan rebels based in Angola in 1977 and 1978[486] and by neighbouring Rwanda in 1996, which led to war.[487] Ethnic violence, regional ethnic conflict, rebellions, and political violence under the dictatorship of Mobutu have severely affected the country for more than four decades;[488] the country faced at least eight wars between 1960 and the 1990s and during the 1990s; scholarship considered it a failed state.[489]

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[484] Also see e.g. Gallus (n124) 729.

[485] See e.g. Georges Nzongola-Ntalaja, *From Zaire to the Democratic Republic of Congo* (Nordic Africa Institute 2004).

[486] See e.g. Crawford Young, 'Zaire: The Unending Crisis?' (1978) 57 Foreign Affairs 169.

[487] See e.g. Gérard Prunier, *Africa's World War: Congo, the Rwandan Genocide and the Making of a Continental Catastrophe* (Oxford University Press 2008).

[488] For a detail account of Congo's political crisis see e.g., Léonce Ndikumana and Kisangani Emizet, *The Economics of Civil War: The case of the Democratic Republic of Congo* in Nicholas Sambanis (ed) *Understanding Civil War: Evidence and Analysis.* (The World Bank 2005); Koen Vlassenroot and Timothy Raeymaekers, 'The Politics of Rebellion and Intervention in Ituri: the Emergence of a New Political Complex?' (2004) 103 African Affairs 385; Denis M Tull, 'A Reconfiguration of Political Order? The State of the State in North Kivu (DR Congo)' (2003) 102 African Affairs 429; Filip De Beock, 'The Apocalyptic Interlude: Revealing Death in Kinshasa' (2005) 48 African Studies Review 11; Paul S Orogun, 'Crisis of Government, Ethnic Schisms, Civil War and Regional Destabilization of the Democratic Republic of

The tribunal's failure, in 1997, to place a higher burden of expectation on AMT remains puzzling, and Mr Mbaye's separate opinion reflects this. The separate opinion could have been a good example for other tribunals as host developing countries become new destinations for foreign investors from the West, and which also suffer from political instability, turmoil, and crisis.[490]

5.2.A.d Pantechniki

The Greek company Pantechniki S.A. Contractors and Engineers entered a contract with Albania's General Road Directorate to carry out a project of construction of bridges and roads in Albania in 1994.[491] Political unrest in the country in 1997 violent riots ensued in many parts of the country (also known as the Pyramid crisis or Albanian Anarchy),[492] affecting the project. At one point Pantechniki was forced to abandon its work site and repatriate its officials and workers. The equipment and facilities of the company were looted and destroyed. In *Pantechniki SA Contractors and Engineers vs.*

Congo' (2002) World Affairs 25; Thomas Turner, *The Congo Wars: Conflict, Myth and Reality* (Zed Books 2007).

[489] See e.g. Ndikumana and Emizet (n 488); Theodore Trefon Saskia, Saskia Van Hoyweghen and Stefaan Smis, 'State Failure in the Congo: Perceptions and Realities' (2002) 29 Review of the African Political Economy 379; Jean-Claude Willame, *Patrimonialism and Political Change in the Congo* (Stanford University Press 1972); David Eaton, 'Diagnosing the Crisis in the Republic of Congo' (2006) 76 Africa 44.

[490] For an account of political instability and crisis in developing countries and their relevance to foreign investments see e.g. Elizabeth Asiedu, 'On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different? (2002) 30 World Development 107; Elizabeth Asiedu, 'Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability' (2006) 29 The World Economy 63; Bade Onimode, *A Political Economy of the African Crisis* (Zed Books 1988); Mahmood Mamdani, 'African States, Citizenship and War: a Case-Study' (2002) 78 International Affairs 493; Merilee Serrill Grindle, *Challenging the State: Crisis and Innovation in Latin America and Africa* (Cambridge University Press 1996); Mahmood Mamdani, 'Making Sense of Political Violence in Postcolonial Africa' (2009) 39 Socialist Register 132; Ali Al'Amin Mazrui, *The African Condition: a Political Diagnosis* (Cambridge University Press 1980); Larry Diamond, Juan Linz and Seymour Martin Lipset, *Politics in Developing Countries* (Reinner 1990).

[491]See e.g., Pantechniki SA Contractors and Engineers vs. Albania, ICSID Case No. ARB/07/21, Award, 30 July 2009.

[492] For further detail on the issue see e.g. MA Smith, *Albania 1997-98* (Conflict Studies Research Centre 1999); Miranda Vickers and James Pettifer, *Albania: From Anarchy to a Balkan Identify* (New York University Press 2000); Marcella Favretto and Tasos Kokkinides, 'Anarchy in Albania: Collapse of European Collective Security?' (1997) 21 British American Security Information Council Occasional Papers on International Security Policy <http://archive.today/GnHr0> accessed 29 April 2014; Also see Sands (n18) Chapter 6.

Albania[493] the claimants alleged that the state had violated various protections provided under the Greece–Albania BIT,[494] including breach of the FET standard.[495]

In favour of considering a country's circumstances, the sole arbitrator of the tribunal acknowledged that,

> 'The Claimant cannot say today that it felt entitled to rely on a high standard of police protection. (Indeed an absence of such expectations may well explain the logic and value to the contractor of Clause 11 of the Contracts by which the Employer accepted the risk of loss caused by civil disturbance). My view may have been different if police were present and turned their back.…[E]vidence was to the contrary. [Claimants] testified that the police said they were *unable* to intervene. That is crucially different from a *refusal* to intervene given the scale of the looting. *I conclude that the Albanian authorities were powerless in the face of social unrest of this magnitude.*'[496] [Emphasis original]

By distinguishing between outright negligence or refusal on the part of law enforcing agencies to protect the foreign investor and its property the state from inability to take appropriate action, without any *mala fide*, as in the present case, this *dictum* exempts the host country from liability. By stressing the fact that in the present case the claimant cannot claim that it was entitled to rely on a 'high standard of police protection', the tribunal is clearly emphasising that the foreign investors should not expect that level of protection from a country like Albania.

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[493] Pantechniki (n 491).
[494] Greece–Albania BIT, 1 August 1991 <http://unctad.org/sections/dite/iia/docs/bits/greece_albania.pdf> accessed 29 April 2014.
[495] Pantechniki (n 491) Paras 28 and 85.
[496] Ibid Para 82.

The tribunal rejected all claims on merit. However the Tribunal did not give enough weight to the political unrest issue in this particular dispute, which was a vital factor for alleged breach of investment protection standards. Nonetheless the tribunal emphasised that such a lack of resources and incapacity in the situation is not a factor in determining state liability under international law.[497] It stated that an assessment of 'the human factor of obedience to the rule of law' would guide the award,[498] asking,

> 'Should a state's international responsibility bear some proportion on its resources? Should a poor country be held accountable to a minimum standard which it could attain only at great sacrifice while a rich country would have little difficulty in doing so? No such proportionality factor has been generally accepted with respect to denial of justice. Two reasons appear salient. The first is that international responsibility does not relate to physical infrastructure; states are not liable for denial of justice because they cannot afford to put at the public's disposal spacious buildings or computerized information banks. What matters is rather the human factor of obedience to the rule of law. Foreigners who enter a poor country are not entitled to assume that they will be given things like verbatim transcripts of all judicial proceedings – but they are entitled to decision-making which is neither xenophobic nor arbitrary. The second is that a relativistic standard would be none at all. *International courts or tribunals would have to make ad hoc assessments based on their evaluation of the capacity of each state at a given moment of its development.* International law would thus provide no incentive for a state to improve. It would in fact operate to the opposite effect: a state which devoted more resources to its judiciary would run the risk of graduating into a more exacting category.'[499] [Emphasis added]

[497] Ibid Para 76.
[498] Ibid.
[499] Ibid.

Here the tribunal suggests that a host country's resources should not be a factor in determining its liability under international law, suggesting that proportionality of resources of the host country is not empirically measurable. Thereby it denies any obligation to assess a host country's resources and struggles in satisfying the expectations and demands of the foreign investors, or the reasonable expectation of investors based on observable facts at the time of investment. This confined approach differs from those that prevailed in *Bayindir* and *Toto* and even *AMT*, although *Bayindir* occurred roughly concurrently with *Pantechniki*.

Developing countries often have a lack of resources,[500] which invariably affects their ability to protect the resources of foreign investors.[501] Decisions like *Pantechniki* render developing countries in an uncertain and weak position before investment tribunals on the issue of their political situation and lack of resources.

The crisis that prevailed in Albania at that time was so severe that the state had no control.[502] The tribunal acknowledged that there was no *mala fide* on the part of the police authority but it did not make any attempt to discuss the scale of the political crisis and how such unrest impacted upon the foreign investor. This outcome puts a chill on

[500] See e.g., Lack of resources threatens water and sanitation supplies in developing countries – UN <http://www.un.org/apps/news/story.asp?NewsID=41763#.U33Q7b5wYdU> accessed 29 April 2014; Arye L Hillman and Eva Jenkner, *Educating Children in Poor Countries* (IMF 2004); <http://yougov.co.uk/news/2012/09/10/what-causes-extreme-poverty-developing-countries/> accessed 29 April 2014; Lack Of Natural Resources <http://economics-exposed.com/lack-of-natural-resources/> accessed 29 April 2014; Potential benefits for developing countries – Design options for a UNEO, Institute for International and European Environmental Policy <http://www.ecologic.eu/download/projekte/200-249/221-01/221-01-report.pdf> accessed 29 April 2014; Clive Crook, Third World Economic Development <http://www.econlib.org/library/Enc1/ThirdWorldEconomicDevelopment.html> accessed 29 April 2014.

[501] Muchlinski, 'Caveat Investor?' (n 47) 538.

[502] See e.g. Smith (n 492); Favretto and Kokkinides (n 492).

the position of developing countries, which often face political instability like that of the Albanian crisis in 1997, in the future.

5.2.A.e Synopsis of the Awards on Political Instability

These four decisions reveal an inconsistent approach by tribunals in dealing with the political instability in the host countries. Thus the *AMT* tribunal, even though it had to deal with a more serious and complicated political crisis and instability and had to address a similar situation to *Toto* of post-war events, did not consider the importance of the situation to the same degree as the *Toto* tribunal. On the other hand, dealing with similar kinds of political instability and turmoil, the *Bayinder* and *Pantechniki* tribunals had very different approaches. The *Bayinder* tribunal gave the prevailing political instability greater weight in determining the responsibility of the host country and considered that, based upon particular country characteristics, the foreign investors should not have had a high expectation of investor protection. The *Pantechniki* tribunal did not directly consider the particular political turmoil and crisis that existed in Albania, and made no direct reference to it. It narrowly interpreted the relevance of the host country's resources to investment protection standards. The *Pantechniki* and *AMT* Tribunals were inadequate in addressing the political instability of the host country and have not had any serious discussion on the issue. This may make developing countries in post-conflict situations in future reluctant to encourage foreign investment; as they are more vulnerable to investment disputes and large amounts of compensation due to political instability (discussed in chapter 8).

5.2.B Socio-Political Circumstances Of The Country Relevant To The Investment Dispute

Part 5.2.A has discussed the arbitral awards where the tribunals had to deal with more serious situations of political crisis or unrest in the host country like that of civil war, military intervention or violence which arose out of ethnic or political conflict. Part 5.2.B will discuss awards in which the dispute arose out of a host country's particular socio-political context. Unlike those in Part 5.2.A, these situations do not involve violence or actual physical destruction of the investor's property. As in part 5.2.A, this part will present the arbitral awards in order of decreasing sympathy to the situations of the host developing countries.

5.2.B.a EDF

EDF, a British investor, entered into a contract for a joint venture with two state owned companies in Romania in 1991. EDF was to provide duty free and other retail services at Romanian airports as well as on board a Romanian airline. The Romanian joint venture partners undertook a series of actions and the government issued an Emergency Ordinance in 2002 to cease all duty free activities in the airport. As a consequence the duty free licenses were revoked which had a serious impact upon EDF's business. One of the joint venture companies ultimately declared bankruptcy and the partnership terminated. In 1998 the Romanian customs authorities also suspended EDF' authorisation to operate in the country for bookkeeping irregularities.

In *EDF (Services) Limited vs. Romania,*[503] EDF claimed that Romania had violated the UK–Romania BIT,[504] and thereby indirectly expropriated and breached the FET obligation. In finding that Romania did not violate the FET obligation under the BIT,[505] the tribunal described legitimate expectation of stability of the legal and business framework as a major component of the FET standard.[506]

The tribunal qualified the concept of legitimate expectation when it emphasised that an 'overly-broad and unqualified formulation',[507] provides a poor foundation for such an expectation. It acknowledged that such a formulation would allow FET to virtually freeze the legal regulation of economic activities and impacts upon the normal regulatory powers of the state on its economic life.[508] The tribunal further observed that a BIT cannot provide an insurance policy against the risk of regulatory change in the host country and therefore such expectations would be 'neither legitimate nor reasonable'.[509] It also stated that FET cannot serve the same purpose as stabilisation clauses, which are specifically granted to foreign investors.[510] With respect to the expectations it could ascribe to an investor after the fact, it stated:

> 'Legitimate expectations cannot be solely the subjective expectations of the investor. They must be examined as the expectations at the time the investment is made, as they may be deduced from all the circumstances of the case, due regard being paid to the host State's power to regulate its economic life in the public interest.'[511]

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503 EDF (Services) Limited vs. Romania, ICSID Case No. ARB/05/13, Award, 8 October 2009.
504 UK–Romania BIT, 13 July 1995.
505 EDF (n 503) Para 301.
506 Ibid Para 216.
507 Ibid Para 217.
508 Ibid Para 217.
509 Ibid Para 217.
510 Ibid Para 218.
511 Ibid Para 219.

These *dicta* reflect a reasonable and flexible approach to legitimate expectation as part of the FET obligation. The tribunal emphasised on the fact that the legitimate expectation of the investor cannot be based on the investor's judgment, but rather on the circumstances of the host country and especially its power to change the laws and regulations that affect foreign investment for a public purpose. The tribunal also emphasised that if legitimate expectation entails the total stability of the business framework then it may ultimately lead to freezing of the regulatory powers of the host state in determining its economic activities. Considering the socio-political context and experiences of instability, the host developing countries may need to adopt new laws in order to respond to new situations. The positive approach to the issue of the need for host states to change laws and regulations in response to public interest and to adapt to new circumstances the award provides a positive influence on developing countries. The tribunal recognised the role of legitimate expectation in FET as well as the potential that not considering the socio-political circumstances of the host country could lead to a standstill situation for the host country; emphasising that FET cannot serve the same purpose as the stabilisation clause.

5.2.B.b GAMI

During the early 1990s the sugar industry in Mexico faced difficulties.[512] In response to this crisis, the Mexican government implemented a number of laws and also expropriated several mills, including five mills of a Mexican company, GAM, in which a

[512] For further information on Mexico's sugar industry and its particular socio-political dynamics see e.g. Antonio Lara and Paul Rich, 'Commodity Policy in an Era of Globalization: The Mexican Sugar Industry and its Problems under NAFTA' (2003) 31 Policy Studies Journal 101; Jonathan A Fox, 'The Politics of Mexico's new Peasant Economy' in Kevin J Middlebrook, Juan Molinar and Maria Lorena Cook (eds), *The Politics of Economic Restructuring: State-Society Relations and Regime Change in Mexico* (La Jolla Centre for US-Mexican Studies 1994).

US company, GAMI Investments, owned shares. GAMI Investments claimed[513] that Mexico had breached a number of obligations under the NAFTA Treaty, including breach of the FET standard.[514] It accused Mexico of maladministration of the sugar industry in Mexico, which resulted in denial of national treatment as well as in breach of international minimum standards.[515]

In *GAMI Investments Inc. vs. The United Mexican States,*[516] the tribunal rejected consideration of the socio-political context of Mexico's sugar industry. It did recognise that 'Agricultural economics tend to be complex' and acknowledged, 'the Mexican sugar industry is characterised by special complicating factors'[517] and also that 'the industry has a considerable political dimension.'[518] Further, it stated that, 'against this background it is not surprising that this Mexican industry has a long tradition of state intervention. Mexico is however far from unique in this regard.'[519] The Tribunal then quoted a description from Mr Antonius which states as follows:

> 'The world sugar industry is also one of most economically distorted, almost notoriously so. In both developed and developing economies one finds evidence of widespread government intervention in the sector.… These practices of protection have also resulted in the sugar industry being one of the most politicised in most economies, as the various interests groups linked to the industry constantly pressure their governments in an attempt to maximize their benefits.'[520]

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513 See e.g., GAMI Investments Inc., vs. The United Mexican States (GAMI), NAFTA Arbitration under the UNCITRAL Arbitration Rules, Final Award, 15 November 2004, (2005) 44 International Legal Materials 545.
514 Ibid Para 24.
515 See e.g. Ibid Paras 44–115.
516 Ibid.
517 Ibid Para 45.
518 Ibid Para 46.
519 Ibid Para 47.
520 See e.g., Ibid Para 47.

This passage acknowledges how common it is for states to intervene in such industries.[521] The facts of the case support the interpretation that Mexico followed a path other states have taken and that rescuing the industry required some legislative actions.[522]

While the tribunal eventually rejected GAMI's claims, it also rejected the Mexican defence based on its administrative capacities. It asserted that it had 'no mandate to evaluate laws and regulations that predate the decision of a foreigner to invest[523] and that:

> 'The duty of NAFTA tribunals is rather to appraise whether and how pre-existing laws and regulations are applied to the foreign investor. It is no excuse that regulation is costly. Nor does a dearth of able administrators or a deficient culture of compliance provide a defence. Such is the challenge of governance that confronts every country.... Breaches of NAFTA are assuredly not to be excused on the grounds that a government's compliance with its own law may be difficult. Each NAFTA Party must to the contrary accept liability if its officials fail to implement or implement regulations in a discriminatory or arbitrary fashion.'[524]

Here the tribunal adopts a narrow interpretation of the host country's administrative capacity and incapability. It renders such conditions irrelevant in determining the liability of the host state under its NAFTA obligation. It also did not consider that a particular host country may face different kinds of challenges to comply with the

[521] See e.g., Ernest J Wilson III, 'Strategies of State Control of the Economy: Nationalization and Indigenization in Africa' (1990) 22 Comparative Politics 401; Thomas Andersson, *Multinational Investment in Developing Countries: A Study of Taxation and Nationalization* (Routledge 2002) 91-168.
[522] See e.g., Gritsenko (n 85) 346.
[523] GAMI (n 513) Para 93.
[524] Ibid Para 94.

investment treaty obligation. It made no distinction even between Mexico and its American and Canadian NAFTA counterparts in terms of administrative capacity and resources.

Significantly, the tribunal referred to *SD Myers Inc. vs. Government of Canada,*[525] adopting a passage which stated that the 'tribunal does not have an open-ended mandate to second-guess government decision making. Governments have to make many potentially controversial choices.'[526] The tribunal rejected any evaluation of the circumstances surrounding a government decision. It stated that a foreign investor might bring claims of maladministration before the Mexican courts and before a NAFTA Tribunal without exhausting local remedies, observing:

> '…*The problem is therefore to identify the type of maladministration that could rise to the level of breach of international obligations.* A claim of maladministration would likely violate Article 1105 if it amounted to an "outright and unjustified repudiation" of relevant regulations. There may be situations even where lesser failures would suffice to trigger Article 1105. *It is the record as a whole – not dramatic incidents in isolation – which determines whether a breach of international law has occurred.*'[527] [Emphasis added]

The *GAMI* award exemplifies the current attitudes of the majority of tribunals. They have been reluctant to consider the administrative capabilities of the host countries in relation to investment disputes. However it preserved the possibility that a host country that violates its own law does not always violate the FET standard:

[525] See e.g., SD Myers (n 122).
[526] See e.g. Ibid Para 261 cited in GAMI (n 513) Para 93.
[527] GAMI (n 513) Para 103.

> '...a government's failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105. *Much depends on context.*'[528] [Emphasis added]

Emphasizing this point, the GAMI Tribunal also referred to the *Waste Management No. 2* Award which states, 'Evidently the standard is to some extent a flexible one which must be adapted to the circumstances of each case'[529]:

> 'Four implications of Waste Management II are salient even at the level of generality reflected in the passages quoted above. (1) The failure to fulfil the objectives of administrative regulations without more does not necessarily rise to a breach of international law. (2) A failure to satisfy requirements of national law does not necessarily violate international law. (3) Proof of good faith effort by the Government to achieve the objectives of its laws and regulations may counter-balance instances of disregard of legal or regulatory requirements. (4) The record as a whole – not isolated events – determines whether there has been a breach of international law. It is in this light that GAMI's allegations with respect to Article 1105 fall to be examined.'[530]

A separate paragraph emphasised the importance of whether a breach of international law had occurred would not depend on dramatic incidents in isolation but on the record as a whole.[531] However, in this particular case, the record as a whole provides no evidence that Mexico had not attempted to implement its own regulations; the necessary cooperation of the private sector and unions had been lacking.[532] The

[528] See e.g., Ibid Paras 91, 94 and 97.
[529] Waste Management (n 292) Para 109, cited in GAMI (n 513) Para 96.
[530] GAMI (n 513) Para 97.
[531] Ibid Para 103.
[532] Ibid Paras 104, 108 and 110.

tribunal's attribution of failures to the government suggest that the cause, its lack of infrastructural and administrative incapacities, constitute a violation of the FET standard. The *GAMI* Tribunal adopted a very narrow approach to the administrative capacity and the socio-political circumstances of the host country in the sugar industry of Mexico; it stated that such drawbacks in the host country cannot be an excuse for any breaches of its NAFTA obligation.[533] This broad interpretation of the treaty obligation surely ignores the socio-political context of the host country.

Significantly, Mexico expropriated the mills because of turmoil and crisis in the sector, which the socio-political circumstances of developing countries can make common. As Gritsenko observes, many developing countries implement similar actions in response to similar circumstances, and socio-political conditions may support such actions.[534] The *GAMI* Tribunal's decision to disregard the crisis situation in the industry therefore represents an inadequate approach to addressing the socio-political circumstances of the host country and its duty to intervene in the public interest. Ignoring the difficulties host developing countries face under such circumstances would raise concern for the host developing countries in future in investment disputes.

5.2.B.c Tecmed

In *Técnicas Medioambientales Tecmed, SA vs. United Mexican States*[535] the tribunal refused to consider a host country's particular socio-political context and experience in regulation of investors as a part of its FET analysis. Tecmed a company incorporated in Spain, had invested in Mexico through its two Mexican subsidiaries, Tecmed and Cytrar. The project concerned the operation of a landfill containing hazardous industrial waste.

[533] Ibid Para 94.
[534] Gritsenko (n 85) 346.
[535] Tecmed (118).

Mexico's National Ecology Institute (INE)[536] granted Tecmed a licence for the work in 1996, which it extended until November 1998, at which time it refused a renewal. Local citizens had protested the landfill, which was proximate to the municipality of Hermosillo. Tecmed claimed Mexico had violated the Spain—Mexico BIT[537] by breaching the obligation of FET; along with the claim of breach of protection against expropriation and of full protection and security.

Mexico denied that its refusal to renew the licence was arbitrary, saying that INE had used its discretionary powers in a highly regulated sector which is very closely linked to the public interest.[538] Mexico stressed the community's concerns about the landfill's threat to the environment and public health.[539]

In its award, the tribunal highlighted Mexico's socio-political circumstance—the locals' protest against the project and the resulting public pressure against it, rather than legal considerations. However it found that Mexico had failed to present evidence of community opposition to the landfill, which Mexico had claimed was 'intense, aggressive and sustained'.[540] In the absence of any evidence that the project was a 'real or potential threat to the environment or to the public health,' or that 'massive opposition' existed, the tribunal found that 'although they amount to significant pressure on the Mexican authorities' community pressure did not 'constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.'[541] It took into account the lack of transparency in

[536] Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico, and agency of the Mexican Federal Government within the Ministry of the Environment, Natural Resources and Fisheries.
[537] Spain-Mexico BIT, 18 December 1996.
[538] See e.g. Tecmed (n 118) Para 46.
[539] Ibid Para 49.
[540] Ibid Para 144.
[541] Ibid Para 144.

relations with the investor and found that this had violated investors' basic expectations, which the tribunal considered a violation of the FET standard. It construed the investor's legitimate expectation as follows:

> 'The foreign investor expects the host State to act in a *consistent manner*, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. *Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations.* The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing 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. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle.'[542] [Emphasis added]

[542] Ibid Para 154.

