

BETRAYAL, SHOCK AND OUTRAGE - RECENT DEVELOPMENTS IN NAFTA ARTICLE 1105

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I. INTRODUCTION

WHAT DO STATE PARTIES to international investment treaties mean when they say they want to assure that investments of investors receive "treatment in accordance with international law, including fair and equitable treatment and full protection and security"? What is "fair and equitable treatment"?

The interpretation of these simple terms has caused a great deal of controversy in the arbitrations under the investment dispute provisions of the North American Free Trade Agreement (NAFTA). At the centre of the controversy has been the attempt by the NAFTA Parties to re-write NAFTA Article 1105 (Article 1105) through the mechanism of an all Party interpretation. Professor Sir Robert Jennings, an eminent scholar, summarized the situation in an expert opinion he provided to one of the NAFTA Chapter 11 (Chapter 11) panels involving the United States as the respondent:

It would be wrong to discuss these three-party 'interpretations' of what have become key words of this arbitration, without protesting the impropriety of the three governments making such an intervention well into the process of arbitration, not only after the benefit of seeing the written pleadings of the parties but also virtually prompted by them. In the present case, without even asking for leave, one of the actual Parties to the arbitration has quite evidently organized a demarch intended to apply pressure on the Tribunal to find in a certain direction by amending the treaty to curtail investor protections. This is surely against the most elementary rules of due process of justice. The phrase due process is itself of United States origin and has become international (see NAFTA Article 1110) because the United

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States has been for so long regarded as the guardian of due process. It is very sad to see this present betrayal of principles of which the United States has long been the revered author and practitioner.¹

While talk of betrayal, improprieties and unseemly pressuring of Tribunals has provided drama in the elevated climes of NAFTA arbitrations, in the broader context, the very idea of "international law" has also been under pressure over the past few years. In particular, the events surrounding September 11th and the invasion of Iraq by the United States have prompted a reassessment of the relevance of international law, and the role of international organizations like the United Nations. The context for that re-assessment is the age-old conundrum of international law - the balance of national self-interest against the interests of the broader international community. Added to this balancing is the inherent driving force of international law toward harmonization and integration with the resulting diminishment of national sovereignty.

In this context, we have Article 1105 with its assurance of "treatment in accordance with international law" and a number of arbitral claims that have clearly caused the three NAFTA Parties a great amount of anxiety. Article 1105 can be seen as a clear expression of international law imposing obligations detached from domestic obligations. Because Article 1105 contains wording similar to other international standards of treatment clauses found in over 1,800 Bilateral Investment Treaties (BITs), and the investment provisions of other free trade treaties like the NAFTA, the recent Tribunal awards will have an important impact on the development of this key area of the law of investor-state dispute resolution.

Fundamentally, provisions like Article 1105 are intended to provide foreign investments with the security of knowing that their host state cannot treat them any worse than the standard of treatment provided for under international law. In other words, such clauses make the important recognition that there exists a standard of treatment for investments under international law that is separate and independent from domestic laws.

This international law standard can be contrasted to other standards of treatment for investments, such as the national treatment and the most-favoured nations (MFN) treatment standards, which provide for treatment no less favourable than that received by similar domestic or other foreign investors. National treatment and MFN are relative standards, while the international standard is absolute. What this means is

¹ Fourth Opinion of Sir Robert Jennings, *Methanex Corporation and United States of America (Methanex)*, "The Meaning of Article 1105(1) of the NAFTA Agreement," September 6, 2001 at 4-5.

that, even if the domestic law of a state accepting international investment treats all investors equally badly under domestic law, international law assures a standard of conduct that governments cannot transgress. The question is - where is that line drawn? What is that international standard with respect to investments?

Over the past five years this debate has accelerated dramatically. This article will make a modest attempt to recount the key turns in the road and map out the present and future direction of this international standard for investments.

II. THREE VARIATIONS OF THE INTERNATIONAL LAW STANDARD OF TREATMENT FOR INVESTMENTS

UPON REVIEW OF RECENT TREATY PRACTICE and arbitral case law, three basic variations of the international standard of treatment clause can be identified. These three types of clauses vary mainly as to how they deal with what is called the "fair and equitable treatment" standard. The first variation can be described as the "additive provision", the second as the "inclusive provision", and the third as the "customary international law provision".