Subsequent tribunals have frequently cited this passage, informally known as the TECMED test, in relation to foreign investors' legitimate expectations.[543] However, this represents fairly broad criteria for legitimate expectations. Social and political turmoil makes it difficult for developing countries to guarantee that the goals of the relevant policies and administrative practices or directives will be static. Crises may require change in policies and directives upon which the foreign investor relied before making the investment, without any *mala fide*. The TECMED test may prevent many developing countries from passing such a restricted filter. The *TECMED* test is investor oriented; its insensitivity to host countries' socio-political circumstances relevant to a given investment dispute threatens their ability to benefit from foreign investment.

The TECMED test leaves open the question as to whether a stronger public protest would constitute a crisis and therefore a justification for an action like Mexico's. Foreign investment in developing countries often meets with public protest, where the projects are directly related to public interests.[544] As Thomas M Franck notes, citizens of developing countries often consider foreign investment a 'disguised emissary of an exploitative colonialist regime.'[545] Governments that make concessions to such protests risk making a decision that a tribunal may deem prejudicial to the foreign investors. The *Tecmed* tribunal, as well as subsequent tribunals that have cited it, have not commented on this issue. From the observations made by the tribunal it appears that it decided on the consideration that Mexico had failed to present the evidence of the urgency to take

[543] See e.g. CMS (n 119) Para 279; Occidental (n 116) Para 185; LG& E (Decision on Liability) (n 121) Paras 102 and 127, 128; National Grid PLC vs. Argentina Republic, Award, 3 November 2008 Para 173; MTD Equity (n 119) Para 114; Saluka (n 104) Para 302.

[544] See e.g. David Wheeler, 'Racing to the Bottom? Foreign Investment and Air Pollution in Developing Countries' (2001) 10 The Journal of Environment and Development 225; Friedrich Schneider and Bruno S Frey, 'Economic and Political Determinants of Foreign Direct Investment' (1985) 13 World Development 161; Jennifer Clapp, 'Foreign Direct Investment in Hazardous Industries in Developing Countries: Rethinking the Debate' (1998) 7 Environmental Politics 92; John M Rothgeb, *Foreign Investment and Political Conflict in Developing Countries* (Greenwood Publishing Group 1996).

[545] Franck, *Fairness in International Law and Institutions* (n 106) 438.

those actions. Tribunals generally have little expertise to evaluate the strength or gravity of the public protest in a host country; the socio-political context of the host country makes the issue complex. Therefore it is almost impossible for an investment tribunal to evaluate such evidence. Only the host country government can make such assessment.

The government of the host country alone will address the results of public protest; public interest may require decisions that jeopardise the interests of foreign investors. Sovereign power bestows decisions such as Mexico made in the *Tecmed* case on central governments; genuine public interest may require them to exercise this power. From that view point, *Tecmed* award is inadequate in response to the public interest in developing countries.

5.2.B.d Duke Energy

The US Company Duke Energy Electroquil Partners acquired an ownership interest in INECEL, a state owned power Company in Ecuador, through its Ecuadorian subsidiary Electroquil S.A.[546] In 1995 and 1998, INECEL entered into power purchase agreements (PPAs) with Duke Energy. It required Electroquil to receive a guaranteed price for the supply of electricity and to return certain amounts of electric power. Under the agreement, INECEL was entitled to fine the company in the event of its failure to supply the required amount of electricity. Within a year of the agreement, INECEL had fined Electroquil and by 2002 these fines amounted to over 8 million US dollars. In *Duke Energy Electroquil Partners & Electroquil S.A vs. Republic of Ecuador,*[547] the investors

[546] See e.g., Duke Energy (n 122).
[547] Ibid.

claimed that INECEL had improperly levied these fines and violated Ecuador's FET obligation under the US–Ecuador BIT.[548]

The tribunal made some important observations regarding the legitimate expectations of an investor in a country like Ecuador considering its socio-political circumstances. It stated:

> 'To be protected, the investor's legitimate expectations must be legitimate and reasonable at the time when the investor makes the investment. The assessment of reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State.'[549][Footnotes in the original text omitted]

Here the tribunal described legitimate expectation in two ways, firstly in relation to its existence at the time of investment, and secondly in relation to the investor's actual reliance upon such expectations when making the investment.[550] The tribunal observed that legitimate expectations in relation to the stability of the legal and business environment are an important element of the FET standard and emphasised the existence of limitations to such expectations.[551]

While the tribunal found a violation of the FET obligation under the BIT because Ecuador had failed to make payments the 1998 PPA had guaranteed, which

[548] US–Ecuador BIT, 27 August 1993.
[549] Duke Energy (n 122) Para 340.
[550] Ibid Para 340.
[551] Ibid. Also see e.g. Jane Hofbauer and Cristina Knalir, 'International Centre for Settlement of Disputes: Legal Maxims-Summaries and Extracts from Selected Case Law' in Giuliana Ziccardi Capaldo (ed), *The Global Community Yearbook of International Law and Jurisprudence* (Oxford University Press 2010) 901.

contravened the investor's legitimate expectation,[552] the *Duke Energy* award provides criteria and explanation of the investor's legitimate expectation as part of the FET standard more sympathetic to host countries than the *Tecmed* award. It calls on tribunals to consider the socio-political context of the host state in relation to investor complaints, emphasising that 'political, socioeconomic, cultural and historical conditions prevailing' in the host state form an essential part of investors' legitimate expectation. The above *dictum* from *Duke Energy* did not have the persuasive authority over the subsequent tribunals; rather many opted to quote the restrictive *dictum* from *Tecmed* in order to describe the legitimate expectation of the foreign investor in investment disputes.[553] Current tribunals' general preference for the *Tecmed* test suggests a reluctance to adopt a more flexible approach to considering the socio-political circumstances of host countries in determining the legitimate expectations of the investors from the host country under the rubric of the FET obligation.

5.2.B.e Azurix

Azurix Corporation, a US Company, entered into a 30-year concession for the distribution of potable water services and the treatment of sewerage in the Argentinean Province of Buenos Aires through its local subsidiary Azurix Buenos Aires SA (ABA).[554] Under the concession agreement the province agreed to complete certain infrastructural repairs, which it never did. As a result during April 2000, the health authorities had to issue a warning to customers that they had to boil tap water due to an algae outbreak. Azurix alleged the government had incited public panic and encouraged them to refuse to pay their water bills following the incident. In July 2001 the company requested that

[552] Duke Energy (n 122) Para 491.
[553] See e.g. CMS (n 119) Para 279; Occidental (n 116) Para 185; LG& E (Decision on Liability) (n 121) Paras 102 and 127, 128; National Grid (n 543) Para 173; MTD Equity (n 119) Para 114; Saluka (n 104) Para 302.
[554] Azurix (n 116).

the government rectify the breaches of the concession, but the government refused. ABA terminated the concession in October 2001. The province rejected the termination and asked ABA to continue the work. In March 2002 the province terminated the concession agreement based on the allegation that the company failed to provide due services. In *Azurix Corporation vs. The Argentine Republic*,[555] Azurix initiated proceedings against Argentina under the US–Argentina BIT 1994 and claimed that such actions amounted to expropriation and violation of full protection and security and the FET obligation under the treaty.

Public utility services represent crucial public health and safety issues; any government should act when a threat exists, and the health authority's warning was responsible. Ignoring the algae in the water might have instigated a serious crisis. However, the tribunal in its finding that Argentina had breached its FET obligation, claimed that 'it is also clear that the tariff regime was politicized because of concerns with forthcoming elections and because the Concession was awarded by the previous government.'[556] The award provides no direct support for this assumption that the government acted on political, rather than public health concerns. It does not address the potential consequences of silence in light of an algae outbreak.

An algae outbreak not disclosed to water customers would create public health threat in any country. Given Argentina's social and political turmoil in the latter part of the twentieth century, an algae outbreak could have led to social unrest. A 2000 incident in Argentina's neighbour Bolivia, the 'Conchabamba Water Wars,' present a sobering example; Bolivia ultimately imposed martial law in the wake of an investment treaty

[555] Ibid.
[556] Ibid Para 375.

conflict in which privatisation of water and sewer services led to protest and social unrest resulting in civilian deaths.[557]

The commentary of Muchlinksi on *Methanex Corporation vs. USA*[558] bears on Azurix. Muchlinski in his article stated that the Canadian investors in that case should have known about the risk of foreseeable future regulatory change in the absence of a stabilisation commitment in the NAFTA treaty. This logic precludes tribunals from deeming ordinary regulatory change a breach of the FET standard, regardless of the change's effect on the investor's interest.[559] This example raises the question as to how the tribunal can consider ordinary regulatory change by developing countries a breach of obligation while excluding such changes by developed countries like the US.

5.2.B.f Synopsis of the Awards on Socio-Political Circumstances of the Host Country

Like part 5.2.A, part 5.2.B has shown the reluctance of the majority of investment tribunals to emphasise the socio-political circumstances of host developing countries. This particular contextual background is also an important factor in evaluating the facts of the dispute. The *GAMI* Tribunal was unwilling to discuss the socio-political background of the sugar industry in Mexico and refused to consider the particular capabilities of the host country in this context. Though the *GAMI* Tribunal did refer to

[557]Franck, 'Development and Outcomes of Investment Treaty Arbitration' (n 20) 444.
[558] Methanex Corporation vs. USA (UNCITRAL) (NAFTA), Award, 3 August 2005. In this case the dispute arose between the Canadian based company Methanex Corporation, which is the world's largest producer of methanol, and the United States under NAFTA when the State of California issued a ban on the use of MTBE (methy teriary butyl ether; methanol is a key component that increases oxygen content and boosts octane in gasoline). The ban reflected increasing human health and safety concerns and its impact upon the environment due to the use of MTBE, because of its large presence in the drinking water system in California. Methanex argued that ineffective regulation and non-enforcement of domestic environmental laws, including the US Clean Water Act, 1972 had led to MTBE's level in the drinking water system. The company argued that the ban was tantamount to an expropriation under NAFTA as well as breach of national treatment and the FET obligation.
[559] Muchlinski *'Caveat Investor?'* (n 47) 551–552.

a *dictum* from *Waste Management No. 2* that '*much depends on context*' it nonetheless ignored the dispute's vital socio-political contextual background. The *Tecmed* tribunal also rejected consideration of the socio-political context of the dispute, adopting a very strict approach to legitimate expectation. In *Tecmed* the tribunal conceptualised legitimate expectation as extending to situations that might lead to a host country's freezing of its legal environment. The socio-political context prevailing in the majority of these host developing countries renders such a restrictive approach unrealistic, but the *Tecmed* formulation nonetheless represents a very strict objective criteria and persistent use of it, and the decision that 'community pressure' 'does not constitute a real crisis or disaster of great proportions',[560] by subsequent tribunals without addressing the possibility of a 'real crisis or disaster' represents a sobering example for host developing countries. Similarly, the award in *Azurix* exhibited a complete disregard of government's legitimate interest in protecting public health and safety issues, effectively exempting the investor from risk.

In *Duke Energy* and *EDF,* the tribunals constructed legitimate expectation differently, acknowledging the need for host countries to be able to change law and regulations due to prevailing socio-political and economic conditions. Overall the current tribunals are reluctant to consider the socio-political context of the host developing state; they prefer to adopt the restrictive approach of the *Tecmed* tribunal.

5.2 Conclusion

This chapter has discussed a number of arbitral awards in light of their approach to the political instability and socio-political circumstances of host developing countries in

[560] Tecmed (n 118) Para 144.

interpreting the FET standard. The tribunals have been generally inconsistent and inadequate in addressing substantive issues. Overall, they give minimal importance to host developing countries' circumstances. Only the *Bayinder, Toto,* and the *EDF* Tribunals directly address them; the rest discuss them generally and apart from the question of liability. However, this thesis argues that *Bayinder* and *EDF* correctly identifies the role of socio-political conditions in relation to foreign investors' legitimate expectations.

Chapter 6

Current Arbitral Practice Relating to Countries in Transition: The FET Standard in Context

6.1 Introduction

This chapter will discuss selected selection of awards against countries in transition, a category created after the collapse of the Soviet Union, as Chapter 4 discussed in brief. These countries include the ex-Soviet states and some Eastern and Central European states which made a transition from communist centrally planned economies (CPEs) to market based economies after 1989.[561] After the collapse of communism these countries became the new destination for many foreign investors and FDI due to the liberalisation of the embargo on foreign and private investments.[562] However the difficulties of these countries in transition led to a number of investment disputes; transition affected all aspects of the state, including its social, political, and economic life.[563] As this chapter will show, transition and the resulting economic and socio-political conditions had both direct and indirect effects that led to the disputes in question, and the tribunals at times addressed this difficulty of the host country in the process of transition in their awards, and in relation to investors' legitimate expectations as part of the FET obligation. The awards discussed below demonstrate the full range of approaches of the current investment tribunals' responses to these countries' particular transitory status in relation to the alleged breach of the FET standard. Some are not specifically related to breach of FET but are nevertheless significant in this

[561] See e.g., Hill (382); Agh (n 382); Zaslavsky (n 382); Sokol (n 382); Suny (n 382).
[562] See e.g. Lankes and Venables (n 412); Kinoshita and Campos (n 412).
[563] See e.g., Josef C Brada, Ali M Kutan and Taner M Yigit, 'The Effects of Transition and Political Instability on Foreign Direct Investment Inflows' (2006) 14 Economics of Transition 649.

discussion in terms of the current tribunal's approach towards the transitionary status of the host countries.

6.2.a. Parkerings-Compagniet

In *Parkerings-Compagniet AS vs. Lithuania*[564] the tribunal rejected the violation of FET claim of the investor made under the Lithuania–Norway BIT.[565] The Norwegian company Parkerings-Compagniet AS established a Lithuanian subsidiary to carry out a parking system project in Vilnius. The Municipality of Vilnius was to receive a portion of fees and charges and also a fixed monthly fee. In 2000 the government amended certain laws which affected the project, indicating that the parking plan had not been completed in a timely manner and the company had failed to pay the fees under the Project Agreement. Parkerings-Compagniet claimed municipal actions and omissions and the legislative changes had caused the delay, and that these represented a breach of the legitimate expectation of the investor. The company also claimed that Lithuania had violated the obligation to provide 'equitable and reasonable treatment' under Article III of the BIT.[566] They argued that, under the aforesaid treaty, the obligation to grant 'equitable and reasonable treatment' requires host countries to adhere to stricter standards of conduct than the FET standard that appears in other BITs.[567] The claimants further argued that, 'A showing of breach of Article III of the Treaty

[564] Parkerings (n 468).
[565] Agreement between the Government of the Republic of Lithuania and the Government of the Kingdom of Norway on the Promotion and Mutual Protection of Investments (Lithuania–Norway BIT) 16 August 1992 <http://unctad.org/sections/dite/iia/docs/bits/norway_lithuania.pdf> accessed 20 August 2014.
[566] Parkerings (n 468) Para 197. Article III of the Lithuania–Norway BIT (n 565) states, '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. Such investments shall be subject to the laws and regulations of the contracting party in the territory of which the investments are made.'
[567] Parkerings (n 468) Paras 198 and 272.

therefore requires less than a showing of breach of the standard of "fair and equitable treatment.'"[568]

The tribunal rejected this argument,[569] observing, 'The Claimant did not show any evidence which could demonstrate that, when signing the BIT, the Republic of Lithuania and the Kingdom of Norway intended to give a different protection to their investors than the protection granted by the "*fair and equitable*" standard.'[570] Accordingly the Tribunal held that it 'intends to identically interpret the notion "equitable and reasonable" and the standard "fair and equitable."'[571]

In relation to the question as to whether Lithuania violated Parkerings-Compagniet's legitimate expectation when it changed its laws, the tribunal stated,

> 'In fact it would have been foolish for a foreign investor in Lithuania to believe at the time, that it would be proceeding on stable legal ground as considerable changes in the Lithuanian political regime and economy were undergoing.'[572]

Further, it observed the transitory status of the host country:

> 'at the time of the Agreement, the political environment in Lithuania was characteristic of a country in transition from its past being part of the Soviet Union to candidate for the European Union membership. Thus, legislative changes, far from being unpredictable, were in fact to be regarded as likely. As any businessman would, the Claimant was aware of the risk that changes of laws would probably occur after the conclusion of the Agreement. The

[568] Ibid Para 198.
[569] Ibid Paras 271–279.
[570] Ibid Para 277.
[571] Ibid Para 278.
[572] Ibid Para 306.

> circumstances surrounding the decision to invest in Lithuania were certainly not an indication of stability of the legal environment. Therefore, in such a situation, no expectation that the laws would remain unchanged was legitimate.'[573]

Here the tribunal considered Lithuania's particular transitory status in making its award, acknowledging that this status required the adoption of new laws in changing social and political circumstances, and imposing the understanding of this risk on investors. The Tribunal observed in relation to the host country's regulatory power that,

> '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.'[574]

Here the tribunal asserts that any sovereign state has the right to change it laws, in addition to the fact that a country in transition will need to do so frequently, and required investors to recognise the risks associated with investing in those countries. It rejected Parkerings-Compagniet's claim to have had a legitimate expectation that the government of Lithuania would not pass any law which could harm its investment,[575] and rejected the claim of a breach of the 'equitable and reasonable treatment' requirement under the treaty, holding it to be equivalent to the FET obligation.[576]

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[573] Ibid Para 335.
[574] Ibid Para 332.
[575] Ibid Para 338.
[576] Ibid Para 465 (b).

6.2.b Nagel

William Nagel, a British citizen entered into a contract with the state enterprise Sprava Radiokomunikaci Praha to obtain a telecommunication licence in the Czech Republic. In *William Nagel vs. Czech Republic,*[577] Nagel claimed that the Czech Republic had breached its obligation under the UK–Czech Republic BIT,[578] which included the FET standard, when it refused to give him a telecommunication licence, awarding it to the state enterprise and another foreign investor. The tribunal found that Mr Nagel did not have an investment and therefore did not address the treaty provision.[579] However, its statement that it 'takes into account the rather special factual background to the dispute' in determining the merits of Nagel's claim, are significant in relation to the transitory status of the host country.[580] Referring to the investor's own evaluation of the investment, the tribunal observed that,

> 'The Arbitral Tribunal considers that Mr Nagel may, in good faith, have been over-optimistic in interpreting the informal signals he received from his influential personal friends and contacts within the Czech Government. *He may also not have taken sufficient account that the country was still in a state of transition, in which the Government and public authorities were labouring to develop the newly born democratic system and to create a well-functioning market economy.* This involved a lengthy process of planning the route the country was to follow in the privatisation process of various important sectors of the state-controlled economy, including telecommunications.'[581] [Emphasis added]

[577] William Nagel vs. Czech, 2003, 13 ICSID Reports 33, Award, 9 September.
[578] UK–Czech and Slovak Federal Republic BIT, 10 July 1990.
[579] See e.g. Nagel (n 577) Paras 297–329.
[580] Ibid Para 286.
[581] Ibid Para 293.

This statement recognised the Czech Republic's status as a state in transition, although the award primarily reflected the technical points of the parties' contract, stating,

> 'Legal terms in an international treaty do not necessarily have the same meaning as similar terms in the domestic laws of the Contracting Parties. In a treaty such terms should often be considered to have an autonomous meaning appropriate to the contents of the specific treaty and to the issues it intends to regulate.'[582]

The tribunal concluded that,

> 'Mr Nagel's rights under the Cooperation Agreement – alone or in conjunction with surrounding factors, such as the conduct of persons acting on behalf of the Czech Government – did not constitute an asset and an investment protected under Article 1 of the Investment Treaty.'[583]

In dismissing Mr Nagel's claims entirely,[584] the tribunal did not directly address the FET standard as it concluded that such a claim was not admissible under the present arbitration.[585]

Nonetheless it is important to recognise the tribunal's emphasis on the importance of foreign investors' responsibility to investigate when the bureaucratic process involved investing in countries in the process of social and political transition, and its *dictum* showing sympathetic approach for countries in transition, even though its dismissal of the claim meant it did not engage in any discussion of the violation of the investment protection standards against the background of those socio-political factors of the country in transition.

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[582] Ibid Para 296.
[583] Ibid Para 335.
[584] Ibid Para 326.
[585] Ibid Para 271.

6.2.c Generation Ukraine

In *Generation Ukraine Inc. vs. Ukraine*[586] the dispute arose out of an allegation of expropriation. Generation Ukraine, a US company, claimed that Ukraine had breached the US–Ukraine BIT[587] when the local authorities interfered with the realisation of the commercial project in Kiev. This interference, the company claimed, amounted to expropriation. The tribunal accepted that the claimant company had 'experienced frustration and delay caused by bureaucratic incompetence and recalcitrance'[588] but concluded that Ukraine's treatment of the investor did not fail the obligations guaranteed under the BIT. It incorporated the host country's economic condition and its transitory status in the award in plain words. The Tribunal stated that,

> '….*it is relevant to consider the vicissitudes of the economy of the state that is host to the investment in determining the investor's legitimate expectations*, the protection of which is a major concern of the minimum standards of treatment contained in bilateral investment treaties. *The Claimant was attracted to the Ukraine because of the possibility of earning a rate of return on its capital in significant excess to the other investment opportunities in more developed economies.* The Claimant thus invested in the Ukraine on notice of both the prospects and the potential pitfalls. Its investment was speculative.'[589] [Emphasis added]

Here the tribunal examined the legitimate expectation of the investor in light of the economic conditions in the host country. The tribunal observed that the investor selected Ukraine for investment because it sought the higher return that a risky

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[586] Generation Ukraine, Inc. vs. Ukraine (Generation Ukraine), ICSID Case No. ARB/00/9, Award, 16 September 2003.
[587] US–Ukraine BIT, 4 March 1994 <http://www.bilaterals.org/IMG/html/US-UKR_BIT_1996_.html> accessed 20 August 2014.
[588] Generation Ukraine (n 586) Para 20.37.
[589] Ibid Para 20.37.

investment can offer, which signified its understanding that Ukraine lacks a stable and sound economy. Here the tribunal emphasized the necessity of investor due diligence in assessing legitimate expectations.[590] The host country's transitory status played a part in the tribunal's decision to reject the claim.[591] While this award related to expropriation, it seems reasonable that similar logic would apply to the FET standard. If knowledge of commercial risk can contribute to rejection of an allegation of expropriation, then similarly any claim of a breach of the FET standard should also be rejected.

6.2.d Tokios Tokelés

The Lithuanian company Tokios Tokelés was running its business of advertising, printing and publishing through two Ukrainian subsidiaries; Ukrainian nationals holding 99 percent of its shares.[592] In *Tokios Tokelés vs. Ukraine*[593] it alleged that Ukraine had violated the investors' protections guaranteed under the Ukraine–Lithuania BIT,[594] which included the FET standard. Tokios Tokelés alleged that the Kiev Tax administration had targeted and oppressed its subsidiaries for political gain. While the tribunal ultimately rejected[595] all claims on the grounds that the nationality of Tokios Tokelés's shareholders disqualified the company from seeking protection under the BIT, it also provided an elaborate description of Ukraine's political and economic situation.[596] It stated that 'The long history of suffering and oppression endured by the Ukraine and its peoples forms an inescapable background to the dispute,'[597] and that, 'the events of 2001–2003 which form the substance of the present dispute were played

[590] Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International 2009) 288–289.
[591] Generation Ukraine (n 586) Para 20.38.
[592] Tokios Tokelés vs. Ukraine, ICSID Case No. ARB/02/18, Award, 26 July 2007.
[593] Ibid.
[594] Ukraine–Lithuania BIT, 8 February 1994.
[595] Tokios Tokelés (n 592) Para 147.
[596] See e.g. Ibid Paras 7–11.
[597] Ibid Para 7.

out against a backdrop of volatility and fragmentation in the Ukrainian political life.'[598] Few tribunal awards provide this level of detail on a country's history. However, the tribunal did not discuss these contextual factors in relation to the alleged violation of the investment treaty clauses, which limits its applicability to future disputes.