1. Variation One - The Additive Provision

The additive provision is a variation that is common to many BITs around the world. For example, the BIT between the Czech Republic and the United States includes the following provision:

Article II

2. (a) Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.²

On its face, this provision would appear to consider the fair and equitable treatment standard as one that is in addition to the standard under international law, a standard that is self-contained and distinct from the content of the international law standard. Otherwise, one could argue, it

² Online: <http://www.tcc.mac.doc.gov/cgi-bin/doit.cgi?204:64:859493330:41,<http://www.export.gov>>.

would not be necessary for the treaty to provide that an investment "... shall in no case be accorded less than that required by international law." The provision also strongly suggests that the fair and equitable treatment standard is a higher standard than the "no less" required by international law. This type of provision arguably provides the highest standard of protection for investors and their investments.

2. Variation Two - The Inclusive Provision

An example of our second type of provision, the inclusive provision, can be found in the NAFTA's investment chapter at Article 1105(1), as follows:

Article 1105: Minimum Standard of Treatment

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

In this provision, the drafters appear to indicate that the fair and equitable treatment standard should be considered subsumed under international law and not as a separate or autonomous standard of treatment.

3. Variation Three - The Customary International Law Provision

The third variation, which can be termed the customary international law provision, has developed in the past two years in the BIT practice of the United States in response, it appears, to the perceived weaknesses or lack of clarity of Article 1105. Article 10.4 of the U.S.-Chile Free Trade Agreement provides as follows:

Article 10.4: Minimum Standard of Treatment

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by

that standard, and do not create additional substantive rights. The obligation in paragraph 1 is to provide:

(a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

(b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.

3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.³

What is critical in this provision is the change from the standard NAFTA type text of "treatment in accordance with *international law*" to "treatment in accordance with *customary international law*". Moreover, the United States has attempted to clarify what it means by the terms "fair and equitable treatment" and "customary international law".⁴ Based on the content of the NAFTA Free Trade Commission Note of Interpretation, one could say that Article 1105 now could also be categorized under this third type.⁵

What these three variations of the international standard have in common is that they all explicitly include a reference to "fair and equitable treatment", and "full protection and security". The three variations also provide for an international standard under "international law", or some sub-set of international law such as customary international law or principles of international law.

³ See the website of the USTR for the final text of the US-Chile Free Trade Agreement, June 6, 2003, online: <<http://www.ustr.gov/new/fta/Chile/final/10.investment.PDF>>.

⁴ The US attempted this interpretation in such early cases as *S.D. Myers* and *Pope & Talbot*, as discussed below.

⁵ However, the fact that the United States has adopted the specific wording in its most recent treaties, such as the US-Chile Free Trade Agreement, begs the question again as to whether the FTC Note of Interpretation was an amendment of the NAFTA rather than an interpretation in the technical sense of those terms in international law.

However, the three variations apparently differ in how they view the relationship between the fair and equitable treatment standard and international law as follows:

- The *customary international law* provision makes it clear that the fair and equitable treatment standard is customary international law;
- The *inclusive provision* is less narrow and allows one to conclude that the fair and equitable standard is included under the sources of international law more generally, perhaps as a principle of international law, or as part of customary international law, or both; and
- The architecture of the *additive provision* suggests that fair and equitable treatment is a standard that provides a greater level of protection than is provided under international law, and hence, is not "included" in an international law standard such as the "minimum standard of treatment" which is considered to give a relatively lower standard of protection.

It is the author's view that the real difference between the three variations, as demonstrated by recent arbitral decisions, is not great if a claim is made solely under the fair and equitable treatment standard.⁶ Whether one characterizes the fair and equitable standard as being customary international law or not, as additive to or included in international law, the question is always - what is the substantive content of the fair and equitable treatment standard? The discussion below attempts to address this question in the context of recent arbitral awards.

⁶ However, the implications of the three variations for more general claims under "international law" are considerably greater. The customary international law provision arguably involves a dramatic narrowing of the scope of the international standard protections for investments. The recent agreements of the United States with Chile and Singapore provide examples of a trend to use this type of clause, and certainly bodes ill for future such agreements, like the Free Trade Area of the Americas (FTAA) Agreement. By restricting international law protections to customary international only, and by excluding other sources of international law such as principles, treaty law, case law and the works of publicists, the task of establishing such law has been made very difficult indeed.