6.2.e Genin

In *Alex Genin, Eastern Credit Limited, Inc and AS Baltoil vs. The Republic of Estonia*[599] the tribunal also recognised the host country's economic conditions and developmental stage without relating them to the award's final outcome. The dispute concerned the revocation of a banking licence of Mr Genin's company, Estonian Innovation Bank (EIB), which purchased the Koidu Branch of Estonia Social Bank. The Bank of Estonia revoked the EIB's licence on the grounds that the share registry and the list of shareholders it provided had discrepancies. EIB charged this revocation violated Estonia's obligation under the US–Estonia BIT,[600] which stipulated the FET standard and the 'non-discriminatory and non-arbitrary treatment' standard.

The tribunal found that considering the Bank of Estonia's actions required 'proper context' and that actions such as revoking a licence were 'extremely technical'.[601] It also found that the Bank of Estonia's stated reasons for revoking the licence were 'exceptionally formalistic' and 'superficial,' failed to 'justif[y]…the revocation of EIB's license'.[602] It called the revocation process 'somewhat irregular'[603] and 'contrary to

[598] Ibid Para 8.
[599] Alex Genin, Eastern Credit Limited, Inc and AS Baltoil vs. The Republic of Estonia, ICSID Case No. ARB/99/2, Award, 25 June 2001.
[600] US–Estonia BIT, 19 April 1994 <http://www.state.gov/documents/organization/43560.pdf> accessed 22 August 2014.
[601] Genin (n 599) Para 361.
[602] Ibid Para 352.
[603] Ibid Para 355.

generally accepted banking and regulatory practice'[604] which 'invites criticism'.[605] Nevertheless, the tribunal found that its actions were not unsound. It rejected the claim that Estonia had breached the FET obligation under the BIT.[606] It stated,

> 'It is quite obvious that the Banking Supervision Department had good reason to be critical of various aspects of EIB's business and operations. It was perfectly justified to request the information which it sought. The question the Tribunal must answer, however, is whether the central bank afforded Claimants due process in the procedure in leading to the revocation of EIB's license. Not without some hesitation, we conclude that the actions of the Bank of Estonia did not amount to a denial of justice.'[607]

In describing how it overcame this 'hesitation,' the tribunal stated that it,

> 'considers it imperative to recall the *particular context in which the dispute arose,* namely, that of a renascent independent state, coming rapidly to grips with the reality of modern financial, commercial and banking practices and the emergence of the state institutions responsible for overseeing and regulating areas of activity perhaps previously unknown. *This is the context in which Claimants knowingly chose to invest in an Estonian financial institute,* EIB.'[608] [Emphasis added].

The tribunal took the fact that Estonia was going through a transition from communism to a market based economy into account in excusing the host country's rather bureaucratic behaviour,[609] stating that investors must take the local authorities'

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[604] Ibid Para 364.
[605] Ibid Para 365.
[606] Ibid Paras 345–347.
[607] Ibid Para 357.
[608] Ibid Para 348.
[609] Åsa Romson, 'International Investment Law and Environment' in Marie-Claire Cordonier Segger and Andrew Paul Newcombe (eds.), *Sustainable Development in World Investment Law* (Kluwer International 2011)

degree of sophistication into consideration when investing in a country like Estonia and having its particular economic conditions. The tribunal noted that investors cannot expect the level of investor protection from a country, or supervision and regulation from the central bank, from host country which is struggling to cope with modern financial and banking practices that a country with a market based developed economy provides. Muchlinski, commenting on the award, opines that, 'Where that country is like Estonia, in a process of change and transition, this may require a higher degree of candour and transparency than might be expected when dealing with a more developed market economy State.'[610] He emphasises the investors' duty to enter into investments with full knowledge of the risk involved in the host country.[611]

The tribunal found an enormous number of shortcomings in the treatment of investors by the Bank of Estonia,[612] and recognized Estonia's capabilities and the weak administrative and technical capacity due to its transitory economic condition. However it did not base its conclusion that Estonia had not violated the FET standard on these conditions. Rather it cited Mr Genin's poor conduct and his failure to disclose the shareholding interest of the company:

> 'It is the opinion of this Tribunal that the decision taken by the Bank of Estonia must be considered in its proper context – a context comprised of serious and entirely reasonable misgivings regarding EIB's management, its operations, its investments and, ultimately, its soundness as a financial institution.'[613]

This was the very reason the Bank of Estonia cited for its treatment of the EIB.[614]

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47. For criticism of this view see e.g. Kaj Hobér, *Investment Arbitration in Eastern Europe: In Search of a Definition of Expropriation* (Juris Publishing Inc. 2007) 255.
610 Muchlinski, 'Caveat Investor?' (n 47) 541.
611 Ibid.
612 See e.g. Genin (n 599) Paras 352, 355, 361, 364 and 365.
613 Ibid Para 361.
614 Ibid Para 362.

In fact, the shortcomings of Estonia's process which the tribunal identified in its award generally reflected its status as a developing country and country in transition, but the tribunal did not directly make this connection, in spite of recognising this status in light of Genin's legitimate expectations. Rendering the award in Estonia's favour only on technical grounds and in light of the EIB's failures of management limits the positive implications of this decision for future decisions.[615]

6.2.f Lemire (Decision on Jurisdiction and Liability)

Mr Joseph Charles Lemire, a US citizen, invested in the Ukraine radio broadcasting industry, Gala Radio, after the government opened the sector for privatisation. In *Joseph Charles Lemire vs. Ukraine*[616] Mr Lemire alleged that Ukraine breached FET and other stipulations of the US–Ukraine BIT[617] by failing to provide additional frequencies to his radio station and subjecting it to arbitrary and discriminatory measures in the process of awarding broadcasting frequencies. The claimant alleged that Ukraine had granted broadcasting licences to other radio stations but had improperly and repeatedly denied his claims for additional frequencies. This had significantly frustrated his radio station's plans for expansion. The tribunal decided Ukraine had violated FET but rejected Lemire's other claims, including breach of the settlement agreement.[618]

The tribunal noted Ukraine admitted in responding to the allegations that 'in the initial years of independence, constant battles and economic battles and economic instability

[615] Ibid Para 361.
[616] Joseph Charles Lemire vs. Ukraine, ICSID Case No. ARB/06/18, Decision on Jurisdiction, 14 January 2010.
[617] US–Ukraine BIT, 4 March 1994 <http://www.bilaterals.org/IMG/html/US-UKR_BIT_1996_.html> accessed 20 August 2014.
[618] Lemire (Decision on Jurisdiction) (n 616) Para 422.

caused lack of coordination in the activities of the state bodies and hampered their ability to create an effective system of government,'[619] but did not cite Ukraine's developing and transitory status in relation to the alleged breach of the FET standard. Rather, the Tribunal held, 'On a general level, Claimant could expect a regulatory system for the broadcasting industry which was to be consistent, transparent, fair, reasonable, and enforced without arbitrary or discriminatory decisions.'[620] Further, it stated, 'The FET standard defined in the BIT is an autonomous treaty standard, whose precise meaning must be established on a case-by-case basis,' going on to describe certain thresholds and factors the tribunal would need to examine in order to define the standard.[621] It described the precise scope of the standard against certain other factors of the host state, stating,

> 'The evaluation of the State's action cannot be performed in the abstract and only with a view of protecting the investor's rights. The Tribunal must also balance other legally relevant interests, and take into consideration a number of countervailing factors, before it can establish that a violation of the FET standard, which merits compensation, has actually occurred:
>
> - the State's sovereign right to pass legislation and to adopt decisions for the protection of its public interests, especially if they do not provoke a disproportionate impact on foreign investors;
> - the legitimate expectations of the investor, at the time he made his investments;
> - the investor's duty to perform an investigation before effecting the investment;

[619] Lemire (Decision on Jurisdiction) (n 616) Para 239.
[620] Ibid Para 267.
[621] Ibid Para 284.

- the investor's conduct in the host country.'[622]

The tribunal recognized Ukraine's situation affecting its 'smooth and effective system of government,'[623] but did not consider these factors in determining liability and therefore found the state liable for violating the FET standard.

Dr Jürgen Voss dissented,[624] criticising the majority's application of the FET standard, which he considered overly broad. He argued that this interpretation would have harmful consequences for host countries, particularly as applied to review the tender process.[625] He referenced Para 3 of the Annex to the BIT, which included a provision reserving their right to deviate from the national treatment obligation in circumstances relating to certain activities, which included radio broadcasting.[626] Dr Voss felt this provision should have defeated the claimant's allegation of breach of FET.[627]

6.2.g Lemire (Award)

While the tribunal did not consider Ukraine's transitional status in determining its liability[628], *Joseph Charles Lemire vs. Ukraine (Award)*[629] does address the developmental stage and economic characteristics of the host country in relation to damages. The claimant had proposed a methodology which the US National Association of Certified Valuation Analysts (NACVA) had developed to determine the discount rate to be

[622] Ibid Para 285.
[623] Ibid Para 239.
[624] Dissenting Opinion of Dr Jürgen Voss in Lemire (Decision on Jurisdiction) (n 616) < http://italaw.com/sites/default/files/case-documents/ita0455.pdf> accessed 22 August 2014.
[625] Ibid Paras 115–120.
[626] Ibid Paras 129–130.
[627] Ibid Para 132.
[628] Lemire (Decision on Jurisdiction) (n 616).
[629] Joesph Charles Lemire vs. Ukraine, ICSID Case No. ARB/06/18, Award, 28 March 2011.

applied in the case, under the discounted cash flow (DCF) model.[630] In financial terms, DCF values a project/investment based on the concept of the time value of money. To implement, the user estimates all cash flow projections and discounts them to ascertain the present value of the project/investment. The discount rate typically reflects the project/investment's risk.

The tribunal deemed DCF model only appropriate to 'domestic' situations, observing,

> 'is appropriate to value companies in the US and possibly in other developed nations. It does not however, reflect country risk, i.e. the fact that the same company, situated in the US or Ukraine, is subject to different political and regulatory risks; to reflect this difference, *ceteris paribus* the discount rate in Ukraine must be higher (and the valuations lower) than the US. The NACVA approach does not acknowledge this difference, while the Damondaran methodology includes a specific item to reflect country risk and thus is to be preferred.'[631]

This reference to 'country risk' implicitly incorporated Ukraine's particular position. The tribunal elected instead to rely on assumptions[632] that, it acknowledged, 'must be checked, applying tests of reasonableness'.[633] The assumptions included the 'risk environment' in which the investor Mr Lemire invested and the tribunal observed that,

> 'Mr Lemire was not a passive investor in a mature market. He had the courage to venture into a transitional State and to create from scratch a completely new business. *Transitional economies need such investors, who take considerable risks and commit themselves with great energy, notwithstanding the absence of clear recovery horizons.*

[630] Gritsenko (n 85) 350. Also see e.g. Lemire (Award) (n 629) Paras 216–226.
[631] Lemire (Award) (n 629) Para 280.
[632] Ibid Para 249.
[633] Ibid.

> Such investors come and go, many of them risking and losing everything because their idea was not sound, or they were too quickly discouraged, or the venture turned out to require greater resources than what they were able to mobilise. When they lose, they have no right to compensation. Legal liability by the host state arises only if the duties of legal investment protection have been breached, and is transformed into monetary recovery only when there has, in consequence, been an appreciable loss.'[634] [Emphasis added]

In light of this, the tribunal set out to determine an amount of compensation that would be 'a fair reflection of the actual loss, reasonably proportional to the investment.'[635] It observed that the investor in this case is 'not to be equated with a US investor'[636] and that there was 'indeed an adequate proportionality'[637] in that Lemire had invested 'not in cash alone but in a combination of cash, risk-taking, personal commitment, and the essential contribution of a path breaker.'[638] This case differs from *Genin* and *Generation Ukraine* not only in that it did not involve a dismissal of claims, but also in that the tribunal emphasised investors' duty to know the responsibilities attached to investing in that country. As a 'path breaker,' rather than a mere investor, the tribunal deemed Lemire should have been aware of the host country's particular circumstances.[639] The distinction between the Tribunal on Jurisdiction and Liability and the Tribunal on Award's approach to the same dispute against Ukraine was that they had different approaches to the issue of the host country as a country in transition suggests that the tribunal considered that these issues only relevant when calculating the damages. This is

[634] Ibid. Para 303.
[635] Ibid Para 304.
[636] Ibid Para 305.
[637] Ibid Para 306.
[638] Ibid.
[639] Gritsenko (n 85) 351.

surely an inadequate approach of the tribunal in response to the host country's transitory status.

6.2.h Alpha

In 2001, the Austrian real estate investor company Alpha Projectholding GmbH entered into an agreement with the Ukrainian state-owned enterprise in Kiev to renovate and reconstruct a hotel named Hotel Dnipro. In *Alpha Projectholding GmbH vs. Ukraine,*[640] Alpha brought an action against Ukraine for breach of various clauses under the Austria–Ukraine BIT,[641] including the FET obligation in relation to the failure of the project. Alpha claimed that the agreement entitled it to participate in the operation of the business of the hotel as well as to receive monthly income distributions. It alleged that during the period of 2001–2007, Ukraine's actions had resulted in loss to the investor company and their rights attached to it.

The tribunal found that the interference by the government into the contractual relationship between the claimant and the hotel had violated the investors' legitimate expectation and the FET obligation under the treaty. It observed that,

> 'As stated by the *Vivendi* tribunal, the fair and equitable treatment standard is an "an objective standard." As stated in an UNCTAD report, "where the fair and equitable standard is invoked, the central issue remains simply whether the actions in question are in all the circumstances fair and equitable or unfair and inequitable." This means, in part, that governments must avoid arbitrarily changing the rules of the game in a manner that undermines the legitimate

[640] Alpha Projectholding GmbH vs. Ukraine, ICSID Case No. ARB/07/16, Award, 8 November 2010.
[641] Austria–Ukraine BIT, November 8 1996.

expectations of, or the representations made to, an investor.'[642] [Footnotes in the original text omitted]

The tribunal did not discuss Ukraine's particular capabilities and conditions or its socio-political context as a country transitioning from communism to a market based economy; it only observed that 'the Claimant was investing in Ukraine at a time of great political, legal and commercial uncertainty.'[643]

While the tribunal did not engage in any further discussion of the impact and influence of these uncertainties, it appears these factors influenced its determination of the rate of interest. Rather than acceding to the claimant's request to base the interest rate on the twelve-month London Interbank Offered Rate (LIBOR)[644] rate and compound annually, the tribunal sought a 'more appropriate rate.' It stated, the 'risk-free rate plus market risk premium…better reflects the opportunity cost associated with Claimant's losses, adjusted for the risks of investing in Ukraine.'[645]

The tribunal provided no further explanation, which makes it a more worrying case in terms of the socio-political context of the host developing country. While it implicitly acknowledged the risks involved in investing in a country like Ukraine, it did not describe how it assessed those risks, even though it had not acknowledged these risks in relation to liability. In the absence of direct discussion of the socio-political contextual

[642] Alpha (n 640) Para 420.
[643] Ibid Para 320.
[644] The leading banks in London use the London Interbank Offered Rate (LIBOR) to estimate the average interest rate that they would be charged if borrowing from other banks. For an overview of LIBOR see e.g. Riccardo Robonato, *Modern Pricing of Interest Rate Derivatives: The LIBOR Market Model and Beyond* (Princeton University Press 2002).
[645] Alpha (n 640) Para 514.

background of the dispute, the award provides little guidance, and a troubling precedent, for future tribunals dealing with countries in transition.

6.2.i Kardassopoulos

The tribunal in *Kardassopoulos and Fuchs vs. Georgia*[646] discussed its interpretation of the FET standard at length. In this case the claimants, Ionnis Kardassopoulos and Ron Fuchs, Greek and Israeli investors respectively, were the co-owners of Tramex International Oil Company. In 1992, they invested in Georgia in a thirty-year joint venture project GTI with the state owned Georgian Oil Company for a concession over Georgia's main oil pipeline. In 1996 Georgia terminated the concession contract and formed a governmental commission to compensate the investors. However, by 2004 the state had made no compensation and a new governmental commission concluded that the investors were not entitled to any compensation. Mr Kardassopoulos proceeded against Georgia for breaching the expropriation and FET standards under the Georgia–Greece BIT,[647] and under the Energy Charter Treaty (ECT); Mr Fuchs proceeded only under the Georgia–Israel BIT.[648] The same tribunal adjudicated the proceedings jointly. Georgia asked for an exemption from its FET obligation on the grounds of the economic and political situation that prevailed during the period, heavily relying on *Parkerings*.[649]

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[646] Kardassopoulos and Fuchs vs. Georgia, ICSID Case Nos. ARB/05/18 and ARB/07/15, Award, 3 March 2010.
[647] Georgia–Greece BIT, 3 August 1996.
[648] Georgia–Israel BIT, 19 June 1995 <http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/InternationalAgreements/IP14.pdf> accessed 22 August 2014.
[649] See e.g. Kardassopoulos (n 646) Para 420.

The tribunal discussed the FET standard comprehensively;[650] however, it did not address Georgia's claim that investors could not reasonably expect a stable political environment during its transition from the Soviet era,[651] although this condition had a direct relation to the stability of its political environment. The tribunal found that Georgia had breached the FET obligation, a finding that considering the host country's transitory status might have been affected.

6.3 Conclusion

Tribunals dealing with countries in transition generally acknowledge the struggles and difficulties these host countries face in the process of transition from communism to market based economies to some degree. The *Parkerings* award emphasised investors duty to adjust their legitimate expectations in light of the inherent risks associated with these countries,[652] but the remaining representative awards discussed in this chapter are inadequate in their approach to countries in transition. The tribunal in *Lemire (Decision on Jurisdiction and Liability)* did not consider the developing and transitory status of the host country. Though the *Lemire (Award)* adopted certain methodologies to calculate compensation which better reflected the country risk. The *Alpha* tribunal was implicitly influenced by these factors but failed to address the gravity of the issue. In this connection it is pertinent to refer to Kriebaum who thinks that,

> 'Confronted with a need to take into account the special situation prevailing in a developing country, a tribunal should first investigate whether it can do so in the decision on liability by using the existing flexibility in the substantive standards.

[650] See e.g. Ibid Paras 428–452.
[651] Ibid Paras 419–420.
[652] In this connection a particular *dictum* from *Maffezini* is worth mentioning. *Maffezini* involved the actions of developed host country Spain, but the tribunal emphasised that 'Bilateral Investment Treaties are not insurance policies against bad judgments.' See e.g. Maffezeni (n 120) Para 64. Similar expression given in MTD Equity citing Maffezini, see e.g. MTD Equity (n 119) Para 178.

> If this is not possible, it can still address this need at the level of compensation'.[653]

However from the awards discussed in this chapter it does not appear that the majority of the tribunals have considered the special situation of the host developing country in a systematic manner to draw any conclusion as to why they have not considered this pivotal fact in the liability phase or in other awards, only in the compensation phase without giving sufficient reasons.

The tribunal in *Nagel* did make some useful observations on investor responsibility in investing in a country in transition. It acknowledged the 'factual background' of the dispute. Namely the state's transition and its struggle to cope with the new system, but its dismissal of the claimant's invocation of the BIT blocked further engagement with these issues. The tribunal in *Tokios Tokelés*, similarly, engaged with the transitory background of the host state and rejected all the claims investors had forwarded, but unfortunately did not engage in any discussion as to whether the socio-political context had any impact upon the alleged breach of investment protection standards. The tribunal in *Kardassopoulos* adopted an approach inconsistent with the other tribunals in relation to countries in transition; it did not make any observation as to the plea Georgia raised that its social and political transition exempted it from its FET obligation.

The awards discussed in this chapter do not provide consistent guidance for future tribunals as to the relevance of the particular conditions of the countries in transition to determine the legitimate expectation of investors in those countries as part of the FET standard. While they represent a spectrum of approaches towards countries in

[653] Kriebaum, 'Are Investment Treaty Standards Flexible Enough to Meet the Needs of Developing Countries' (n 85) 339.

transition, as a group the current tribunals have not assigned this important contextual background of disputes in those countries due weight.

Chapter 7

Current Arbitral Practice Relating to Economic Crises in Host Developing Countries: The FET Standard in Context

7.1 Introduction

This chapter will discuss arbitral awards in which the investment disputes arose as a result of a host developing country's actions to address an economic crisis. Foreign investors alleged that the actions and measures taken in response to the economic crisis had violated FET and other investment protection standards. It will discuss how the tribunals addressed the issue and whether they took this particular economic context into account. Most of the cases concern Argentina; due to the numerous disputes accusing the country of breaching the FET standard which came before investment tribunals following the country's 2000–2001 economic crisis,[654] the worst in its history.[655] Therefore the discussion in this chapter is largely dominated by the disputes against Argentina. The *Economist* described Argentina's collapse as 'a decline without parallel' and 'an economic collapse to match the Great Depression of the 1930s'.[656]

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[654] See, e.g., Paolo Di Rosa, 'The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties: Background and Principal Legal Issues' (2004) 36 The Universtiy of Miami Inter-American Law Review 41; William W Burke-White, 'The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System' in Michael Waibel, Asha Kaushal, Kyo-Hwa Liz Chung and Claire Balchin (eds.), *The Backlash Against Investment Arbitration* (Kluwer Law International 2010) 407; James Harrison, 'Human Rights Arguments in Amicus Curiae Submissions: Promoting Social Justice?' in Ernst-Ulrich Petersmann Pierre-Marie Dupuy, and Francesco Francioni (eds), *Human Rights in International Investment Law and Arbitration* (Oxford University Press 2009) 396, 398; José Alvarez and Kathryn Khamsi, 'The Argentine Crisis and Foreign Investors: a Glimpse into the Heart of the Investment Regime' in Karl P Sauvant (ed), *Yearbook on International Investment Law and Policy* (Oxford University Press 2009) 397.

[655] See, e.g., J F Hornbeck, 'The Argentine Financial Crisis: A Chronology of Events' <http://fpc.state.gov/documents/organization/8040.pdf> accessed 1 May 2014; Martin Feldstein, 'Argentina's Fall' (2002) 81(2) Foreign Affairs 8. Also see Chapter 1 in 1.2.2 Developing Countries in Investment Dispute Arbitration 5.

[656] 'A decline without parallel-Argentina's collapse' *The Economist* (2 March 2002); 'Liberty's Great Advance' *The Economist* (28 June 2003).

Argentina has faced more disputes than any other host developing country in the world, not least because foreign investors considered it very investor-friendly prior to the crisis, due to a number of initiatives its government had taken. By November 2002 more than half the population of the country was living in poverty.[657] Against this contextual background by 2006 more than thirty investment arbitration claims were pending against Argentina.[658] The total value of the claims, approximately 17 billion US dollars, is almost the entire budget of the national government.[659] According to the ranges of development index at that particular moment Argentina fell within the category of a developing country.[660] As this chapter will describe, the tribunals did not generally view these issues as reasons to exempt the country from liability or moderate the amount of compensation awarded to foreign investors.

Part 7.2.A will discuss the impact of economic crises upon developing countries and hence their significance in investment disputes. Part 7.2.B will discuss disputes that arose out of economic turmoil in Argentina as well as in Mexico, Indonesia, and Paraguay.

7.2.A Economic Crisis and its Impact upon Developing Countries

This thesis argues that tribunals should take economic crises in developing host countries into account because of the limited resources available and capability of the

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[657] Harten, *Investment Treaty Arbitration and Public Law* (n 1) 2.
[658] Ibid 2.
[659] Ibid.
[660] See e.g. Dev Kar and Devon Cartwright-Smith, 'Illicit financial flows from developing countries: 2002–2006' <http://works.bepress.com/cgi/viewcontent.cgi?article=1001&context=dev_kar&sei-redir=1&referer=http%3A%2F%2Fscholar.google.co.uk%2Fscholar%3Fhl%3Den%26q%3Dlist%2Bof%2Bdeveloping%2Bcountries%2B2002%26btnG%3D%26as_sdt%3D1%252C5%26as_sdtp%3D#search=%22list%20developing%20countries%202002%22> accessed 4 May 2014; UNCTAD, 'The Least Developed Countries Report 2002: Escaping the Poverty Tap' <http://unctad.org/en/docs/ldc2002_en.pdf> accesssed 23 July 2014.

host developing countries to manage such crises. These countries' efforts to manage economic crises largely depend upon their resources and level of development. In particular, developing (and transitioning) countries tend to experience more severe impact as a result of economic crises than developed countries as their governments with limited resources struggle to alleviate the devastation caused by the crisis.

Several studies of the global economic crisis over the last decade show that the global recession affected the world's poor countries more severely than richer countries,[661] which has impacted upon them in a number of ways. As a study by ActionAid states, 'Although developing countries didn't make this crisis, it has become all too clear that they are in the firing line when it comes to suffering its effects.'[662] The effects of economic crisis are particularly severe in such countries.[663] The global economic crisis of 2007–2008 has led to a real drop in financial flows and export earnings in some developing countries,[664] and the economic turmoil had an impact upon the equities market.[665] The ActionAid study describes the severity of the crisis in the following terms: 'what is clear [is] that developing country losses from a crisis that started in the developed world are real and significant, and will be compounded as time goes on by the impact on the domestic economy within developing countries'.[666] Economic crises also cause a reduction in government revenues, taxes and borrowings.[667]

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[661] See, e.g., 'Feeling the pinch: impacts of the financial crisis on developing countries' <http://panos.org.uk/resources/feeling-the-pinch-impacts-of-the-financial-crisis-on-developing-countries/> accessed 1 May 2014.
[662] ActionAid, 'Where does it hurt' The impact of the financial crisis on developing countries' 1 <http://www.actionaid.org.uk/sites/default/files/doc_lib/where_does_it_hurt_final.pdf> accessed 1 May 2014.
[663] Ibid 6 and 8.
[664] See e.g. Peter Thal Larsen, 'Capital flows to developing world at risk of collapse' <http://www.ft.com/cms/s/0/6fab9488-ecbf-11dd-a534-0000779fd2ac.html#axzz31bddS6jO> accessed 5 May 2014. Also see, e.g., ActionAid 'Where does it hurt' (n 662) 4–6.
[665] Action Aid (n 662) 5.
[666] Ibid 6.
[667] Ibid.

In relation to international investment, the ActionAid study finds that 'preliminary results imply that in many developing countries the exposure to international trade – their dependence on export revenues, level of concentration of exports, trade balance and reserves – is the biggest factor in their vulnerability to the crisis.'[668] An IMF survey of the 2007–2008 global recession argues that the global impact of the resulting economic crisis upon developing countries is likely to be more serious and more long-term than the impact of recession itself.[669] The study notes that, in increasing their vulnerability to economic crisis, developing countries are also likely to have increased their risk of exposure to more serious recessions.[670] Indeed, Griffith-Jones and Ocampo show that the recession, which began in the developed world, had multiple negative impacts in developing countries, including sharp falls of FDI in those countries,[671] and that emerging markets, which are more integrated into the international private capital markets than established ones, experience the impact of the global economic crisis more severely.[672] They argue that history suggests that past experiences of economic crises are in fact inevitable in developing countries' deregulated financial systems.[673] Therefore, the systematic risk inherent in the financial system poses a greater risk.[674] In other words, as the IMF survey indicated, developing countries are more vulnerable to economic crisis.

The ActionAid study demonstrated that different countries experience economic crises differently,[675] but that 'the crisis will be severe in every [developing] country, both for

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668 Ibid 7.
669 See, e.g., World Economic Outlook, October 2008, 'Financial Stress and Economic Downturns' Chapter 4 (IMF 2008) <http://www.imf.org/external/pubs/ft/weo/2008/02/pdf/text.pdf> accessed 23 July 2014.
670 Ibid.
671 Stephany Griffith-Jones and José Antonio Ocampo, *The Financial Crisis and its Impact on Developing Countries*, Working Paper No 53 (International Policy Centre for Inclusive Growth 2009) 1–2.
672 Ibid 6.
673 Ibid 12.
674 Ibid.
675 The study particularly described the range of experiences of South Africa, India, Brazil, and China. Action Aid (n 662) 9.

people immediately affected, and for long-term development prospects'[676], and will include such phenomena as unemployment, reduced state spending, increasing poverty and, eventually, increasing mortality.[677] It noted, 'the comparisons here are all about degrees of disaster, and capacity to bounce back from disaster, and don't imply that any country can escape the shocks all together'.[678] While this study was conducted in the aftermath of the 2007–2008 global financial crisis, its apprehensions reflect the conditions developing countries continue to face.

Another study by Oxfam conducted to assess the human impacts of the economic crisis in eleven countries[679] shows that the global economic crisis hit the poor countries through a number of transmission channels but each at 'different speeds and intensities'.[680] The extent of the impact depended on their integration into global financial markets, their dependence on FDI or their dependence on developed countries for aid, trade, and remittance.[681] The study also found that though the impacts in different regions will be of different kinds, nevertheless all regions are definitely going to be impacted by the global economic crisis.[682]

Another study conducted by the Overseas Development Institute (ODI) shows that many developing countries and especially small and African countries are ill-equipped to face another crisis.[683] It describes the global economic crisis of 2007–2008 as having

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[676] Ibid 11.
[677] Ibid 10.
[678] Duncan Green, Richard King and May Miller-Dawkins, 'The Global Economic Crisis and Developing Countries' Oxfam Research Report, (Oxfam Inernational 2010) 7–8.
[679] Ibid.
[680] Ibid 54.
[681] See e.g., 'Feeling the pinch: impacts of the financial crisis on developing countries' (n 661).
[682] Green, King and Miller-Dawkins The Global Economic Crisis and Developing Countries' (n 678) 4.
[683] Dirk Willem Te Velde and others, *The Global Fnancial Crisis and Developing Countries: ODI Background Note* (Overseas Development Institute 2008) 2.

financial implications in developing countries[684] with effects that included declines in remittances, pressure on FDI and equity investment, pressure on commercial lending, the risk of defaulting on debt, declines in aid budget and also pressure on capital adequacy ratios of development finance institutes.[685] The study concludes that, while these effects varied from country to country, the economic impact of crisis in the future could also include 'weak export revenues, further pressure on current accounts and balance of payment, lower investment and growth rates, lost employment' and also social impacts like 'lower growth translating into higher poverty, more crime, weaker health systems and even more difficulties meeting the Millennium Development Goals.'[686]

A study conducted by Naomi Hossain describes the social impact of the economic crisis.[687] After the 2007–2008 crisis the World Bank's chief economist for Africa predicted that the economic crisis would imperil the lives of many children.[688] The Oxfam study describes wage freezes and reductions in working hours in developing countries.[689]

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[684] Ibid 3.
[685] Ibid 4.
[686] Ibid.
[687] In her study Hossain analyses how the economic crisis has affected communities in five developing countries—Bangladesh, Indonesia, Jamaica, Kenya, and Zambia. These affects, which including rising crime rates, are matters of serious social concern which can lead to widespread insecurity in the community and also can give rise to issues of national concern. For example she cites the food riots in Haiti due to the economic crisis. See e.g. Naomi Hossain, 'Crime and Social Cohesion in the Time of Crisis: Early Evidence of Wider Impacts of Food, Fuel and Financial Shocks' (2009) 40(5) Institute of Ddevelopment Studies Bulletin 59.
[688] See e.g.<http://blogs.worldbank.org/africacan/a-sub-prime-crisis-in-the-us-and-infant-deaths-in-africa> accessed 27 July 2014. Also see e.g. Jed Friedman and Norbert Schady, *How Many More Infants Are Likely To Die In Africa As A Result Of The Global Financial Crisis?* World Bank Policy Research Working Paper No.5023 (August 2009) <http://siteresources.worldbank.org/INTAFRICA/Resources/AfricaIMR_FriedmanSchady_060209.pdf > accessed 10 September 2014.
[689] Green, King and Miller-Dawkins The Global Economic Crisis and Developing Countries' (n 678) 4.

Economic crises have direct and indirect linkage to a host country's poor administrative and infrastructural capabilities,[690] and many of the claims against Argentina as a result of its severe economic crisis addressed administrative capacity. Investor protection by a state requires administrative and legal capacity; economic crises tend to weaken these mechanisms,[691] and raise the risk that an administrative and legal system will treat foreign investors in a way that they perceive to be unfair. Here again the legal question is whether foreign investors can legitimately expect that a developing host country will provide the same protection as a developed one. So far, investment tribunals have largely concluded that they can.

7.2.B Arbitral Awards involving Economic Crises

This part discusses selected awards to demonstrate the full range of approaches investment tribunals have taken when an economic crisis was clearly a relevant contextual background to the dispute. Most reflect a refusal to consider economic crises in host developing countries; as well as the inconsistent approaches adopted by different tribunals on some substantive issues which all raise concerns for developing countries in the future. This part will first discuss the Argentine economic crisis cases in chronological order with a view to demonstrate the flow of analysis of the tribunals which were dealing with the disputes that arose out of the similar legal and factual context and also to see to what extent earlier findings of the tribunals have influenced the later tribunals dealing with the same issues. It will then discuss three other cases in other countries involving similar economic crises situations which occurred prior to the Argentine crisis. Due to the recent numerous awards against Argentina, which raised

[690] Gallus (n 124) 719.
[691] Ibid.

concern for the host developing countries (discussed in chapter 1), this part prioritises the Argentine cases.

7.2.B.a CMS

CMS vs. Argentina,[692] is the most discussed Award which demonstrates various inconsistencies in the Tribunal's approach to dealing with the severe economic crisis in Argentina. The tribunal found a breach of the FET standard, which Argentina challenged before the *ad hoc* Committee.[693] The *ad hoc* Committee found fault in various aspects of the Tribunal's Award such as 'manifest errors of law' and that it 'suffered from lacunae and elisions,'[694] and therefore annulled the decision but not the award.[695] Therefore the Award and findings rendered by the tribunal prevail in effect.

In this case the US company CMS held a 30 per cent share in Transpotadora de Gas del Norte (TGN), a private Argentinean gas company. The Argentine government encouraged privatisation in the energy sector through various initiatives, including the convertibility law allowing TGN to calculate tariffs in US dollars and convert them into pesos at the prevailing exchange rate at the beginning of 1989. This superseded the previously existing system which introduced gas tariffs to be calculated in US dollars and adjusted twice a year based on the United States Producer Price Index (US PPI). When Argentina encountered economic difficulties in the late 1990s, the government met with the gas companies, and they agreed that the adjustment of the tariffs would be temporarily suspended. As the economic crisis worsened, Argentina extended the

[692] CMS (n 119).
[693]CMS Gas Transmission Company vs. The Argentine Republic, ICSID Case No. ARB/01/8 (Annulment Proceeding) Decision of the Ad hoc Committee on the Application for Annulment of the Argentine Republic, September 25 2007.
[694] See e.g., Ibid Para 158.
[695] Ibid.

arrangement indefinitely. In response to the most severe economic crisis in its history, the government of Argentina further enacted the Emergency Law No. 25.561 on 6 January 2002,[696] which eliminated the practice of pegging the value of the peso to the US dollar, resulting in the devaluation of the peso. The legislation also provided for different industries to have different exchange rates, but provided no special treatment for gas export or transportation tariffs. It also created a new process for negotiating licence agreements for industries outside of the gas sector.

CMS claimed that the Emergency Law and the continuation of the tariff freeze decreased TGN's tariff revenue by 75 percent, and that CMS's investment in TGN therefore lost 92 percent of its value. With decreased revenue, TGN was unable to honour its loans, which totalled USD 590 million.[697] CMS further claimed that the government laws and regulations had artificially depressed gas prices, thereby providing an 'effective subsidy benefiting the rest of the Argentine economy'.[698] Finally CMS claimed that Argentina had violated the FET and other investment protection standards under the US Argentina BIT.[699] CMS claimed compensation of USD 261.1 million.[700]

In its response Argentina argued that the licence agreements with TGN did not constitute a guarantee against financial losses, but only provided for the right of the licensee to a fair and reasonable tariff encompassing costs of operation, taxes,

[696] In the event of its most severe financial crisis in its history Argentina had to issue the Emergency Law No. 25,561 of 6 January 2002 which provided '(i) abolish the currency broad that had linked Argentine peso to the U.S. dollars, resulting in a significant depreciation of the Argentine peso; (ii) abolished the adjustment of the public service contracts according to agreed upon indexations; and (iii) authorize the Executive branch of government to renegotiate all public service contracts.'
[697] CMS (n 119) Para 171.
[698] Ibid Para 72.
[699] Ibid Para 88. US–Argentina BIT, 14 November 1991. <http://unctad.org/sections/dite/iia/docs/bits/argentina_us.pdf> accessed 16 July 2014.
[700] CMS (n 119) Para 89.

amortizations, and a reasonable return on investments.[701] It further argued that the Argentine government implemented the measures to which CMS objected in order to regulate a matter of national importance.[702] It claimed discretion to regulate gas tariffs, and that 'public considerations' had prompted its actions.[703] Argentina further argued CMS had undertaken a risk that domestic policies would change in response to a serious economic crisis and that Argentina could not be liable for CMS's financial losses.[704] Argentina raised the defence of necessity and stated that claims by individuals or corporations could not supersede its right to invest in the country.[705] It invoked the actions of countries such as the United States, who took such emergency measures during economic crises to devaluate their currencies, for example, during the economic crisis in the 1930s, in accordance with national and international law.[706]

In relation to the economic crisis, which also gave rise to a political and social crisis, the tribunal observed,

> 'There is a broad agreement on the fact that Argentina was affected by a deep crisis of an economic, social and political nature. The *downturn in the economy commencing in 1999, the rising levels of poverty, and the rapid turnover of politicians occupying the highest offices in the nation, coupled with social upheaval and civil disobedience, was dramatic reality*.…These developments have been deplored by the Claimant. Needless to say, also *the Tribunal has the greatest sympathy for the plight of the Argentine*

[701] Ibid Para 91.
[702] Argentina argued that regulation of the distribution and transportation of gas constituted regulation of a 'national public service which must take into account particular needs of social importance.' See e.g. Ibid Para 93.
[703] See e.g. Ibid Para 93.
[704] Ibid Paras 94–97.
[705] Ibid Para 94.
[706] See e.g. Ibid Para 272.

people under the circumstances and respects its efforts to overcome the situation.'[707] [Emphasis added]

Accordingly Argentina claimed the defence of necessity for an exemption of its liability under international law and the treaty law due to the severe economic and social crisis that it was facing.[708] The Tribunal acknowledged the economic circumstances that prevailed in Argentina during that period but considered them irrelevant to the award itself.

The tribunal accepted that the collapse of Argentina's economy influenced the standard of conduct it could be expected to provide in its treatment of foreign investors. It stated, 'the Claimant cannot ask to be entirely beyond the reach of the abnormal conditions prompted by the crisis, as this would be unrealistic.'[709] It reaffirmed the point predecessor tribunals had made[710] that the investment treaties did not provide an insurance policy against business risk. It stated,

> 'The crisis had in itself a severe impact on the Claimant's business, *but this aspect must to some extent be attributed to the business risk the Claimant took on when investing in Argentina,* this being particularly the case as it related to decrease in demand. Such effects cannot be ignored as if business had continued as usual. Otherwise, both parties would not be sharing some of the costs of the crisis in a reasonable manner and the decision could eventually amount to an insurance policy against business risk, an outcome that, as the Respondent has rightly argued, would not be justified.'[711] [Emphasis added]

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[707] Ibid Para 211.
[708] Ibid Para 99.
[709] Ibid Para 244.
[710] See e.g. Maffezeni (n 120) Para 178.
[711] CMS (n 119) Para 248.

Here the tribunal stated that, the economic crisis appears to be relevant to damages; the effects of the crisis minimise the damages and Argentina cannot be expect to pay for damages that directly stem from the economic crisis and that CMS should have realised could happen. The tribunal will not provide any insurance for taking such business risk for investing in the country.

Despite these observations, the tribunal found that Argentina's conditions were not severe enough to exclude liability or to preclude the wrongfulness of Argentina's measure.[712] It further stated that,

> 'There is of course the question of the reality of the crisis that has been described. The Tribunal explained above that this reality cannot be ignored and it will not do so. The crisis, however, can only be taken into account as a matter of fact. And *facts of course do not eliminate compliance with the law but do have a perceptible influence on the matter in which the law can be applied*.'[713] [Emphasis added]

Therefore, while the tribunal placed the obligation to recognise the possibility of an economic decline on the investor, it made no move to grant a host country latitude to respond to the crisis unless it could do so without hurting the investors. The tribunal granted that the crisis had occurred, but refused to grant that the crisis might change the state's legal obligations.

In awarding compensation, however, it stated that it should consider the crisis in setting compensation. It diminished the status of the crisis, stating, '….the crisis in and of itself

[712] Ibid Para 165.
[713] Ibid Para 240.

might not be characterized as catastrophic.'[714] This admission suggests the tribunal was trying to find a middle way to address the issue. It acknowledged that the country was suffering from issues of rising levels of poverty, political instability, social unrest, and civil disorder.[715] It expressed sympathy for the crisis situation[716] but did not take into account Argentina's situation in deciding liability. The economic crisis functioned only as a factual issue in this regard.

While the tribunal signalled that it would consider the economic crisis and the difficulty the Argentine government faced in tackling the crisis, it appears it did not. In its calculation of damages owed to CMS, the tribunal applied the principle of restitution.[717] It used the discounted cash flow method to calculate the lost value of CMS's shares, which amounted to compensating CMS, not only for the lost value of its initial investment, but the value of its investment plus its profits until the date at which damages were calculated (17 August 2000).[718] It neither calculated the effect of the size of the award on the Argentine government nor calculated the diminished expectations CMS should have in light of the economic crisis. In effect it decided that the FET standard guarantees a stable economic and regulatory environment, essentially providing the substantive value of the profits from an investment.[719]

The *CMS* Tribunal heavily relied on the factual circumstances in *CME vs. Czech Republic*[720] and *Tecmed*[721] in its interpretation of FET, in spite of decidedly different facts in the cases. Neither of the disputes in *CME* or *Tecmed* arose out of a severe economic

[714] Ibid Para 356.
[715] Ibid Para 211.
[716] Ibid Para 211.
[717] Ibid Paras 399–405.
[718] Ibid Para 466–467.
[719] Mayeda (n 47) 279.
[720] CME vs. Czech Republic, Final Award, 14 March 2003, SCC (Under UNCITRAL Rules) 9 ICSID Reports 264.
[721] Tecmed (n 118).

crisis. Therefore the interpretation of FET based on *CME* and *Tecmed* should have been substantially different in *CMS*. In utilizing them, it effectively dismissed Argentina's argument that its obligation to provide investment stability could not trump the government's obligation to prevent severe poverty and social damage. It interpreted the FET standard as being able to limit the implementation of a legitimate government policy.[722]

As this chapter will describe, a number of tribunals have used *CMS* as a precedent in relation to disputes that arose out of the same Argentine economic crisis. Kreibaum has pointed out the ambiguity of the award, which does not make it clear whether the economic conditions that prevailed in Argentina, the host country, should have any influence on the threshold for the FET standard or whether the tribunal considered the breach was so egregious that it had to act.[723]

7.2.B.b CMS ad hoc Committee for Annulment Proceedings

As noted above, an *ad hoc* committee annulled *CMS,* but left its effects intact. Waibel et al argue that the observation that the Tribunal applied the law 'cryptically and defectively'[724] and that the central part of the award's legal reasoning was erroneous[725] was in fact directed at the general investment arbitration community.[726] They observe,

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[722] Trebilcock and Howse pointed this out when they commented on *Mondev.* In their words, 'the approach that tribunals have so far articulated with respect to "minimum standard of treatment" creates little risk that ordinary legitimate government action, including judicial and administrative decision making, can be impugned. To violate the minimum standard of treatment, the government's conduct must be improper to the extent that it would shock or surprise an impartial international tribunal'. See e.g. Michel J Trebilcock and Robert Howse, *The Regulation of International Trade* (3rd edn, Routledge 2005) 466.
[723] Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (n 113) 402.
[724] See e.g. CMS (Annulment Proceedings) (n 693) Para 136.
[725] Ibid Para 158.
[726] Michael Waibel and others, 'The Backlash Against Investment Arbitration: Perceptions and Reality in Michael Waibel and others (ed), *The Backlash Against Investment Arbitration: Perceptions and Reality* (Kluwer Law International 2010) xlii.

> 'The Committee's expansive commentary on that point, despite its limited mandate, seems to be directed at the general investment arbitration community. Such criticism from *within* fulfils a dual function. First, it shores up the system's legitimacy by bringing bad practices to light and opening the way of catharsis in future cases. Second, it serves as a warning shot: change course or risk putting the long-term health of the entire regime at risk.'[727]

It is unfortunate that the *ad hoc* Committee did not affirm Argentina's defence of necessity[728] or annul the damages although it[729] found fault with various aspects of the Tribunal's Award of 2005, such as 'manifest errors of law' and that it 'suffered from lacunae and elisions.'[730] As a result, the *ad hoc* Committee in the Annulment Decision ultimately fails to provide a workable approach to disputes arising from severe economic difficulty in host developing countries.

7.2.B.c LG&E (Decision on Liability)

LG&E vs. Argentina (Decision on Liability)[731] took a slightly different approach in addressing Argentina's economic crisis and plea of state of necessity. Three US companies, LG&E Energy Corp, LG&E Capital Corp, and LG&E International Inc (collectively LG&E), had invested in three Argentinian gas companies that distribute natural gas having been encouraged by the privatisation initiatives of the Argentine government in the early 1990s. LG& E was granted a licence until 2027. However the

[727] Ibid xlii.
[728] August Reinisch, 'The Proliferation of International Dispute Settlement Mechanisms: The Threat of Fragmentation vs. The Promise of a More Effective System? Some Reflections From the Perspective of Investment Arbitration' in Isabelle Buffard and others (eds), *International Law between Universalism and Fragmentation: Festschrift in Honour of Gerhard Hafner (Baetens)* (Martinus Nijhoff Publishers 2009) 118.
[729] CMS (Annulment Proceeding) (n 693).
[730] See e.g., Ibid Para 158.
[731] LG&E (Decision on Liability) (n 121).

convertibility law abrogated the guarantees provided at the time of privatisation in 2002, and the profitability of the company's gas distribution business declined sharply. LG&E alleged Argentina had violated the FET standard, umbrella clause, protection against expropriation, and also discrimination under the US–Argentina BIT.[732] The tribunal did not fully allow Argentina's claim of defence of necessity for such measures, but acknowledged that plea partially. Although the tribunal found in favour of the plaintiffs, it found that Argentina was in a state of necessity between 1 December 2001 (the date of the Decree repealing the convertibility law) and 26 April 2003[733] (the date on which the new President of Argentina took office[734]) and therefore the state should be released from international responsibility for losses that LG&E faced during this period.[735] It subtracted the losses incurred by LG&E during the period of the state of necessity from the general damages,[736] stating,

> 'This exception is appropriate only in emergency situations; and once the situation has been overcome, i.e. certain degree of stability has been recovered; the State is no longer exempted from responsibility for any violation of its obligations under the international law and shall reassume them immediately.'[737]

The Tribunal recognised the economic crisis and particular political and social circumstances when it decided on the amount of compensation,[738] which, however, was fixed at 57.4 million US dollars.[739] It accepted Argentina's plea to invoke Article XI of the US–Argentina BIT, which grants an exception for measures to maintain public

[732] US-Argentian BIT (n 699).
[733] LG&E (Decision on Liability) (n 121) Para 226.
[734] See e.g. Ibid Paras 226–258.
[735] Ibid Para 229 and 257.
[736] Ibid Para 267 (d).
[737] Ibid Para 261.
[738] See e.g. Ibid Para 139.
[739] LG&E Energy Corporation vs. Argentine Republic, ICSID Case No. ARB/02/01, Award, 25 July 2007 Para 109.

order or security,[740] and excluded Argentina from liability for breaches of the treaty during the period of the state of necessity.[741] It observed:

> 'Having found that the requirements for invoking the state of necessity were satisfied, the Tribunal considers, that it is the factor excluding the State from its liability vis-à-vis the damage caused as a result of the measures adopted by Argentina in response to the severe crisis suffered by the country.'[742]

Nevertheless, the tribunal held that the measures Argentina took had breached its FET obligation under the treaty, saying it 'went too far by completely dismantling the very legal framework constructed to attract investors.'[743] It found that the measures taken by Argentina were unfair and inequitable[744] and that Argentina had violated its FET obligation to honour the guarantees provided to the foreign investors by failing to ensure the 'stability and predictability' requirement.[745] Thus it argued providing stability of the legal and business framework is an essential element of FET.[746] It concluded that specific tariff guarantees for the gas distribution sector were aimed at achieving such stability.[747] However it outlined a caveat, that allowing that a threat to the state's existence limits the guarantee in relation to the regulatory framework: 'the stability of the legal and business framework is an essential element of fair and equitable treatment in this case, provided that they do not pose any danger for the existence of the host State itself.'[748] It observed:

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[740] Article XI of the US–Argentina BIT (n 699) states, 'This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.'
[741] LG&E (Decision on Liability) (n 121) Para 229.
[742] Ibid Para 259.
[743] Ibid Para 139.
[744] Ibid Paras 133–138.
[745] Ibid Paras (n) 127, 131 and 132.
[746] Ibid Para (n) 124.
[747] Ibid Para (n) 119.
[748] Ibid Para (n) 124.