III. Review of Arbitral Decisions on the Fair & Equitable Treatment Standard

EIGHT RECENT ARBITRAL AWARDS MADE under the NAFTA or BITs provide a foundation for a modern understanding of the fair and equitable treatment obligation for investments. Six of these awards have been made by the Chapter 11 Tribunals, while the remaining two awards, *Lauder* and *CME*, were made with respect to BITs involving the US, the Netherlands and the Czech Republic. All of these awards touch on the meaning of the fair and equitable treatment standard to a greater or lesser degree. The *Mondev* arbitration, however, can be characterized primarily as relating to claims of denial of justice and not directly concerning fair and equitable treatment.

In the context of the events surrounding these arbitrations and awards, the announcement of the NAFTA Free Trade Commission (FTC) Note of Interpretation concerning Article 1105 on July 31, 2001 is a notable landmark in the development of the fair and equitable standard in the NAFTA. The FTC Note of Interpretation states as follows:⁷

Note of Interpretation concerning Article 1105 on July 31, 2001 is a notable landmark in the development of the fair and equitable standard in the NAFTA. The FTC Note of Interpretation states as follows:⁷

Having reviewed the operation of proceedings conducted under Chapter Eleven of the North American Free Trade Agreement, the Free Trade Commission hereby adopts the following interpretations of Chapter Eleven in order to clarify and reaffirm the meaning of certain of its provisions:

B. Minimum Standard of Treatment in Accordance with International Law

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

⁷ Online: <<http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>>

international agreement, does not establish that there has been a breach of Article 1105(1).

The FTC Note of Interpretation was announced unexpectedly in response to the awards of the Tribunals in *Metalclad*, *S.D. Myers and Pope & Talbot* and to on-going arbitrations such as *Methanex* and *Loewen*.⁸ One could argue, as a number of NAFTA claimants and Sir Robert Jennings did, that the FTC Note of Interpretation was intended to pre-empt a number of the on-going Chapter 11 arbitrations addressing Article 1105. To allow the reader to follow the progression of these awards, the NAFTA cases will each be addressed chronologically and divided with regards to whether they are pre- or post- FTC Note of Interpretation, as follows (dates of relevant awards in brackets):

- *Metalclad* (August 30, 2000),
- *S.D. Myers* (November 13, 2000),
- *Pope Merits No. 2* (April 10, 2001),
- FTC Note of Interpretation (July 31, 2001),
- *Pope Damages Award* (May 31, 2002),
- *Mondev* (October 11, 2002),
- *ADF* (January 9, 2003).

With respect to the *Lauder* (September 3, 2001) and *CME* (September 13, 2001) awards, they will be dealt with separately after the discussion of the Chapter 11 arbitrations.

1. Pre-FTC Note of Interpretation

The three early NAFTA Tribunals, *Metalclad*, *S.D. Myers and Pope & Talbot*, grappled with a range of possible meanings for Article 1105. At a general level, one could characterize the two main approaches to the interpretation of the fair and equitable treatment standard before the three Tribunals as representing; firstly, a plain meaning approach; and secondly, an approach equating the standard with the historical international law minimum standard of treatment.⁹

⁸ Note that there was neither public consultation prior to the announcement of the Note of Interpretation nor any transparency with respect to the deliberations that did take place. The irony of the FTC Note of Interpretation is that, in addition to the interpretation of Article 1105, it sought to provide more transparency to the Chapter 11 process.

⁹ A similar assessment is made by the authors of "Fair and Equitable Treatment", UNCTAD Series on Issues in International Investment Agreements (1999) at 10.

At its most basic, the plain meaning approach essentially involves the assessment of whether any given government conduct may be considered to fall outside the literal understanding of what is "fair" or "equitable". The inherent danger of this approach is its potentially subjective nature and that some Tribunals may take the opportunity to apply what is equivalent to an equitable jurisdiction *ex aequo et bono*.¹⁰ If the application of this approach is not grounded objectively in the particular context, object and purpose of the treaty, and sources of international law, it may give rise to conflicting and inconsistent interpretations.

However, this approach need not be totally devoid of objective content. As noted in the UNCTAD Series on Issues in International Investment Agreements, "it is possible to identify certain types of behaviour that appear contrary to fairness and equity in most legal systems." The authors gave a number of examples of such treatment, including:

... for instance, if a State acts fraudulently or in bad faith, or capriciously and wilfully discriminates against a foreign investor, or deprives an investor of acquired rights in a manner that leads to the unjust enrichment of the State, then there is at least a *prima facie* case for arguing that the fair and equitable standard has been violated.¹¹

Both the additive and inclusive variations of the international standard provisions outlined above are open to the application of the plain meaning interpretive approach to the fair and equitable treatment standard. In particular, Article 1105 is drafted in a manner which would clearly allow for a plain meaning interpretation. This is, of course, why the NAFTA Parties have been so aggressive in their attempts to "clarify" its meaning to one that is more limited in scope.