> 'The essential interests of the Argentinean State were threatened in December 2001. It faced an extremely serious threat to its existence, its political and economic survival to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace.'[749]

Here the tribunal admits that necessity affects the FET obligation. It noted the difficulty if defining the FET standard due to its generic nature and its changing interpretation in the course of time and depending on the circumstances of the dispute.[750]

On the question of compensation of investors for losses during the state of necessity, the tribunal resorted to Article 27 of the Draft United Nation's Articles on Responsibility of States for Wrongful Acts 2001. Article 27 does not address whether any compensation was payable to the party affected by the losses, and it also does not specify the kind of losses that could be compensable or the circumstances in which compensation should be payable.[751] Therefore it appears to be doubtful whether a foreign investor can qualify for compensation under Article 27 and thereby the tribunal's contention in this regard becomes unconvincing.

LG&E established the existence of an emergency, which seems relevant to the interpretation of what is fair and equitable in a given situation. What is fair and equitable in a state of emergency might thus differ from what is fair and equitable in the normal

[749] Ibid Para 257.
[750] Ibid Para (n) 123.
[751] Article 27 of the Draft Articles on Responsibility of States for Wrongful Acts states, 'The invocation of a circumstance precluding wrongfulness in accordance with this chapter is without prejudice to (a) Compliance with the obligation in question; if and to the extent that the circumstance precluding wrongfulness no longer exists; (b) The question of compensation for any material loss caused by the act in question.'

course of business.[752] It acknowledged the importance of necessity in interpreting FET when it took the severe economic crisis and state of necessity into account.

In a specific departure from *CMS,* the tribunal did consider the issue of state responsibility. Despite the similarities in fact and law between *CMS* and *LG&E*, the Tribunals reached opposite conclusions on assessing the extent of the state of necessity.

Kriebaum argues that *LG&E* applies an 'unspecified reduced FET.'[753]Such unspecified reduction in the standard might raise concern for developing countries. As this does not allow the developing countries to understand under what conditions the standard would be reduced in future and predict the scope of the FET standard. Schill criticises that *LG&E* gives a host country almost unfettered flexibility to change any policy, given that the state is the only authority to decide whether such measures are the 'only way' to protect the national interest.[754] He further opines that by analysing this requirement on the basis of burden of proof, the *LG&E* award leaves host countries too much scope. Generally a party relying on an exception bears the burden of proof; *CMS* took this approach. *LG&E* reverses this rule; Schill thinks that this was done with 'tenuous

[752] In both CMS (n 119) and LG&E (Decision on Liability) (n 121) the Tribunals disagree on the issue of burden of proof concerning exceptions to the state of necessity, in particular the question as to whether the investor or host state must prove that less restrictive measures could not have been taken and that the host state did not contribute to this crisis. For a detailed discussion on the issue of state of necessity see e.g. Waibel, 'Two Worlds of Necessity in ICSID Arbitration: CMS and LG&E' (n 125); Forji (n 125); Stephan W Schill, 'International Investment Law and the Host State's Power to Handle Economic Crises –Comment on the ICSID Decision in LG&E v. Argentina' (2007) 24 Journal of International Arbitration 265; Argañarás, 'CMS Gas Transmission Company v. The Republic of Argentina – The Defense Raised by Argentina' (n 125); G Falkof, '"State of Necessity" Defence Accepted in LG&E v. Argentina ICSID Tribunal' (2006) 3 Transnational Dispute Management; LF Castillo Argañarás, 'The State of Necessity as International Defense Raised by a State Undergoing a Financial Crisis. A Case Study' (2007) 4 Transnational Dispute Management.

[753] Kriebaum, 'Are Investment Treaty Standards Flexible Enough to Meet the Needs of Developing Countries' (n 85) 335.

[754] See e.g. Schill, 'International Investment Law and the Host State's Power to Handle Economic Crises – Comment on the ICSID Decision in LG&E v. Argentina' (n 752).

justification'.[755] He fears that *LG&E* invites abuse by the state of the classification of a state of necessity.

However, states do have that latitude of inherent sovereign power to self-judge its state of necessity. No one outside the state machinery or the investment tribunals is in a position to evaluate a country's macroeconomic policies under a state of necessity, which is very complex. If a host country wants to confiscate the rights of foreign investors it can do so by expropriation subject to certain conditions of compensation prescribed under international law, which, however, is very rare in today's world. Necessity has been accepted only in exceptional circumstances, like that of threat to the security or existence of states. The idea that it will become a principle that can be utilised by host countries to defend any policy measure they want to take is far-fetched. Therefore Schill's apprehension that host countries will abuse their right of invoking a state of necessity in the investment law context do not appear to be convincing in light of reality.

Despite *LG&E* making the defence of necessity available in terms of compensation, some scholars have already predicted that it would be looked upon as an aberration.[756] This assumption seems to be true. Apart from *National Grid PLC vs. Argentina*,[757] which also arose in a similar context, no subsequent tribunals on the Argentine economic crisis cases followed the path of the *LG&E* award. The tribunal in *National Grid* also held that Argentina was not liable for breach of FET and the losses thereby incurred by the

[755] Ibid.
[756] See e.g. Schneiderman (n1).
[757] National Grid (n 543). The British firm National Grid P.L.C invested in Argentina through two subsidiary companies Transener and Transba, in the electricity sector. This sector was also subject to the benefits under the same Peso-Dollar Convertibility laws. The National Grid also initiated proceeding against Argentina that such measures had violated amongst others the FET obligation under the UK-Argentina BIT. The Tribunal concluded that Argentina had violated the FET obligation on the grounds that it had 'fundamentally changed the legal framework on the basis of which the Respondent itself had solicited investments and the Claimant had made them.' Para 179.

investors during the first six months when the crisis started.[758] The *National Grid* tribunal also emphasised that the FET standard must be qualified in time and stated that, 'what would be unfair and inequitable in normal circumstances may not be so in a situation of an economic and social crisis.'[759] The majority of the subsequent awards against Argentina did not recognise the economic crisis as the basis for a defence of necessity or a ground to exempt the host country from liability either fully or partially.

Though there is no scope for precedent in international Investment Tribunals, the ICSID Tribunals often rely on persuasive authority from previous awards. Therefore two aspects of the *LG&E* decision are particularly striking. Firstly it mentions *CMS* only once,[760] and not in relation to necessity. It undertakes no explanation as to why the tribunal differs from the *CMS* tribunal, although both the tribunals consider the same economic crisis, the same facts, the same convertibility law, and the same BIT and it was adjudicated eighteen months later. Secondly, the ICJ Judge Francisco Rezek served as Argentine appointed Arbitrator in both cases. *LG&E* should clearly have referred more extensively to *CMS* and specifically stated why it came to different conclusions. Reinisch observes that in fact both the *CMS* and *LG&E* Tribunals 'disregarded less about the interpretation of the law of state responsibility than on the qualification of the actual facts'.[761] He notes,

> 'While it may be understandable that reasonable persons disagree about such fundamental issues like whether an economic crisis amounted to a state of necessity in international law, it is hardly understandable that the tribunal

[758] Ibid Paras 179–180.
[759] Ibid Para 180.
[760] LG&E (Decision on Liability) (n 121) Para 125. The only reference to CMS (n 119) in LG&E is in the discussion of FET.
[761] August Reinisch, 'The Proliferation of International Dispute Settlement Mechanisms: The Threat of Fragmentation vs. The Promise of a More Effective System? Some Reflections From the Perspective of Investment Arbitration' (n 728) 118.

deciding such an important issue disregarded the findings of a previous tribunal.'[762]

Neither tribunal provided clear justification for their reasoning. This split on the application of the necessity plea is deeply worrying for international investment law as well as a matter of concern for the host developing countries, given their vulnerability to economic crisis.[763] This inconsistency and split further undermines legal certainty and fuels concerns about the legitimacy and integrity of the whole system of investment treaty arbitration as well as being alarming for host developing countries (discussed in chapter 8).

7.2.B.d Enron

Enron vs. Argentina[764] arose from the same legal changes in the convertibility laws as *CMS* and *LG&E*. The two US companies, Enron Corporation and Ponderosa Assets LLP, both US companies, held an indirect equity interest in the Argentine gas transportation company TGS. The Tribunal found a violation of the FET standard under the US–Argentina BIT on the basis that a 'stable legal framework for the investment'[765] was a key element of the FET standard and that Argentina had breached it.[766] Argentina contended that it had repealed the convertibility law in the public interest. It charged the claimants had the knowledge of country risk and cannot 'pretend

[762] Ibid. Also see e.g., August Reinisch, 'Necessity in International Investment Arbitration – An Unnecessary Split of Opinions in Recent ICSID Cases – Comments on CMS v. Argentina and LG&E v. Argentina' (2007) 8 The Journal of World Investment and Trade 191.
[763] ActionAid 'Where does it hurt' (n 662); 'Feeling The Pinch: Impacts of the Financial Crisis on Developing Countries' (n 661); Griffith-Jones and Ocampo (n 671); Te Velde and others (n 683); Green, King and Miller-Dawkins (n 678).
[764] Enron Corp and Ponderosa Assets LP vs. Argentina ICSID Case No. ARB/01/3 Award, 22 May 2007.
[765] Ibid Paras 251, 252 and 260.
[766] Ibid Paras 251–268.

to charge higher tariffs for a risk, and later, if that risk materialized argue that such risk should not be borne by them.'[767]

The Tribunal rejected this argument. It observed that 'country risk or default risk is related exclusively to the risk of default of a given country on its foreign debt' and that such risks 'may in some way interact' but they operate 'independently from each other and are subject to different safeguards.'[768] It described currency devaluation as a 'different kind of risk' that 'responds to a different rationale.'[769] It also rejected the relevance of country risk in the damages phase, stating that the risk of freeze and pesification of tariffs cannot constitute a risk when the regulatory framework separately and specially protects it.[770] The Tribunal further observed that,

> 'This is not to say that the Government did not have the sovereign authority to change its mind later, as in fact it did. The rationale for this change might be perfectly reasonable in light of changing economic conditions in the country, a matter which is not for the Tribunal to judge.'[771]

The defence of necessity is a well-accepted principle in international law and grounds for exemption from certain liabilities. While judging the macroeconomic policies of a host country exceeds the purview of an investment tribunal, it could nonetheless respect measures a state takes in a time of necessity. The host country itself is the only authority to decide the particular measures it needs to undertake for the greater public good. Tribunals could apply the 'margin of appreciation' principle, which the European

[767] Ibid Para 120.
[768] Ibid Para 149.
[769] Ibid.
[770] Ibid Para 378.
[771] Ibid Para 104.

Court on Human Rights uses, to disputes that involve sovereign state actions,[772] which includes the host country's cultural and historical context.[773] The principle would allow the investment tribunal to judge whether the host country applied due process and acted in a manner that was not outright arbitrary and unfair.[774]

As in the *CMS* award, the tribunal acknowledged the economic reality of the crisis[775] but found that the government's unilateral action breached the FET standard.[776] It found the economic crisis was insufficient grounds for the state's action[777] and it provided no 'legal excuse'.[778] The *Enron* Tribunal totally discarded any such defence of necessity.

7.2.B.e Sempra

In *Sempra Energy vs. Argentina*[779]Sempra Energy, a US company, had invested an equity interest in two Argentine gas distribution companies, Camuzzi Gas Pampeana and Camuzzi Gas del Sur, during the privatization of Argentina's national gas sector. Like the other Argentine cases in this chapter, the dispute in this case related to the convertibility laws. The tribunal's award found a violation of the FET obligation under

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[772] Burke-White WW and Von Staden A, 'Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties' (2007) 48(2) Virginia Journal of International Law 307, 348–349. For details on the notion of 'margin of appreciation' see e.g. Eyal Benvenisti, 'Margin of Appreciation, Consensus, and Universal Standards' (1998) 31 New York University Journal of International Law and Policy 843; Howard C Yourow, *The Margin of Appreciation Doctrine in the Dynamics of European Human Rights Jurisprudence*, vol. 28 (Martinus Nijhoff Publishers 1996); Thomas A O'Donnell, 'Margin of Appreciation Doctrine: Standards in the Jurisprudence of the European Court of Human Rights' (1982) 4 The Human Rights Quarterly 474.

[773] See e.g. Yuval Shany, 'Toward a General Margin of Appreciation Doctrine in International Law?' (2005) 16 European Journal of International Law 907.

[774] Fair and Equitable Treatment, Series on the Issues in International Investment Agreements Vo. III (n 259) 40. Also see Muchlinski, *Multinational Enterprises and the Law* (n 52) 637–638; Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (n 47) 133.

[775] Enron (n 764) Para 143.

[776] Ibid Para 144.

[777] Ibid Paras 221 and 222.

[778] Ibid Para 232.

[779] Sempra Energy International vs. Argentina Republic, ICSID Case No. ARB/02/16 Award, 28 September 2007.

the US–Argentina BIT, stating, '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.'[780] Accordingly it decided that Argentina had committed 'an objective breach of the fair and equitable treatment due under the Treaty…to the detriment of the Claimant's rights.'[781] It did not accept Argentina's defence of necessity, but did consider the effects of the economic crisis in relation to valuation. It acknowledged that the economic crisis was serious. On the one hand it considered that such 'unfortunate events do not in themselves amount to a legal excuse' and while on the other, 'neither would it be reasonable for the Claimant to believe it remains wholly unaffected by them.'[782] The Tribunal also observed,

> 'the manner in which the law has to be applied cannot ignore the realities resulting from a crisis situation, including how a crisis affects the normal functioning of any given society. This is the measure of justice that the Tribunal is bound to respect.'[783]

Here the tribunal took account of the economic crisis in the process of a Discounted Cash Flow (DCF) valuation of the investment. It predicted a 'but for scenario' to decide what the government would reasonably have done under the circumstances, as well as the objective effects of the crisis[784] and reduced the amount of compensation[785] which reflects the influence of the crisis in the damages phase.

7.2.B.f Sempra ad hoc Committee on Annulment Proceeding

[780] Ibid Para 303.
[781] Ibid Para 303.
[782] Ibid Para 269.
[783] Ibid Para 397.
[784] Ibid Paras 416–450.
[785] Ibid Paras 458 and 478.

Argentina challenged the *Sempra* award before the *ad hoc* Committee on Annulment Proceeding.[786] Unlike the *ad hoc* Committee in the Annulment Proceeding against the *CMS* Award, it annulled the tribunal's findings entirely. Argentina challenged the award based on the argument that the tribunal had exercised manifest excess of powers and that it failed to apply Article XI of the BIT.[787] The committee deemed that tribunal was unclear on the application and scope of Article XI of the Treaty.[788] It discussed the tribunal's findings in relation to Article XI of the BIT in detail, observing,

> 'The Tribunal has held, in effect, that the substantive criteria of Article XI simply cannot find application where rules of customary international law – as enunciated in the ILC Articles – do not lead to exoneration in case of wrongfulness, and that Article 25 "trumps" Article XI in providing the mandatory legal norm to be applied. Thus, the Tribunal adopted Article 25 of the ILC Articles as the primary law to be applied, rather than Article XI of the BIT, and in so doing made a fundamental error in identifying and applying the applicable law.
>
> 'The Committee is therefore driven to the conclusion that the Tribunal has failed to conduct its review on the basis that the applicable legal norm is to be found in Article XI of the BIT, and that this failure constitutes an excess of powers within the meaning of the ICSID Convention.'[789]

[786] Sempra Energy International vs. Argentine Republic, ICSID Case No. ARB/02/16 (Annulment Proceedings), Decision of the *ad hoc* Committee on the Application for Annulment of the Argentine Republic dated 29 June 2010.
[787] Ibid Para 165.
[788] Ibid Para 194.
[789] Ibid Paras 208–209.

On the invocation of state of necessity the committee observed that Article 25 of the ILC does not provide any useful guidance to interpreting Article XI of the BIT.[790] The Committee further observed that,

> 'More importantly, Article 25 is concerned with the invocation by a State Party of necessity "as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State". Article 25 presupposes that an act has been committed that is incompatible with the State's international obligations and is therefore "wrongful". Article XI, on the other hand, provides that "This Treaty shall not preclude" certain measures so that, where Article XI applies, the taking of such measures is not incompatible with the State's international obligations and is not therefore "wrongful". Article 25 and Article XI therefore deal with quite different situations. Article 25 cannot therefore be assumed to "define necessity and the conditions for its operation" for the purpose of interpreting Article XI, still less to do so as a mandatory norm of international law.'[791]

The committee also found that the excess of powers by the Tribunal was also manifest.[792] However it did not discuss the tribunal's finding on the breach of the FET standard, although its annulment of the award annulled the tribunal's findings on breach of the FET standard. However, on the issue of breach of treaty obligation, the committee found that,

> 'It is true that that BIT does not prescribe who is to determine whether the measures in question are or were "necessary" for the purpose so invoked – whether, in other words, Article XI is or is not self-judging. But if the measures

[790] Ibid Para 199.
[791] Ibid Para 200.
[792] See e.g. Ibid Paras 211–219.

> in question are properly judged to be "necessary", then there is no breach of any Treaty obligation. In that event, it is not the case that "judicial control must be…concerned with whether the requirements under customary law or the Treaty have been met and can thereby preclude wrongfulness'".[793]

Out of all the disputes on the Argentine economic crisis the *Sempra* Award seems to be the only example which has been annulled in its entirety, thereby recognising that the economic crisis presented a state of necessity and the actions did not breach the treaty obligations. This finding of the *ad hoc* Committee is certainly a positive outcome for host developing countries for future reference.

7.2.B.g AWG

AWG vs. Argentina[794] also arose because of the repeal of the convertibility laws.[795] The British investor Anglian Water Group Ltd. (AWG) had entered into a concession agreement through its Argentinian subsidiary, Augus Argentinas SA (AASA), with the Argentine government for one of the world's largest water distribution and waste water treatment projects in the city of Buenos Aires. The government's actions under the emergency law had a serious impact on AASA's business, and the claimants alleged that the government had indirectly expropriated the investment project and breached FET and other standards under the UK–Argentina BIT.[796]

[793] Ibid Para 204.
[794] AGW Group Ltd. vs. Argentina, UNCITRAL Arbitration Rules, Award, 30 July 2010.
[795] See e.g. Ibid Para 44.
[796] UK–Argentina BIT, 11 December 1990.

The tribunal found that Argentina had breached its FET obligation. It examined the investor's legitimate expectations from an 'objective and reasonable point of view,'[797] noting the host country need only to respect those expectations which are 'legitimate and reasonable in the circumstances,'[798] and argued the host country had breached them. Thus the tribunal seems to have adopted an approach that any state action contravening the investor's legitimate expectation of the stability of the legal framework *per se* violated the FET obligation. Thereby the tribunal raised a fundamental question as to the legitimate and reasonable expectation of the investors about the investment over a period of thirty years in Argentina, bearing in mind the country's 'history and its political, economic, and social circumstances?'[799] Despite these acknowledgements of the country characteristics of instability in its economic and socio-political context, the tribunal did find a breach of FET standard.

Arbitrator Pedro Nikken rendered a separate opinion that took an alternate view .[800] He said that the unpredictability of the emergency laws does not make them illegitimate; that their legitimacy depends on whether the actions the government took were 'unreasonable, disproportionate, discriminatory, or in any way arbitrary.'[801] He emphasised that a state of emergency such as Argentina faced at the time is an unpredictable situation, and this uncertainty does not make the state action illegal. This view appears to be a more reasonable interpretation of legitimate expectation of the investors as part of the FET obligation, particularly in the context of a developing country in an emergency situation.

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[797] AGW (n 794) Para 228.
[798] Ibid Para 229.
[799] Ibid Para 228.
[800] Separate Opinion of Arbitrator Pedro Nikken in AWG (n 794) < http://italaw.com/sites/default/files/case-documents/ita0056.pdf> accessed 26 July 2014.
[801] Ibid Para 36.

7.2.B.h El Paso

The US company El Paso Energy International Company invested in four Argentinian companies involved in electricity and hydrocarbons: Compańías Asociadas Petroleras S.A (CAPSA), Capex, S.A (Capex), Servicios El Paso S.R.L (Servicios) and Central Costanera S.A (Costanera).[802] In *El Paso Energy vs. Argentina*[803] El Paso claimed that the 'demise of [the] convertibility regime and the "pesification" of the economy'[804] had violated various treaty obligations under the US–Argentina BIT, including the FET standard. The tribunal held that the standard involves a consideration of reasonableness and proportionality and that all the surrounding circumstances should be taken into consideration.[805] With respect to investors' legitimate expectations, it observed that 'the general proposition that the state should not unreasonably modify the legal framework or modify it in contradiction with a specific commitment not to do so' should hold.[806] It noted that legitimate expectations of foreign investors are part of the definition of the FET standard, but set a limit by stating that it

> 'considers that the notion of "legitimate expectations" is an objective concept, that it is the result of a balancing of interests and rights, and that it varies according to the context.'[807]

Further, it observed that,

> 'There can be no legitimate expectation for anyone that the legal framework will remain unchanged in the face of an extremely severe economic crisis. No

[802] El Paso Energy International Company vs. Argentina, ICSID Case No. ARB/03/15, Award, 31 October 2011.
[803] Ibid.
[804] Julien Fouret and Dany Khayat, 'International Centre for Settlement of Investment Disputes (ICSID) Case Law Review' (2013) 12 The Law and Practice of International Courts and Tribunals 113, 140.
[805] El Paso (n 802) Para 373.
[806] Ibid Para 364.
[807] Ibid Para 356.

> reasonable investor can have such an expectation unless very specific commitments have been made towards it or unless the alternation of the legal framework is total.'[808]

Referring to *Parkerings-Compagniet AS vs. Lithunia*[809] the Tribunal also observed,

> 'In the Tribunal's understanding, FET cannot be designed to ensure the immutability of the legal order, the economic world and the social universe and play the role assumed by stabilisation clauses specifically granted to foreign investors with whom the State has signed investment agreements.'[810]

The tribunal laid out a detailed analysis of the facts of the case.[811] It found that, on the basis of the legitimate expectation described in the above *dictum*, Argentina's actions were not undertaken in violation of El Paso's rights guaranteed under the relevant BIT. The tribunal considered the gravity of the crisis in Argentina in relation to the legitimate expectation as part of the FET obligation. By doing this it struck a balance between the investor's legitimate expectation and the host country's right to change laws and regulation in the face of a crisis. It found that, the 'pesification' of the Argentinian economy 'cannot be characterised *in isolation*, as a violation of the FET standard.'[812]

Despite these observations, the tribunal took a very different position on the cumulative effect of measures which devalued the US dollar.[813] Referring to *LG&E*, that the host country 'went too far',[814] the tribunal stated that,

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[808] Ibid Para 374.
[809] Parkerings (n 468).
[810] El Paso (n 802) Para 368.
[811] Ibid Paras 365–415.
[812] Ibid Para 416.
[813] Ibid Paras 510–518.
[814] Ibid Para 517 referring to LG & E (Decision on Liability) (n 121).

> 'It cannot be denied that in the matter before this Tribunal the *cumulative effect of the measures was a total alteration* of the entire legal setup for foreign investments, and that all the different elements and guarantees just mentioned can be analysed as a special commitment of Argentina that such a total alteration would not take place.'[815] [Emphasis added]

This way of describing the violation of FET standard, as stemming from the totality of a number of actions rather than any single action, represents a departure from other cases. The tribunal found that Argentina had created a 'creeping violation of FET standard.' It stated that,

> 'The Tribunal considers that, in the same way as one can speak of *creeping expropriation*, there can also be creeping violations of the FET standard. According to the case-law, a creeping expropriation is a process extending over time and composed of a succession or accumulation of measures which, taken separately, would not have the effect of dispossessing the investor but, when viewed as a whole, do lead to that result. A *creeping violation of FET standard* could thus be described as a process extending over time and comprising a succession or an accumulation of measures which, taken separately, would not breach that standard but, when taken together, do lead to such a result.'[816] [Emphasis original]

Accordingly the tribunal found that taking an all-encompassing view of the consequences of the state measures, which also contributed to El Paso's decision to sell its investments in Argentina by their cumulative effect, amounted to a breach of the

[815] El Paso (n 802) Para 517.
[816] Ibid Para 518.

FET standard.[817] It acknowledged the seriousness of the crisis and its impact in relation to the investor's legitimate expectation in relation to the FET standard. This differs slightly from the award in *CMS* and *Enron*, and while it amounts to an approach more sympathetic to the host developing country, it presents an unsound and unconvincing interpretation of the FET standard by envisaging a *'creeping violation of the FET standard'*. The approach adopted by the tribunal to the crisis that appears flexible in fact emerges as restrictive. Therefore it appears that the tribunal was very much determined to find a breach of the FET standard.

Professor Sornarajah provided a Legal Opinion[818] as an expert on behalf of Argentina which Argentina attached to their rejoinder[819] and used as a basis for their arguments.[820] He argued that the parties to the NAFTA Treaty intended to invoke the FET standard equivalent to the international minimum standard without definite content; he charged that 'new, expansionary trends' of interpretation characterized its use by some investment tribunals.[821] On the issue of investors' legitimate expectation that host countries will not change their policies, he observed that 'no prudent investor can have such an expectation'[822] and that,

> 'where the change of policy is due to an economic crisis the ability of all in the state to make profits would be severely curtailed. It is not the function of an

[817] Ibid Para 519.
[818] Legal Opinion of M Sornarajah in El Paso (n 802) 5 March 2007.
[819] El Paso (n 802).
[820] Ibid Para 563.
[821] He stated that, 'When attempted in the context of NAFTA's reference to fair and equitable standards, the effort at expansion met with a swift reaction from the parties who promptly redefined the fair and equitable standard as indistinct from the international minimum standard, which has been in exercise for over a century without definite content. That reinterpretation is to be found in the US Model Treaty as well as in the newer American treaties such as the US–Singapore FTA. In that context, the Argentine–US Treaty must be understood in the light of the American view as to what fair and equitable treatment standard is. The American practice simply does not accommodate the new, expansionary trends to be found in some arbitral awards on which the Claimant builds its case. As pointed out, the American interpretation is more relevant than that of arbitrators as the United States was a party to the Treaty on which this claim is based'. See e.g. Legal Opinion of M Sornarajah in El Paso (n 818) Para 78.
[822] Ibid Para 91.

> arbitral tribunal to indicate policy preferences in favour of certain economic theories on foreign investment and devise a law that favours the interests of the foreign investor on the basis of nebulous notions such as legitimate expectations and fair and equitable standard. Even such standards, when applied fairly and equitably, would require that the circumstances of the change in policy be taken into account.'[823]

He indicated the tribunal should have considered the issue of fairness and equity in the context of the economic crisis in Argentina.[824] However, the Tribunal referred to Sornarajah's legal opinion in explaining the respondent's case[825] but did not heed its arguments or Argentina's plea of defence of necessity. It made no direct reference to Sornarajah's argument in favour of context and thus did not explain why the contentions raised by him are not sustainable. The award's main contribution to existing laws is the creation of the *'creeping violation'* concept based on cumulative consequences of a host country's actions, which is alarming for the host developing countries in future.

7.2.B.i Waste Management No. 2

In contrast with the Argentine cases discussed above, in *Waste Management vs. Mexico*[826] the tribunal acknowledged the state of economic crisis in Mexico in addressing a claim of breach of the FET obligation under NAFTA Article 1105. In this case the US company Waste Management invested in the Mexican city of Acapulco for a fifteen-year concession through its Mexican subsidiary Acaverde SA de CV for public waste

[823] Ibid.
[824] See e.g. Ibid Para 94.
[825] El Paso (n 802) Paras 159–168.
[826] Waste Management (n 292).

disposal services. A state owned bank, Banco National de Obras y Servicios Públicos (Banobras) guaranteed the concession agreement, but Acapulco and Banobras failed to pay *Waste Management* for services under the concession agreement during an economic crisis in 1994. Waste Management claimed compensation for breach of NAFTA Article 1105 (FET) and Article 1110 (expropriation). The tribunal found no violation of breach of FET on the premise that the economic crisis was important background to the dispute, had caused substantial devaluation of the currency and impact on the city, and had led to decline in the city's revenues and the federal bank failing to pay the investors.[827]

The tribunal further observed that this decline of revenues and failure to pay by the bank did not amount to a breach of the investor's expectation.[828] It rejected Waste Management's claim that it had suffered grossly arbitrary conduct and gross unfairness.[829] It acknowledged the state's genuine difficulty, and judged the failure by the city to perform its contractual obligation could be 'explained, albeit not excused, by the financial crisis which meant that at key points the City could hardly pay its own payroll.' [830] It emphasised, 'There is no evidence that it [the City] was motivated by sectoral or local prejudice.'[831]

In relation to NAFTA Article 1110 on expropriation, it described the commercial risk for the business choice made by the investors. It stated,

> 'In the Tribunal's view, it is not the function of the international law of expropriation as reflected in Article 1110 to eliminate the normal commercial

[827] Ibid Para 101.
[828] Ibid Para 102.
[829] Ibid Para 115.
[830] Ibid Para 115.
[831] Ibid Para 115.

> risks of the foreign investor, or to place on Mexico the burden of compensating for the failure of a business plan which was in the circumstances, founded on too narrow a client base and dependent for its success on unsustainable assumptions about customer uptake and contractual performance. A failing enterprise is not expropriated just because debts are not paid or other contractual obligations are not fulfilled.'[832]

Thus the tribunal took a view that legitimate expectation will not function when the investor is accountable for its own business choice. Thus it considered that the investors had taken the risk that the company could not convince its customers to use its system, or that an economic crisis would lead to financial loss,[833] and that investors bear the loss that arise out of an inaccurate risk assessment. They will not be recoverable under the terms of the investment treaty. Such a duty would appear to be entirely consonant with an analysis of the FET standard, given the inherent balancing process that lies at its heart.[834] While the tribunal made this *dictum* in relation to expropriation, its logic could readily apply to redress under the FET standard as well.

Therefore the tribunal took a holistic approach and adopted a reasonable and sympathetic approach to the economic crisis. The tribunal in the Argentine cases discussed above dealt with disputes which arose out of an economic crisis in Argentina far more severe than Mexico's in 1994, yet these tribunals made no reference to the findings of *Waste Management No. 2*. Though there is no scope for precedent in

[832] Ibid Para 177. Also see Feldman vs. Mexico, ICSID Case No. ARB(AF)/99/1 Award, 16 December 2002; (2003) 18 ICSID Review – Foreign Investment Law Journal 488 Para 111.
[833] However a different result may be feasible under the MIGA not yet signed or ratified by states: 'foreign investors on the other hand, need a greater measure of security and protection against non-commercial risks in the face of growing economic and political uncertainties.' See e.g. Ibrahim FI Shihata, 'The Multilateral Investment Guarantee Agency'(1986) 20(2) The International Lawyer 485. It is questionable whether such non-commercial risks include protection from political and economic changes in a state.
[834] Muchlinski, 'Caveat Investor?' (n 47) 542.

international investment law, the subsequent Argentine tribunals did not explain why they differed from the findings in *Waste Management No.2* on the economic crisis, or the special features of the Argentine economic crisis that did not deserve to be considered as an excuse for exempting the host developing country from liability during its crisis period.

7.2.B. j *Olguín*

In *Olguín vs. Republic of Paraguay*[835] the tribunal acknowledged the fragile economy of the host country. The dispute arose from the suspension of operations of *La Mercantil* bank by the government. Mr Olguín had made deposits in the bank to set up a food production and distribution company in Paraguay, and he claimed the Republic of Paraguay had expropriated his assets and negligently failed to supervise the bank, in breach of FET under Article 4(2) of the Peru–Paraguay BIT.[836]

The tribunal found that 'Paraguay's general conduct in relation to the operations of *La Mercantil* Bank was not overly sound' and also that 'there are serious shortcomings in the Paraguayan legal system and in the functioning of various State agencies.'[837] It also found that Paraguay's public bodies had exhibited irregular conduct and considerable omissions had led to the bankruptcy of the bank, and that these bodies had not acted in accordance with their duty to preserve the integrity of the state's financial system and protect foreign investment. [838]

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[835] Eudoro Armando Olguín vs Republic of Paraguay, ICSID Case No. ARB/98/5, Award, 26 July 2001.
[836] Peru–Paraguay BIT, 31 January 1994 <http://www.ftaa-alca.org/WGroups/WGIN/English/toc_ppee.asp> accessed 25 March 2014.
[837] Olguín (n 835) Para 65 (b).
[838] Ibid Paras 69–70.

Despite these severe shortcomings in Paraguay's conduct, the Tribunal did not find a breach of the BIT. It observed that,

> 'in the future, of strict rules that impose economic sanctions on States that fail to closely monitor their financial entities is desirable, the truth is that these rules do not now exist in either Paraguayan law or in the BIT. The Tribunal adds *that they do not exist in the majority of the countries in the region either.*'[839] [Emphasis added]

The tribunal acknowledged the state of Paraguay's economic crisis and its difficulties and therefore the investor's duty to make a prudent business decision. It stated that it 'feels that prudence would have prompted a foreigner arriving in a country that had suffered severe economic problems to be much more conservative in his investments.'[840] It observed that an experienced businessman such as the investor in this case cannot reasonably seek compensation for losses that he had suffered when he made a speculative investment in a country fully knowing the situation in Paraguay.[841] It continued, 'the Claimant contributed significantly, within his own individual circle of action, to the occurrence of the facts that he is also censuring.'[842] It referred to *Maffezini*[843] which had specified that BITs are not insurance policies against bad business judgment[844] urging prudence in investors in relation to countries with severe economic problems,[845] calling Olguín's investment 'speculative or at best not a very prudent investment.'[846]

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[839] Ibid Para 74.
[840] Ibid Para 75.
[841] Ibid Para 65 (b).
[842] Ibid Para 73.
[843] Maffezeni (n 120).
[844] Olguín (n 835) Para 73.
[845] Ibid Para 75.
[846] Gritsenko (n 85) 345.

Therefore the tribunal emphasised an investor's obligation to make prudent decisions when investing in a country which has a history of an unsound economy and bear the cost of making that imprudent decisions.[847] It recognised shortcomings in Paraguay's legal system and functioning of various state agencies, but denied all the investor's claims. The award provides an example of the tribunal shifting the burden of risk on to the investor for investing in a country which is suffering from a fragile economic condition; rather than imposing a burden upon the host country for not meeting the investor's legitimate expectation of a stable legal framework even during a severe economic crisis. Considering the similarities in terms of socio-political and economic culture that exists in Latin America, between Paraguay and Argentina, this finding stands in sharp contrast to that of the tribunals dealing with disputes arising from the Argentine economic crisis.

7.2.B.k Himpurna

In *Himpura vs. PLN*[848] the dispute did not involve a claim of breach of the FET standard, but nevertheless the findings of the tribunal are significant for this chapter's discussion as the dispute also arose out of an economic crisis, which occurred in Indonesia. In this case the two US subsidiary companies, Himpurna California Energy (Himpurna) and Patuha Power Ltd, entered into a contract with the Indonesian state electricity corporation, PT (Persero) Perusahaan Listruik Negara (PLN), for exploration and development of geothermal resources in Indonesia for energy resources. The contract also provided that the US corporation would construct a power plant and sell

[847] Ibid.
[848] Himpurna California Energy Ltd. vs. PT (Persero) Perusahaan Listruik Negara, Ad hoc UNCITRAL Arbitration Rules, Final Award, 4 May 1999.

the electricity it produced to PLN. However, due to a severe economic crisis in 1997,[849] PLN failed to purchase the electricity. Himpurna claimed damages for breach of contract. Though the case did not involve a claim of breach of the FET clause and the tribunal ruled in favour of the investor, and some observations made by the tribunal are relevant for this discussion. It observed, 'The fact remains that it is riskier to enter into a 30 year venture in Indonesia than in more mature economies.'[850] Accordingly the Tribunal increased the discount rate to 19 percent from the claimant's proposed 8.5 percent, which the tribunal described as 'absurd'[851] in light of the present value of the lost profits.[852] In relation to its calculus, the tribunal observed,

> 'First there is a risk of default, not by intentional breach which is excluded in principle, but by default due to large forces – political, social and in any event macroeconomic – which de facto paralyses contractual performance in a manner which makes it fatuous to imagine the creditor is protected by paper entitlements. This is the fundamental issue of country risk, obvious to the least sophisticated businessman.'[853]

The tribunal further observed:

> 'Finally one can hardly ignore that PLN is not a purely commercial enterprise engaged in venture capitalism for the sole benefit of its shareholders, but an instrument of State policy in the interest of public welfare. To view the terms of

[849] See e.g. Steven Radelet and Jeffrey Sachs, 'The Onset of The East Asian Financial Crisis' (National bureau of economic research, 1998) <http://www.nber.org/papers/w6680> accesssed 5 April 2014; Giancarlo Corsetti, Paolo Pesenti and Nouriel Roubini, 'What Caused the Asian Currency and Financial Crisis?' (1999) 11 Japan and the World Economy 305; David C Cole and Betty F Slade, 'Why has Indonesia's Financial Crisis been so Bad?' (1998) 34 Bulletin of Indonesian Economic Studies 61.
[850] Himpurna (n 848) Para 358.
[851] Ibid Para 365.
[852] Ibid Paras 348, 364, 370 and 371.
[853] Ibid Para 364.

a contract of this duration as establishing immutable quantities and prices seems quite unrealistic.'[854]

Here the tribunal took into account of Indonesia's particular economic crisis and the problems sustaining a thirty-year contract in that context. Accordingly it held that the claimant had proposed a wildly high interest rate under the circumstances. It reduced the interest rate because of the economic crisis the country was facing. While the dispute did not involve a claim of breach of the FET standard, the tribunal's willingness to reduce the proposed interest rate based on the economic crisis situation suggests that the investment tribunals in future could address economic crises or other crisis situations with the same approach adopted in this case which is a better reflection of fair and equitable calculation of the damages than other cases.

7.2.B.1 Synopsis of Awards on Economic Crisis

The awards discussed in part 7.2.B reveal the wide range of approaches of the current investment tribunals in addressing disputes against host developing countries under an economic crisis. Largely these awards demonstrate the inadequate approach of the tribunals towards such severe circumstances. They also represent inconsistent approaches on some substantive issues. The tribunal in *CMS,* even after undertaking a comprehensive discussion in relation to the economic crisis background of the dispute and acknowledging that the country was going through a crisis period, nevertheless rejected the plea of Argentina of defence of necessity and came to a conclusion that Argentina had breached the FET standard. The *AWG* tribunal also took the same approach like *CMS*, wherein they did recognise the economic turmoil of the host state

[854] Ibid Para 365.

but nevertheless found a breach of the FET standard. But the tribunal in *Enron* took a position that a "country risk" is a different kind of risk which operates separately and cannot be a plea for the host country in an economic crisis. Surprisingly, the tribunal in *El Paso* considered that the FET standard involves consideration of 'reasonableness' and 'proportionality' and that all the surrounding circumstances should be taken into account, but nevertheless played a very dubious role and found a "creeping violation of the FET standard." These tribunals considered that though the crisis was 'severe', it was not 'severe enough' to provide a 'legal excuse' and exempt the host country from its liability for taking emergency measures in public interest. Only the tribunals in *LG&E* and *National Grid* have accepted partially the defence of necessity and excluded the host country from liability for certain periods during the emergency. The discussion undertaken above also show that there is a clear contrast between the findings of the *CMS* and *LG&E* tribunals. This is unconvincing considering the fact that, less than a year after *CMS*, the tribunal in *LG&E* found under the same BIT and the same situation that the host country was under a state of necessity for certain period. The *Sempra* tribunal was reluctant to accept the defence of necessity plea due to the economic crisis but did consider the effects of the crisis at the valuation stage. However, the *Sempra* award has been annulled entirely by the *ad hoc* Committee and thereby is the only example on Argentine economic crisis cases where the host state has been fully exempt from any liability due to the actions taken on the basis of defence of necessity.

Besides the Argentine economic crisis disputes, in *Waste Management No.2* the tribunal did recognise the Mexican economic crisis and considered that this was an important part of the background of the dispute. But none of the tribunals dealing with the Argentine economic crisis situation engaged in any discussions on the findings of *Waste*

Management No.2. In *Olguín* the tribunal emphasised the investor's duty to make a proper business judgment as to where it is investing and accordingly have stressed the fact that if the investors were aware of the fragile economic conditions of the host country as well as the other conditions of Paraguay as a developing country then the burden of investing in a speculative venture lies with him. None of the awards in the Argentine disputes mentioned anything relating to the investor's conduct or their liability in investing in a country which has a long history of economic and political turmoil. The *Himpurna* award, though not in the context of FET, recognised that risk of investing in an immature economy and accordingly increased the discount rate for value of lost profit which could be a good reference for future tribunals dealing with economic crisis. The tribunals dealing with the Argentine cases did not adopt any such method of calculation of damages or compensation or rate of interest considering the economic crisis that prevailed in the host country.

7.3 Conclusion

In summarising Awards addressing economic crises in host developing countries, this chapter has shown the degree to which tribunals have recognised the role of an economic crisis in generating disputes and moderating foreign investors' legitimate expectations and rights under the FET standard. Despite the reference to the magnitude of the crisis and acknowledging its socio-political consequences, in general the tribunals have declined the defence of necessity and dismissed the severity of economic crisis, employing logic that is largely inadequate and inconsistent. In the Argentine cases, tribunals invariably found the breach of the FET obligation even where it had partially accepted a defence of necessity. From the majority of the awards discussed in this chapter it appears that the tribunals were overly enthusiastic to protect the interests of

the foreign investors ignoring the perspectives of the host developing countries suffering from economic crises. The recent awards in relation to the Argentine economic crisis raise concern for host developing countries, considering their vulnerability to economic crises, including those that originate in developed countries. Many developing countries across Latin America, Asia and Africa in the recent past have faced economic crises of the kind that arose in Argentina. These countries are more likely to be severely affected by any economic crisis in comparison to any developed country. Certainly such economic crises might not be an issue for investor protection for a country like the USA or Canada but this was certainly a factor for a country like Argentina or other developing countries which already have a fragile economy.[855] With their limited resources and capabilities developing countries run the risk of being overburdened with liabilities to comply with the legitimate expectations of the foreign investors under such economic crisis situations. The current investment tribunals have failed to appreciate this vulnerability, and the resulting awards were test cases before the tribunals which raise alarms for developing countries in the future.

[855] See e.g., ActionAid (n 662); Griffith-Jones and Ocampo (n 671).

Chapter 8

Key Problems in the Interpretation of the FET Standard by Current Arbitral Tribunals and Reconceptualising the FET Standard from Developing Countries' Perspectives

8.1 Introduction

This final chapter will address the overarching argument of this thesis that there is a pressing need to reconceptualise the FET standard from the perspectives of host developing countries and will describe how investment tribunals might achieve such reconceptualisation. Chapter 1 introduced the importance of this goal; Chapter 2 provided context by describing the historical development of the standard in the investment treaties; Chapter 3 addressed the various constructions of the FET as a standard. With this foundation, Chapter 4 introduced the developmental issues, challenges, and circumstances developing countries face that affect investment protection, such as limited resources or administrative capacity, political instability, social unrest, post-conflict situations, economic crisis, their transitory status, and policy in need of reform. Chapter 5, 6, and 7 built on this information to substantiate the key argument by demonstrating that arbitrators have used their discretionary power inconsistently and unfairly in favour of foreign investors. Tribunals have rarely given due consideration to the conditions, circumstances, and challenges that host developing countries face.

This chapter will conclude the thesis by demonstrating the key problems with the approach investment tribunals have taken to date. Part 8.2.A will discuss the key

problems with the interpretation of the FET standard tribunals have been employing with specific reference to the awards which Chapters 5, 6 and 7 have described. Part 8.2.B will discuss how investment tribunals might reconceptualise the FET standard to take into account the perspectives of the host developing countries relevant to the investment disputes more appropriately.

8.2.A Key Problems in the Interpretation of the FET Standard by Current Arbitral Tribunals

Due to its breadth and flexibility, foreign investors' complaints cite breaches of the FET standard more than other investment protection standards. Investment tribunals have likewise relied on it more than any other obligation as a basis for awarding damages against host countries.[856] In bringing claims citing measures ranging from regulatory changes adopted by the host country involving public sectors such as highway construction,[857] water and sewerage projects,[858] telecommunication services,[859] and waste disposal[860] and natural resources like gas and oil[861] to finance and banking regulation,[862] foreign investors have frequently achieved the aim of recovering damages while tribunals subordinate the public interest.[863] Interpretations of the legitimate expectations of the investors have failed to adequately account for developing countries' limited

[856] Harten, 'Investment Treaties as Constraining Framework' (n 24) 164.
[857] See e.g. Bayinder (n 446) in 5.2.A.a Bayindir Insaat Turizm 117; Pantechniki (n 491) 5.2.A.d Pantechniki 125; Toto (n 462) in 5.2.A.b Toto 120.Current Arbitral Practice Relating to Social and Political Circumstances in Host Developing Countries: FET Standard in Context
[858] See e.g., Azurix (n 116) in 5.2.B.e Azurix 143; AWG (n 794) in 7.2.B.g AWG 197.
[859] See Nagel (n 577) in 6.2.b Nagel 152.
[860] See Tecmed (n 118) in 5.2.B.c 137; Waste Management No.2 (n 292) in 7.2.B.i Waste Management No. 2 203.
[861] See Duke Energy (n 122) in 5.2.B.d Duke Energy 141; Kardassopoulos (n 646) in 6.2.i Kardassopoulos 166; CMS (n 119) in 7.2.B.a CMS 177; LG &E (Decision on Liability) (n121) in 7.2.B.c LG&E (Decision on Liability)184; Enron (n764) in 7.2.B.d Enron 191; Sempra Energy (n779) in 7.2.B.e Sempra 193 and Himpurna (n 848) in 7.2.B.k Himpurna 208.
[862] See Genin (n 599) in 6.2.e Genin 156; Olguín (n 835) in 7.2.B. j *Olguín* 206.
[863] See e.g. Sands (n 18) Chapter 6: 'A Safer World For Investors'. Sands also criticises the system as being at times a subordination of public interests to commercial interests.

capacity in terms of resources, infrastructure, technology, experience, and administrative efficiency and the challenges that they face due to circumstances like political instability, social unrest, and economic crisis.

The awards rendered against the host developing countries and the large amount of damages rendered against them[864] send a strong signal that a wide range of regulatory measures adopted by host developing countries could eventually trigger an investor claim. As Chapter 1 discusses,[865] the outcomes of the disputes also bring a potentially devastating overall economic impact upon these countries. Therefore this thesis will analyse the key problems in the interpretation of the FET standard by the tribunals at the current time, and make proposals for how these can be remedied. This thesis has identified two key problems of the tribunal's interpretation, namely (a) inconsistency, (b) an inadequate approach to consider the issues host developing countries face and their relevance to investment disputes.

8.2.A.a Inconsistency

The awards discussed in Chapters 5, 6, and 7 clearly suffer from lack of consistency on substantive issues. Even decisions based on similar facts and issues were sometimes decided in contrary ways. This section will highlight some key inconsistencies and describe the particular concerns they raise for host developing countries.

[864] For the amount of different Awards see e.g. Harten, 'Investment Treaties as Constraining Framework' (n 24) 158 and 170 (references made in footnote 4 of the text).
[865] See e.g. Ibid 158.

It should be noted that in the context of international investment disputes, no rule of precedent or a formal rule of *stare decisis* binds arbitrators.[866] Tribunals make substantial reference to previous decisions[867] and to some extent they do have persuasive value, they do not create any precedents for future tribunals. These efforts to consider past decisions obviously aim at increasing persuasive authority, and hence the legitimacy of the award. They are certainly absolutely vital in order to achieve an appropriate level of consistency.[868] Further, the inconsistency of interpretation and application of the FET standard raises questions about the legitimacy of the whole system.[869]

For example, the outcomes of *Bayinder* and *Pantechniki* discussed in Chapter 5 reveal inconsistency in the approach towards breaches of the FET standard in the event of a political instability in a host country. The tribunal decided these cases in the same period, concerning disputes arising out of a similar kind of political instability—in Pakistan and Albania respectively—and took completely different approaches to interpretation of the FET standard. The political turmoil in Pakistan was a major ground for the tribunal's finding that the host country did not breach the FET standard in *Bayinder,* but the tribunal in *Pantechniki* did not even consider the context of a similar political crisis in Albania.

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[866] See e.g. Tai-Heng Cheng, 'Precedent and Control in Investment Treaty Arbitration' (2006) 30(4) Fordham International Law Journal 1014, 1031–1037; Campbell McLachlan, Laurence Shore, and Matthew Weiniger, *International Investment Arbitration* (Oxford University Press 2007) 71 (et seq); Also see discussion in AES Corporation vs. Republic of Argentina, ICSID Case No. ARB/02/17, Decision on Jurisdiction, 26 April 2005 Para 18; Jeffery P Commission, 'Precedent in Investment Treaty Arbitration: A Citation Analysis of a Developing Jurisprudence' (2007) 24(4) Journal of International Arbitration 129.

[867] McLachlan, Shore, Weininger *International Investment Arbitration* (n 866) 74, speaking of a '*de facto* doctrine of precedent'.

[868] Kläger, 'Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness' (n 47) 451.

[869] Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 141.

Similarly, as Chapter 6 described, the tribunal in *Parkerings* considered the transitory status of Lithuania and recognised its challenges. It found that the host country did not breach the FET standard because of this context. Other awards discussed in Chapter 6 did not do this. In particular there exists a sharp contrast of approach to the *Kardassopoulos* award. In *Kardassopoulos,* the tribunal overlooked discussion of these challenges of the host country and totally ignored the transitory status of Georgia.

Another major issue of inconsistency relates to host countries' raising of the defence of necessity in crisis situations. This defence is a well-established doctrine of international law, which can be of significant importance for developing countries. The awards in Chapter 7, particularly on the Argentine economic crises, reveal clear inconsistencies in the tribunals' interpretation of the defence of necessity. In addressing several disputes arising from a single measure Argentina took to address a particular economic crisis, the Convertibility Laws, the tribunal partially accepted the defence of necessity in two cases, but not in a third, though all invoked the same BIT. The awards in *LG&E*[870] and *National Grid*[871] are clearly inconsistent with the award in *CMS*. As Chapter 7 describes, the differences of facts between the *CMS* and *LG&E* awards do not account for this inconsistency. Chapter 7 also describes the approach of the tribunal in *Waste Management No.2,* which considered the Mexican economic crisis as a ground for determining the liability of the host country for breach of FET standard, and the approach of *Olguín,* which considered Paraguay's economic crisis as a reason to shift the burden of loss on to the foreign investors. A number of awards including *CMS* approached economic crises in a very different way from *Waste Management No.2,* and *Olguín* as Chapter 7 revealed.

[870] LG&E (Decision on Liability) (n 121) Para 259.
[871] National Grid (n 543) Paras 179–180.

While international investment arbitration renders inconsistent decisions in relation to a variety of standards, this thesis focuses on interpretation of the FET standard for a number of reasons.[872] The vagueness of the FET standard leaves it particularly vulnerable to inconsistencies, and means that it cannot guide behaviour without consistent interpretation. While the FET standard's inherent flexibility makes it impossible for arbitrators to achieve full consistency, citing justifiable reasons would make it internally coherent. The flexibility of FET certainly allows different outcomes in different factual situations, since one of the standard's purposes is to guide interpretation of a variety of possible facts.[873] When contradictory decisions address the same facts and issues (as in *LG&E* and *CMS*) or facts that are virtually indistinguishable (as in *Bayinder* and *Pantechiniki*) or even with the same case,[874] the rational basis for justifying the distinction becomes questionable. Then it appears that at least one of the decisions is suffering from a legitimacy deficit.

When tribunals render inconsistent awards on similar facts or issues, the only way to maintain their legitimacy is to justify their reasons for differing from the previous tribunals, or explain the conditions of the particular disputes which merit different conclusions from previous tribunals dealing with similar kinds of issues. In this respect Kläger's observation is worth mentioning:

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[872] Susan Franck categorises these inconsistencies into three groups, namely (i) cases involving the same facts, related parties and similar investment rights, (ii) cases involving similar commercial situations and similar investment rights (iii) cases involving different parties, different commercial situations and the same investment rights. See e.g., Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2005) 73 Fordham Law Review 1521, 1558 *et seq.*

[873] See Chapter 1 in 1.2.5 The Importance of the Arbitrators' Discretionary Powers in Interpreting FET 18.

[874] Contradictory decisions in Roland S. Lauder vs. Czech Republic, UNCITRAL, Final Award, 2 September 2001 and CME Czech Republic vs Czech Republic, UNCITRAL Partial Award, 13 September 2001 exemplify this problem. See e.g. CMS (n 119) in 7.2.B.a CMS 177 and LG&E (Decision on Liability) (n 121) in 7.2.B.c LG&E (Decision on Liability) 184; Franck 'The Legitimacy Crisis in Investment Treaty Arbitration' (n 872).

> 'Since fair and equitable treatment does not encapsulate an intrinsic meaning or justice waiting out 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 for the best concepts and arguments.'[875]

As Kläger observes, the flexibility of the FET standard particularly demands clear reasons for inconsistent decisions. When investment tribunals address complaints arising from similar kinds of issues and situations, if outcomes differ, the later tribunal needs to justify their different interpretation on the facts with a fully rational justification. If this is not done properly then the interpretation of a flexible standard like FET becomes too fluid, which raises concerns about the system as a whole.[876]

The frequent use of the FET standard by foreign investors against host developing countries means that inconsistent and imprecise interpretations of the standard by the arbitral tribunals put the host developing countries at considerable risk of bearing heavy costs.[877] Chapters 5, 6, and 7 touched on the crisis situations host developing countries face and their importance, including economic crises, political instability and social unrest, and the lack of experience and limited resources to cope with the requirements of investment protection standards attending transitory status. The uncertainty host developing countries experience as to the approach of the investment tribunals hinders

[875] Kläger *'Fair and Equitable Treatment' in International Investment Law* (n 47) 255–256.
[876] See e.g., Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration' (n 872) 1558 *et seq.*
[877] See Chapter 1 in 1.2.2 Developing Countries in Investment Dispute Arbitration 5; Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' (n1) 287; UNCTAD 'Investment Policy Framework for Sustainable Development' (n 45) 43.

the smooth and pressure-free functioning of the host developing countries and their state machinery in dealing with the foreign investment regime.

Inconsistency will also impact the developing countries' trust in the investment arbitration system and complicate the investor–host country relationship. The host developing countries are at the mercy of the investment tribunals when the state makes decisions they may consider necessary to protect the state and the public interest. Inconsistency in the decisions of investment tribunals make it impossible to make informed judgments about likely outcomes. As Kläger has rightly pointed out, FET could act as a black box containing unwelcome surprises within the BITs and IIAs.[878] The activities of all branches of state machinery, legislature, executive, and judiciary, potentially could violate the FET standard if the tribunals do not explain their logic.[879] Furthermore, Dolzer states, if the tribunals interpret and apply the FET standard too loosely, it 'has the potential to reach further into the traditional *domaine reserve* of the host state than any one of other rules of [investment] treaties.'[880] Such surprises will tax heavily the host developing countries if there is no consistency in the tribunals to address the issues and challenges these countries face in the investment dispute context.

8.2.A.b Inadequate Approach to the Substantive Issues of the Host Developing Countries Relevant to the Investment Disputes

Tribunals in general have been inadequate in their approach in rendering the awards and their awareness of the conditions, such as social and political instability, transitory status, economic crisis, lack of resources, and limited administrative capacity, that host

878 Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 242.
879 Ibid 252.
880 Rudolf Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37 New York University Journal of International Law and Policy 954.

developing countries face. The majority of the tribunals ignored or marginalised these challenges in interpreting the alleged breach of the FET standard, as this section will discuss.[881] This section will also focus on why such approaches were inadequate considering the particular contextual background of the disputes and why such inadequate approaches raise concerns for host developing countries in the future.

8.2.A.b.i Inadequate approach to lack of resources, administrative capacity, and experience of host developing countries

The limited resources and capabilities of host developing countries should affect any assessment of the country's obligations to investors. The *AMT* Award typifies tribunals' inadequate approach to this principle. The tribunal acknowledged that Zaire differed from developed countries in terms of the environment for investment, but did not reference Zaire's political turmoil to the state's resulting inability to offer the investor the protection he desired under the BIT.[882] Similarly the tribunal in *Pantechniki* held that lack of state resources provides no defence for denial of justice.[883] The *GAMI* tribunal also rejected Mexico's defence based on its administrative capacities, saying that these capabilities had no bearing on the liability of the host country.[884] Such a limitation of resources becomes a pivotal factor, particularly in the context of their ability to satisfy the treaty obligation of foreign investors, as the disputes that arose out of the Argentine economic crisis discussed in Chapter 7 illustrate. They also reflect the tribunals' failure to address this lack of resources and administrative capacity in relation to crisis situations. Similarly, Chapter 6 described only one award, *Parkerings*, in which the tribunal considered these issues. The tribunals dealing with countries in transition have

[881] See Chapter 4 in 4.2.C Perspectives of Host Developing Countries in Investment Disputes 108.
[882] AMT (n 471) Para 7.14–7.15.
[883] Pantechniki (n 491) Para 76.
[884] GAMI (n 513) Para 94.

been largely inadequate in their approach to considering the lack of resources, administrative capacity, and experience of these countries in the process of socio-political and economic transition. In *Kardassopoulos* the tribunal did not even mention the transitory status of the host country, creating a troubling precedent for future tribunals dealing with countries in transition.

Developing countries commonly lack resources, and therefore face challenges in ensuring appropriate investor protection mechanisms under the investment treaties. The current tribunals have not adequately considered this issue in interpreting the FET standard.

8.2.A.b.ii Inadequate approach to recognising how a crisis situation affects the ability of host developing countries in an investment dispute context

Apart from the award in *LG&E* and *National Grid,* which partially exempted the host country for the crisis, and the Annulment Committee's decision on the award in *Sempra* which entirely annulled the findings of the tribunal, the awards in Chapter 7 reveal an inadequate approach to addressing the challenges of economic crisis. Chapter 7 part 7.2.A describes the severity and impact of economic crises for developing countries, revealing that the approach which the majority of the tribunals took in relation to the Argentine economic crisis inappropriately rejected the defence of necessity raised by Argentina. While they acknowledged the severity of the crisis that existed in Argentina to varying degrees, and that grave situations affect legitimate expectations of investors,[885] they dismissed its influence on the proper liability of the host country.[886]

[885] See e.g. CMS (n 119) Para 248; AWG (n 794) Para 228; El Paso (n 802) Para 374.
[886] See the discussion on CMS (n 119), AWG (n 794), El Paso (n 802) and Enron (n 764) in Chapter 7.

The Argentine economic crisis disputes serve as a litmus test for host developing countries to examine the approaches of the current investment tribunals.

The tribunals' dismissal of Argentina's invocation of the defence of necessity could have wide-ranging effects. Developing countries that host foreign investment will have to be cautious in undertaking actions in extreme situations, lest investment tribunals worsen their position with large amount of compensation in rendering awards. The tribunals' prioritisation of the protection of foreign investors leaves host developing countries extremely vulnerable in times of crises.

Burke-White notes this dynamic when he opines that the Argentine cases test the flexibility available to host countries to respond to crisis situations and the scope of investor protections under such circumstances.[887] Developing countries are vulnerable to a broader range of scenarios than developed countries, and the tribunals' response to political instability and social unrest, as discussed in Chapter 5, and disruption for the conditions that attend transition as discussed in Chapter 6 creates similar level of disruption and can put a similar chill on host developing countries' ability to act in the public interest. In the era of globalisation, host developing countries can encounter many crisis situations, such as terrorist attacks (as in Nigeria and Kenya in 2014), rising militancy (as in contemporary Syria and Iraq), debt crisis (as in the Czech Republic in 1990s[888]), severe health crises (such as AIDS in South Africa since the 1980s[889] and

[887] See e.g., Burke-White, 'The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System' (n 654).
[888] See e.g. Helena Tang, Edda Zoli and Irina Klytchnikova, 'Banking Crises in Transition Countries: Fiscal Costs and Related Issues' (Policy research working paper) (World Bank, Europe and Central Asia Region, Poverty Reduction and Economic Management Sector Unit 2000) <http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/12/15/000094946_00111805313297/additional/104504323_20041118114551.pdf> accessed 25 September 2014.
[889] See e.g. Solomon R. Benatar, 'Health Care Reform and the Crisis of HIV and AIDS in South Africa' (2004) 351(1) New England Journal of Medicine 81; John C Cadwell, 'Rethinking the African AIDS Epidemic' (2000) 26(1) Population and Development Review 117.

Ebola in West Africa[890] in 2014), insurgency (as in Ukraine in 2014) and cyber-attacks (as in Estonia in 2007). Political instability and rise of militancy more easily becomes civil war in developing countries than in developed countries. Such problems that are major in developing countries make it impossible for host developing countries to provide the climate for foreign investment that investor's desire.[891] Such crises pressure host developing countries to respond to hitherto unforeseen challenges and take actions investors may view as protectionist and threatening to their interests.[892]

As Burke-White rightly describes, the narrow approach the tribunals adopted in the Argentinian cases raise concerns that host countries will be at risk of breaching the FET standard in taking any policy response to tackle such difficult situations. He further argues that the investment tribunals' responses in the Argentine economic crisis cases put the entire investment arbitration system at risk.[893]He concludes that in rendering these awards, tribunals have made it almost impossible for the host country to invoke the state of necessity defence under customary international law in a situation of economic crisis.[894] Further, he argues that the tribunals have failed to provide an adequate margin of appreciation for the host countries relying on the necessity doctrine, despite the fact that he argues that this was contrary to the intent of the state parties to the relevant BIT.[895] He comments:

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[890] See e.g. M. J. Friedrich, 'World Bank Pledges $200 Million to Stem Ebola Outbreak in West Africa' (2014) 312(11) The Journal of American Medical Association 1088; Joan Stephenson, 'Largest-Ever Ebola Outbreak Still Simmering in West Africa' (2014) 312(5) The American Journal of Medical Association 476; M. J. Friedrich, 'Ebola Outbreak in West Africa' (2014) 311(19) The American Journal of Medical Association 1958.

[891] For a brief discussion on the impact of political crises in developing countries see Chapter 5 and on economic crisis see Chapter 7.

[892] Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n) 248–249.

[893] See e.g., Burke-White, 'The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System' (n 654).

[894] Ibid 432.

[895] Ibid.

> 'In an ever more globalized world in which exceptional circumstances such as financial crisis, terrorist threats, and public health emergencies are all too common, the ability of states to craft viable policy responses becomes ever more critical. In this context, the Argentine ICSID cases test the extent of state freedom to craft critical policies and the reach of investor protection under BIT's and customary law in the face of exceptional, but far from uncommon, emergencies.'[896]

Investment tribunals have not addressed adequately states' need to take emergency actions that might appear to breach the FET standard from an investor's point of view.

8.2.A.b.iii Inadequate approach to recognising the challenges that host developing countries face due to political instability, post-conflict situations, and social unrest

Political instability, conflict and its aftermath, and social unrest impose risks on investment in host developing countries. Of the tribunals discussed in Chapter 5, only those serving in *Bayinder* and *Toto* paid adequate attention to political instability in the host country.[897] For example, the tribunal in *Pantechniki* made no acknowledgement of political instability in Albania as a cause of the investor's losses. Further, *AMT* presented a particularly severe case of instability, and Zaire raised the issue of its political crisis as a defence. The tribunal did not acknowledge the role of several bloody civil wars in determining Zaire's liability. It also did not provide any reason for the omission.[898] This absence of discussion represents a very inadequate approach to the

[896] Ibid 411.
[897] See e.g. Bayinder (n 446) Paras 192–193.
[898] AMT (n 471) Paras 6.06–6.08.

gravity of the situation that existed in Zaire for decades.[899] The tribunal did reduce the amount of compensation in recognition of the crisis,[900] but the finding of liability nonetheless puts host developing countries at risk.

Confounding host developing countries' efforts to avoid paying large amounts of compensation to foreign investors while maintaining law and order, investment disputes often concern highly politically and socially sensitive sectors such as public utility services or natural resources. The tribunals' approach to the political and social concerns such disputes incur has not adequately addressed the issues. For example the tribunal in *GAMI* did not evaluate the circumstances under which the government made the decision the investor alleged violated its FET obligation. The tribunal itself noted that the Mexican sugar industry had a 'considerable political dimension',[901] but it did not engage in any detailed discussion of this dimension as significant background to the dispute. Similarly in *Tecmed,* the tribunal deemed the social protest of the local community against the landfill project as irrelevant, considering it not to be 'real'.[902] It did not address the logic behind this distinction, or describe what it would find in the case of a 'real' protest. The implicit acknowledgement that a 'real' protest permits a state to act in the public interest at investors' expense becomes meaningless without a standard for a 'real' protest. The pattern of investment in developing countries renders this an important point, but the *Tecmed* tribunal did not engage in any discussion on the issue and this question is unanswered. Similarly in *Azurix,* the tribunal ignored the socio-political circumstances of the public utility sectors and the sensitive issues surrounding the sectors from a broader perspective of the host country.

[899] See 5.2.A.c AMT 119.
[900] AMT (n 471) Para 7.13.
[901] GAMI (n 513) Para 46.
[902] TECMED (n 118) Para 144.

Social and political protest on a large scale are quite common in the developing world, and citizens often see foreign investments as a camouflaged form of colonial exploitation perpetuated by foreign investors with no concern for the social problems of a society in which they have no real stake.[903] The investment tribunals exacerbate these problems, by protecting foreign investors from risk—they ensure that foreign investors *don't* have to care about social problems. This makes the natural resources sector in host developing countries a particularly sensitive issue politically. The oil and gas sector in Nigeria,[904] the diamond mining sector, dubbed 'conflict diamonds' in Congo and Sierra Leon,[905] the Phulbari coal mine protest in Bangladesh,[906] the 'Conchabama Water Wars' in Bolivia,[907] the movement for the survival of the Ogoni people against oil companies in Nigeria,[908] the Costa Rican communities protesting against US oil companies,[909] and the recent protest in Liberia against land grabbing by British palm oil company all exemplify the politically high stakes around natural resources in developing countries.[910] Tribunals' reluctance to take into account the perspectives of the governments of host developing countries in investment disputes arising out of such politically sensitive sectors potentially limit such countries' ability to

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[903] Franck, *Fairness in International Law and Institutions* (n 106) 438. Also see e.g. Graeme B. Robertson and Emmanuel Teitelbaum, 'Foreign Direct Investment, Regime Type, and Labor Protest in Developing Countries' (2011) 55(3) American Journal of Political Science 665.

[904] See e.g. Augustine Ikelegbe, 'Civil Society, Oil and Conflict in Niger Delta Region of Nigeria: Ramifications of Civil Society for a Regional Resource Struggle' (2001) 39(3) The Journal of Modern African Studies 437; Eghosa E. Osaghae, 'The Ogoni Uprising: Oil Politics, Minority Agitation and the Future of the Nigerian State' (1995) 94(376) African Affairs 325; Peter M. Lewis, *Growing Apart: Oil, Politics, and Economic Change in Indonesia and Nigeria* (The University of Michigan Press 2007).

[905] See e.g. <http://www.globalwitness.org/campaigns/conflict/conflict-diamonds> accessed 24 September 2014.

[906] See e.g. <http://accproject.live.radicaldesigns.org/section.php?id=43> accessed 17 September 2014.

[907] See e.g. <http://www.pbs.org/frontlineworld/stories/bolivia/timeline.html> accessed 17 September 2014. Also see e.g. Oscar Olivera and Tom Lewis, *¡Cochabamba!: Water War in Bolivia* (South End Press 2008).

[908] Osaghae (n 904). Also see e.g.
< http://wiwavshell.org/about/about-wiwa-v-shell/ > accessed 17 September 2014. Also see e.g. < http://nvdatabase.swarthmore.edu/content/ogoni-people-struggle-shell-oil-nigeria-1990-1995 > accessed 17 September, 2014.

[909] See e.g. <http://nvdatabase.swarthmore.edu/content/costa-rican-communities-defeat-us-oil-companies-protect-local-environment-1999-2002 > accessed 17 September 2004.

[910] See e.g.<https://www.rainforest-rescue.org/mailalert/950/liberia-land-grabbing-for-palm-oil-no-means-no > accessed 17 September 2014.

accept investment. Neglecting these factors under those circumstances in interpretation of the FET standard fails to serve the purpose of the standard.

The tribunals' approach to political instability, post-conflict circumstances, and social unrest in developing countries raises concern for a large group of countries. Countries engaged in civil wars like Iraq, Syria, and Ukraine or experiencing political conflict like South Sudan, Somalia, Pakistan, and Egypt have reason to fear the consequences of these rulings. A trend towards investment in Afghanistan's post-Taliban regime suggests that foreign investors may soon show interest in these countries as political crises in those countries lessen.[911] The inadequate approach of the investment tribunals towards the political crises and post-conflict vulnerability of the host developing countries will have a negative impact on these countries' trust in the whole system.

8.2.A.b.iv Inadequate approach to recognising the host developing countries' need to change policy

The awards discussed in Chapters 5, 6, and 7 reveal that tribunals approach substantive issues like host developing countries' state regulatory powers and change of policy in public utility services and sectors such as exploration of national resources with a lack of sensitivity. It described broad interpretations of FET by tribunals to impede all kind of actions taken by the host country. Subedi rightly opined that the tribunals have gone too far in intruding into the policy space of developing countries, limiting host

[911] See e.g. <http://www.state.gov/e/eb/rls/othr/ics/2013/205289.htm> accessed 23 September 2014. Also see e.g. Al Jazeera, 'Afghanistan Moves To Entice Foreign Investors: New Incentive Package To Include Low Land Costs, Tax Exempt Status, And Multiple Entry Visas For Investors' (21 July 2014) <http://www.aljazeera.com/news/middleeast/2013/07/201372113053618886.html> accessed 23 September 2014; <http://www.aisa.org.af/> accessed 23 September 2014.

countries' sovereign rights in the event of various situations of emergency and crisis.[912] These powers of the state are based on its inherent international legal right to regulate conduct in its territory; such rights supersede any limitation imposed by international agreements and treaties.[913] Subedi identifies the FET standard as a 'catch all' provision that current investment tribunals have interpreted so broadly that a wide variety of state activities fall within it.[914]

If tribunals' will not take the needs of host developing countries into account, the FET standard then significantly limits the regulatory freedom of host country. As Kläger argues, the current tribunals have framed legitimate expectation in such a way as to conflict with the sovereignty of a host country, and deemed exercise of sovereignty as a breach of investment treaties.[915] As Kriebaum points out, developing countries have a pressing need to be able to change policies.[916] She argues the FET standard allows for a balance between the investor protections and the host country's public interest and that tribunals should therefore address the conditions prevailing in the host country in relation to legitimate expectations.[917] She argues that the legitimate expectation of the foreign investor must not jeopardise developing countries' need to change policy in areas like labour law or environmental law, or the protection of cultural heritage, and human rights.[918] Since developing countries lack the same level of development in these areas, Kriebaum argues that developing countries should not be penalised for striving to implement protections in these areas. Further, she argues that foreign investors should

[912] Subedi, *International Investment Law: Reconciling Policy and Principle* (n 1) 2.
[913] Muchlinski, 'Caveat Investor?' (n 47) 533.
[914] Subedi, *International Investment Law: Reconciling Policy and Principle* (n1) 168.
[915] Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 251.
[916] Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (n 113) 404.
[917] Ibid.
[918] Ibid.

have limited expectations as to the stability of the domestic legal system in relation to these areas.[919]

Subedi identifies the FET standard as a 'catch-all' provision that current investment tribunals have interpreted so broadly that a wide variety of state activities fall within it. While foreign investors might regard such actions as a breach of the FET obligation, considering the particular conditions and circumstances as the contextual background of the dispute supports a different view. Accommodating host developing countries' need to change policy in certain sectors, even if they have direct impact upon the profitability of a foreign investment, will conform to international law as to the sovereignty of states.

Chapters 5, 6, and 7 sought to construct the full story behind selected awards that arbitrators have neglected. Arbitrators have not typically considered the substantive background facts of the investment disputes, and therefore they often render awards that neglect the situations that led to host countries' behaviour. While tribunals were often aware of the situation of the host developing country and its bearing on the investment disputes, they typically did not make this knowledge part of interpretation of the FET obligation. Tribunals that compromised by ignoring the context in finding liability while reducing damages or rate of interest on the basis of that context do not satisfy the needs of host developing countries.[920]

Tribunals' refusal to acknowledge the challenges of lack of resources, administrative capacity, challenges due to crisis, political instability, social unrest, and post-conflict

[919] Ibid.

[920] See LG&E (Decision on Liability) (n 118) and National Grid (n 543) in 7.2.B.c LG&E (Decision on Liability)18 184; Lemire (n 629) in 6.2.g Lemire (Award) 161; Himpurna (n 848) in 7.2.B.k Himpurna 208.

situations neglects the fact that these issues and challenges play a catalyst role in host developing countries' ability to provide a fertile environment for investment.

The key problems in the interpretation of the FET standard by the current investment tribunals that Part 8.2.A has identified have a far reaching impact upon host developing countries. There is a pressing need to revisit the concept of the FET standard from the perspectives of host developing countries. Part 8.2.B below will focus on how the FET standard can be reconceptualised from the perspectives of host developing countries.

8.2.B Reconceptualising the FET Standard from Host Developing Countries' Perspectives

Tribunals' interpretation of the FET standard has been for the most part rendered it an investor-oriented protection standard in investment disputes. As Chapter 1 described, a large volume of investment disputes involve host developing countries, and the awards have a large economic impact on these countries. Chapter 1 also discussed the importance of an arbitrator's discretionary power in relation to host developing countries' perspectives in interpreting the FET standard. However, Chapters 5, 6, and 7 reveal that the arbitrators have exercised their discretionary powers in an inappropriate manner to largely prioritise the needs of foreign investors and neglect the perspectives of host developing countries in their interpretation of the FET standard. Gritsenko rightly points out:

> 'There seems to be a divergence of approaches among arbitrators when faced with a defence arising out of the host State's developing status; it remains to be seen whether future decisions will seek to harmonize the varying strands. In practice, absent a generally recognised 'level of development' standard, parties

> will likely continue to make the argument that conditions prevailing in the host state should be factored into the arbitrator's decision, to an extent depending on the factual circumstances of the case."[921]

The awards this thesis has discussed illustrate the prevalence of the argument Gritsenko describes. Current arbitral jurisprudence clearly lacks consensus on the issue of a host country's developmental issues and the challenges they face and their impact on foreign investment.

The clear inconsistency and inadequacy this chapter has described should prompt a reconceptualisation of the standard from the perspectives of the host developing countries, accommodating their developmental issues and challenges with a view to ensuring consistent and adequate approaches by the tribunals to interpret the FET standard. Such a reconceptualisation is a vital part of dealing with difficult cases, which often involve host developing countries, due to the challenges they face. Such difficult cases might involve particular challenges that host developing countries face due to their development issues in the investment context identified in this thesis or the challenges that they might face due to some unforeseen crises of a socio-political or economic nature that this thesis has discussed or those crises identified above. Ensuring a certain level of certainty as to the scope of the standard for host developing countries would make a material difference in these countries' ability to encourage foreign investment. As Sornarajah rightly points out, they have been a vulnerable target of the 'catch-all' nature of the FET standard.[922] For all these reasons, it is important to consider how to reconceptualise the FET standard to appropriately take into account

[921] Gritsenko (n 85) 351.
[922] Sornarajah, 'The Retreat of Neo-Liberalism in Investment Treaty Arbitration' (n 1) 287.

the developmental perspectives of host developing countries in investment dispute context.

8.2.B.a The Perspectives of Host Developing Countries in an Investment Dispute Context

Chapter 4 of this thesis highlighted the classifications of countries different international organisations have forwarded, guided by GDP, GNI, or HDI. These categorisations reflect the social and economic level of development of countries and are useful in explaining their social and economic developmental status. But these classifications do not provide much insight into the difficulties and challenges that the host developing countries face in the investment dispute context. Therefore tribunals need to identify the developmental issues and challenges host developing countries face. This reconceptualised understanding of developmental issues in the investment dispute context would not rely primarily on criteria such as GDP, GNI, or HDI but on factors relevant to developing countries, which form a vital contextual background to the disputes in question. These factors include the issues and challenges of limited resources and lack of infrastructure, technological support, and administrative capabilities, as well as the struggles related to extreme circumstances such as political instability, conflict and its aftermath, social unrest, social and political transitions, and economic crises.

The huge volume of claims against Argentina in the wake of the country's severe economic crisis, as well as in disputes initiated against countries in transition, brought attention of the governments of developing countries and scholars to the particular needs of developing countries. It seems likely that national crises will continue to bring about situations that lead to large numbers of claims against host developing countries,

given their lack of administrative capacity, resources, infrastructure, technological support, and legal capacities, all of which affect their ability to protect investor's interests. Crises weaken these systems and prompt decisions in the public interest that can negatively affect the value of foreign investments.

Under such circumstances, foreign investors should no longer expect that host countries will maintain unchanged regulatory policies. Kriebaum supports the view that tribunals should assess legitimate expectations against the background of the host countries' prevailing circumstances. She argues that the conditions prevailing in the host country are highly relevant in determining the legitimate expectation of foreign investors.[923] Similarly, Muchlinski argues in favour of the principle of 'caveat investor'—that is, that investors should have realistic expectations about the profitability of investing in a high risk-high return location and be aware of both the prospects and pitfalls of the investment. He argues that investor should bear any losses that arise as a result of an inaccurate risk assessment and should not be recoverable under the terms of the investment treaty. Muchlinski argues that imposing such a duty on investors would be entirely consonant with the FET standard, reflecting the inherent balancing process at the heart of the concept.[924] He argues that investors should take the regulatory and political environment into account and that regulations not explicitly stabilised in the relevant investment treaty might change, especially in areas of high levels of regulation,[925] such as natural resources and public utility services.

Given the inherent nature of international investment, political instability, social unrest, crises and an inefficient systems of administration, exacerbate the risks associated with

[923] Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (n 113) 404.
[924] Muchlinski, 'Caveat Investor?' (n 47) 542.
[925] Ibid 546.

investment. The facts in the *AMT*, *Bayinder*, and *Parkerings* disputes illustrate this. Even large multinational corporations can experience a high level of risk investing in unfamiliar host countries.[926] Muchlinski argues the tribunals should assess alleged breaches of the FET standard in light of such risks.[927] The tribunal in *Genin* conformed to this logic when it suggested that investors must take the degree of sophistication of the local authorities into account when investing in foreign country.[928] The awards in the *Bayinder*, *Parkerings,* and *Toto*, as well as the decision of the annulment committee on the *Sempra* award, also followed this approach to limited resources and capabilities under the existing circumstances of the host developing countries. Unfortunately, tribunals have not always approached the FET standard in the manner, and the body of awards do not provide developing countries any guidance as to how the future tribunals will address the complicated situations in which developing countries host foreign investment in a complex, globalised world.

The complexities of this environment are likely to lead to an increase in difficult cases in which the host developing countries are in particularly dire straits. Kläger points out the deficiencies in this when he states that,

> '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

[926] Ibid 534.
[927] Ibid.
[928] Genin (n 599) Para 348.

> to go beyond a mere analysis of case law and be capable of indicating, in difficult cases as well, what justificatory arguments are admissible."[929]

Kläger points out that the current approaches of the investment tribunals do not address the difficult situations that host developing countries might face in their obligation towards foreign investors.[930] The current approach is to simplify the FET standard by categorisation of lines of jurisprudence—*topoi*[931] as Klager terms them (these are legitimate expectations, non-discrimination, fair-procedure, transparency, and proportionality). These *topoi* are not sufficient to address the difficult and the unforeseen situations described above.

The current approach of simplifying the standard and applying it to specific fact situations, does not provide future tribunals any guidelines with which to deal with investment disputes that are likely to occur in relation to host developing countries, especially as national and global crisis situations or post-crisis situations affect host developing countries. These difficult situations are largely unforeseen, so without clearer application of the FET standard, host developing countries will remain vulnerable in increasingly complicated investment disputes. Therefore, this thesis argues that the tribunals need to reconceptualise the FET standard to accommodate the developmental issues and challenges that host developing countries will face in the investment dispute context. This means that factors such as limited resources and lack of infrastructure, technological support, and administrative capabilities, as well as the struggles related to extreme circumstances such as political instability, conflict and its aftermath, social

[929] Kläger, '*Fair and Equitable Treatment in International' in International Investment Law* (n 47) 121.
[930] Ibid. Also see discussion in 1.2.5 The Importance of the Arbitrators' Discretionary Powers in Interpreting FET 18.
[931] Kläger, '*Fair and Equitable Treatment in International' in International Investment Law* (n 47) 116-117.

unrest, social and political transitions, and economic crises should form essential elements in consideration of the FET standard. If the tribunals adopt such an approach to the FET standard that accommodates the difficult situations and development issues that host countries face in relation to foreign investment then this will provide a better reflection of the interpretation of the standard 'fairly' and 'equitably'. This will also enhance the trust of the developing countries in the international investment arbitration system as well as eliminate their fear of the 'catch-all' nature of the standard.

Considering the issues host developing countries face, would resolve the uncertainty of the scope of the standard and also give some clear guidance as to the role these perspectives should play in the interpretation of the FET standard. The inherent vagueness of the standard has given the arbitrators much leeway to interpret the standard. Kriebaum's examination of how tribunals have used this flexibility, which, as she notes, provide 'enough flexibility…to take account of the different stages of development across nations', concludes that tribunals have not made it clear whether the economic and political circumstances of host developing countries have any influence in the application of the standards or in the assessment of violation of even lower standards.[932] Thereby Kriebaum suggests that the flexibility in the substantive investment treaty standards allows the tribunals to consider the special situation prevailing in the developing countries, firstly in the liability stage, and secondly in the damages stage.[933] However no clear indication has emerged in their awards as to whether the investment tribunals will consider the conditions prevailing in the host countries and their developmental issues in future investment disputes. The resulting uncertainty raises concerns for host developing countries, which reconceptualising the

[932] Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (n 113) 402.
[933] Ibid 339.

standard from the perspective of the host developing countries can overcome. This reconceptualised standard should be considered at both the liability and damages stages of the proceedings.

8.2.B.b The Perspectives of Developing Countries in Investment Treaties

The international investment treaties currently lack useful guidance as to the role of level of development or developmental issues of the host countries. IIAs in particular suffer from this deficiency.[934] Other specialised development cooperation agreements, which aim to balance the particular needs of the developing countries with the modalities of economic development, and include aid and investment, may be better suited to the task. The IIAs and BITs cover a narrow range of interests and are usually silent on the level of development of signers and their developmental needs.[935]

The aim of using individual treaties to clarify the FET standard suffers from the fact that the purpose of investment treaties depends solely on the individual treaty, and treaty language diverges. Therefore this thesis cannot draw a general conclusion about their sensitivity to development issues. However, certain commonalities enable some concerns to be raised. Very broadly speaking, investment treaties aim to encourage and promote investment and cooperation for economic growth and development. Very few investment treaties make any concrete reference to the particular challenges that host countries face in an investment context.

[934] See e.g. Scope and Definition: UNCTAD Series on Issues in International Investment Agreements (UNCTAD 2011) 120 < http://unctad.org/en/docs/diaeia20102_en.pdf> accessed 6 October 2014.
[935] Ibid.

Article 19 of the IISD Model International Agreement on Investment for Sustainable Development[936] presents an exception. It incorporates this idea of considering the host country's level of development in applying the FET standard. Article 19 (C) of the Model Agreement states that 'Administrative decision making processes shall include the right of administrative appeals of decisions, *commensurate with the level of development of the host state*….' (emphasis added). Commentary on Article 19 states the concern that some arbitration decisions tend to disregard the level of development of a host state as a factor in assessing the standard of procedural fairness the investor should expect.[937] The commentary also refers to the fact that some tribunals have held expressly that the 'level of development and the political history of a state are relevant factors' in assessing the level or quality of the whole process that an investor should expect from a host state and thus legally be entitled to it.[938]

The Investment Agreement for Common Market for Eastern and Southern African (COMESA) 2010 has similar language.[939] In its Article on the FET standard, the COMESA Agreement refers to the different level of development of the host states. It states,

> '1. Member States shall accord fair and equitable treatment to COMESA investors and their investments, in accordance with customary international law. Fair and equitable treatment includes the obligation not to deny justice in

[936] IISD Model International Agreement on Investment for Sustainable Development (International Institute for Sustainable Development 2006) <http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf> accessed 6 October 2014.
[937] Ibid 32.
[938] Ibid 33.
[939] Investment Agreement for Common Market for Eastern and Southern African (COMESA). <http://vi.unctad.org/files/wksp/iiawksp08/docs/wednesday/Exercise%20Materials/invagreecomesa.pdf > accessed 8 October 2014.

criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.

2. Paragraph 1 of this Article prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments and does not require treatment in addition to or beyond what is required by that standard.

3. *For greater certainty, Member States understand that different Member States have different forms of administrative, legislative and judicial systems and that Member States at different levels of development may not achieve the same standards at the same time. Paragraphs 1 and 2 of this Article do not establish a single international standard in this context.*'[940] [Emphasis added]

The factors that impact host countries' treatment of foreign investors could never be entirely integrated into the text of investment treaties; many might be unforeseeable at the time of drafting, signing or executing and making an exhaustive list of even the foreseeable situations is impracticable. Therefore even investment treaties that mention the relationship of developing countries' situation in the FET clause require arbitrators to articulate an understanding of that relationship. Therefore there is still a need to specify the specific development factors which arbitrators should take into account in their decision-making processes, and thereby to reconceptualise the FET standard from host developing countries perspectives. This will ensure that the host developing countries will be free to encourage and protect foreign investment without bearing excessive risk for the challenges due to developmental issues and difficult circumstances that they face.

[940] Ibid.

8.3 Conclusion

The core argument of this thesis has been that in their interpretation of the FET standard, the investment tribunals prioritise the interests of the foreign investors over the perspectives of the host developing countries, and that this imposes a high cost on developing countries. This thesis has discussed in depth the pressing need to reconceptualise the standard from the perspectives of the host developing countries to accommodate the developmental issues and challenges they face in the interpretation of the FET standard. With that aim, Chapter 1 highlighted the fact that FET serves as a core (if not *the* core) investment protection standard for foreign investors in the investment treaties. It also provided a statistical account to justify the choice to focus the thesis on the treatment of host developing countries due to the high volume of disputes initiated against them and also the economic impact of those awards against them.[941] It discussed the extensive literature on the standard and showed that scholars have not defined the standard according to fundamental principles of justice, but rather empirically studied past arbitral awards in an effort to define the standard. The first chapter also emphasises the fact that scholars engaging in the literature have invariably identified the inherent vagueness of the standard. It has also emphasised the fact that as a 'catch-all' standard in investment treaties, FET can virtually invite foreign investors to invoke claims against governmental actions in any instance of loss.

Chapter 1 also emphasised the importance of the arbitrator's discretionary power to interpret the standard.[942] It stressed the fact that the inherent vagueness of the standard gives the arbitrators a good deal of leeway to interpret the standard from the

[941] See Discussion in 1.2.2 Developing Countries in Investment Dispute Arbitration 5.
[942] See Discussion in 1.2.5 The Importance of the Arbitrators' Discretionary Powers in Interpreting FET 18.

perspective of the host developing countries.[943] It has highlighted the question as to whether the arbitrators have adequately considered the issue in their interpretation of the standard to date. While Kläger describes the similarities between the FET standard and justice,[944] nevertheless he has rightly observed that FET 'does not yet represent an embodiment of justice, but rather symbolises an "expectation of justice" and it is questionable whether this is fully achieved.'[945] This thesis has revealed that although they cannot decide disputes *ex aequo et bono*, the equity and fairness element inherent in the standard and its inherent vagueness allows plenty of room for the tribunals to exercise their discretionary powers, as in Hart's concept of a 'penumbra of uncertainty'.[946] In this way, they balance the inevitable tension between the foreign investors and host developing countries, which Franck has described as a balancing between 'stability and change.'[947]

Chapter 2 provided an account of the standard's genealogy and historical development. It describes the roles developed and developing countries have played in the process of advancement of the standard in investment treaties, revealing that at its initial stage, developing countries, particularly in Latin America opposed the standard. Their shift in approach does not necessarily reflect a change in their understanding that the flexibility of the standard potentially prioritises the needs of foreign investors over those of developing countries. This chapter showed that the standard emerged in the multilateral setting and later entered the bilateral setting, where it proliferated. Most importantly, it highlighted the fact that an investment treaty with an FET clause has, over time, become an almost ever-present feature of international investment law.

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[943] See discussion in 1.2.4 Scholarship on the FET standard 10.
[944] Kläger, *Fair and Equitable Treatment in International Investment Law* (n 47) 143-144; Also see e.g. Franck, *Fairness in International Law and Institutions* (n 106) 34.
[945] Kläger, *'Fair and Equitable Treatment' in International Investment Law* (n 47) 256.
[946] Hart, *Concept of Law* (n 101) 12.
[947] Franck, *Fairness in International Law and Institutions* (n 106) 438.

Chapter 3 argued that limiting the standard with vague principles of international law, like that of the minimum standard, does not clearly limit the scope of FET. It demonstrated that no body of rules clearly establishes the minimum standard of international law or customary international law, and therefore argues that these principles cannot encompass an ever-evolving standard like FET in a way that addresses the present–day, highly complicated investor-state relationship. Therefore the chapter has made it clear in its discussion of FET *minus* that combining the standard with the minimum standard does not create a secure guarantee for developing countries that the scope of the standard will be significantly restricted.[948] It also points out that in some treaties, the parties have made an attempt to limit the FET standard by definitional restriction and by combining it with more specific standards. However given the vast majority of treaty constructions of the text of the standard, these are exceptional instances. Therefore, in the vast majority of the treaties, the host developing countries need to assume that the tribunals will interpret the FET standard as an independent and autonomous standard. The chapter also explained that combining the FET standard with an additional substantive obligation (FET *plus*) does not limit or help to shape the scope of the standard, rather, the sphere of the standard goes beyond these restrictions.[949] Kläger describes these constructions of FET as a 'stylistic question rather than one of substance'.[950] Therefore, despite the different constructions of the standard in different investment treaties, this thesis argues that for the majority of the treaties, FET needs to be construed as a separate and independent clause, allowing the arbitrators to exercise their discretionary powers to interpret the standard.

[948] See discussion in 3.2.A FET *Minus* 62.
[949] See discussion in 3.2.C FET *Plus* 84.
[950] Kläger, *Fair and Equitable Treatment in International Investment Law* (n 47) 17.

Chapter 4 highlighted the fact that adopting a single phrase like 'developing countries' to address the vast majority of the countries in the world means that a wide range of disparities among these countries remain.[951] It argues that the classifications international organisations have used provide a broader perspective on a wide range of issues developing countries face and the developmental level of a country in social and economic terms such as GDP, GNI, or HDI. But these classifications and criteria do not provide adequate assistance in understanding the developmental issues and challenges host developing countries face in the investment dispute context. Therefore this thesis proposes that investment tribunals need to identify an appropriate concept of development relevant to host developing countries in the investment context. Accordingly, Chapter 4 highlights the relevance of issues such as lack of administrative capacity, resources, infrastructure, and technological support; of the particular challenges these countries face due to political instability, social unrest, conflict and its aftermath, transitory status, and economic crisis; and of the need to change policy in sectors related to foreign investments. It argues that the FET standard should reflect these issues.

Chapters 5, 6, and 7 provide in-depth analysis of some selected arbitral awards to demonstrate the wide range of approaches that the tribunals have adopted to address the developmental issues and challenges of the host developing countries in three different situations—socio-political instability, transitory status, and economic crisis. These case studies demonstrated that the tribunals have been inconsistent, and largely inadequate, in their approach to the developmental issues and challenges of the host developing countries. As Kläger rightly states, the approaches investment tribunals have

[951] See discussion in 4.2.B Disparities and Differences Across Developing Countries and the Concept of Development 104.

taken to date are not adequate to address the difficult situations in investment disputes[952] like those discussed in chapters 5, 6, and 7.

Finally, part 8.2.A of the present chapter summarised the key cross-cutting problems of interpretation by the tribunals in addressing the issues and challenges host developing counties face on the basis of the analysis of the arbitral awards. In investigating the loopholes of those interpretations, the present chapter has identified two major areas in which the problem lies, i.e. the inconsistency and the inadequate approach on substantive issues of the host developing countries relevant to foreign investment. Part 8.2.A of the chapter has highlighted that these problems can have a significant impact on host developing countries, which might put the investment arbitration system as a whole at risk. It has also highlighted the fact that in a more globalised world, new exceptional circumstances, crises, and national disasters are more likely to emerge to disrupt the socio-political and economic life of the developing countries similar to those discussed in Chapters 5, 6 and 7. Therefore this part argues that if the tribunals do not adopt an approach to address these difficult situations, the interpretation of a flexible standard like FET will have a far-reaching impact upon host developing countries. As Kläger has rightly identified, there is pressing need for a comprehensive doctrinal approach that goes beyond case law analysis to address the difficult cases and crisis situations of some examples given above.

In line with Kriebaum's point that the conditions prevailing in the host country are highly relevant and that foreign investors' legitimate expectation should not restrict developing countries' need to change policy in sectors which are likely to affect foreign

[952] See Kläger, *Fair and Equitable Treatment in International Investment Law* (n 47) 121.

investment,[953] part 8.2.B of the present chapter proposes a reconceptualised interpretation of the FET standard which would address the developmental issues and challenges host developing countries face in the investment disputes context. It has also highlighted the fact that the current investment treaties do not provide the arbitrators enough guidance as to the role of development in host countries. Therefore, in the absence of treaty guidance, the tribunals need to exercise their discretionary powers to reconceptualise the FET standard to accommodate the developmental issues in their interpretation of the standard. Future lines of interpretation need to consider the developmental issues and the challenges of the host developing countries in more complicated situations in a complex world, to better clarify the application of the standard. In this complex globalised world, developing countries are more vulnerable to situations like the rise of militancy, social unrest, and outbreak of epidemic diseases, and their lack of resources and administrative capacity to face these crises mean that such events threaten the very functioning of host developing countries' state machinery. This vulnerability of developing countries is significant in the investment dispute context. Therefore, this thesis argues for a reconceptualisation of the FET standard from the perspective of host developing countries. It argues that the developmental issues and challenges of these countries require this. Such a reconceptualised standard would provide future investment tribunals with consistent and clear guidance as to how to address disputes against host developing countries. By accommodating developing country–specific conditions in a particular investment dispute, this thesis argues, the investment tribunals can ensure greater the certainty of the interpretation of the FET standard against host developing countries which would ensure the stability of the investment arbitration system, and with it, global investment.

[953] Kriebaum, 'The Relevance of Economic and Political Conditions for Protection under Investment Treaties' (n 113) 404.

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