The second approach equates the fair and equitable treatment standard to what has been referred to historically as the international mini-

¹⁰ Under the Statute of the International Court of Justice, Article 38(2), it is made expressly clear that such an equitable jurisdiction may only be invoked subject to the express agreement of the parties. As Sir Eli Lauterpacht noted, with respect to "fair and equitable" treatment in bilateral investment treaties: "Everybody appreciates that there is no intrinsic or objective concept of equity applicable in those circumstances, but that we are here dealing with a concept the content of which is closely related to the facts of any given case." Sir Eli Lauterpacht, *Aspects of the Administration of International Justice* (1991) at 122.

¹¹ "Fair and Equitable Treatment", UNCTAD Series on Issues in International Investment Agreements (1999) at 12, online: <<http://r0.unctad.org/en/subsites/dite/iaa/IIA-Series/fair.Pdf>>

imum standard of treatment of aliens. The somewhat strained and torturous strategy of all the NAFTA Parties in these early Chapter 11 cases was to limit Article 1105, and the fair and equitable standard, to the minimum standard of treatment and, in particular, to a 1926 US-Mexico General Claims Commission case called *Neer*.¹² Not unexpectedly, the plain meaning approach has consistently been resisted by the NAFTA Parties, especially by the United States, because they perceive it as being an overly expansive interpretation of Article 1105.

The *Neer* case was relied upon by the NAFTA Parties as the “seminal” case on the international minimum standard because it created a low threshold standard of conducts easily reached by any government. After being frequently cited by Canada in its NAFTA arbitration submissions, this standard has become known as the “egregious” standard of treatment. The relevant portion of the *Neer* award repeatedly relied upon by Canada in its submissions of July 7, 2003 stated that:

The propriety of government acts should be put to the test 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 to an insufficiency of government action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.¹³

These arguments foreshadowed the FTC Note of Interpretation which would subsequently “clarify” the meaning of Article 1105 as prescribing “... the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.”¹⁴

The main problem related to the NAFTA Parties’ reliance on the *Neer* case, and the minimum standard, is that the test is a threshold test, and not one with any apparent objective content. In effect, the threshold was set so low, and the examples of that conduct so serious, that Article 1105 became virtually meaningless except in situations of gross violations of due process or human rights. Most tellingly, of all the NAFTA Tribunals

¹² *United States (L.F. Neer) v. United Mexican States* (1926) 4 R.I.A.A. 60, Mexico-US General Claims Commission (*Neer*).

¹³ See *Pope & Talbot v. Canada*, Government of Canada Counter-Memorial (Phase Two), at para. 260 citing *Neer* at para. 4, online: <<http://www.dfait-maeci.gc.ca/tna-nac/Phases-en.asp>>

¹⁴ Free Trade Commission Note of Interpretation at para. B(1).

that have ruled on this issue, none have agreed with the NAFTA Parties' views on the scope of Article 1105, equating the fair and equitable treatment standard expressed in the historical minimum standard of treatment.

Metalclad

On August 30, 2000, the Chapter 11 Tribunal in *Metalclad Corporation and The United Mexican States (Metalclad)* made the first substantive decision on Article 1105 in favour of an investor.¹⁵ The Tribunal found that Mexico, and its local governments, "interfered" with the "development and operation of a hazardous waste landfill" investment and thus breached Mexico's NAFTA obligations as set out in Articles 1105 and 1110 concerning expropriation.¹⁶

The decision of the *Metalclad* Tribunal was partly based on its interpretation of the substance of the fair and equitable treatment requirement of Article 1105. The Tribunal summarized this violation as follows:

Mexico failed to ensure a transparent and predictable framework for *Metalclad's* business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA....

The Tribunal therefore holds that *Metalclad* was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105.¹⁷

The *Metalclad* Tribunal has equated the failure of Mexico to ensure a transparent and a predictable process for investments as evidence of a breach of the fair and equitable treatment standard. The following types of conduct were deemed by the Tribunal in their "totality" to breach the fair and equitable treatment obligations of Article 1105:

¹⁵ *Metalclad Corporation and The United Mexican States*, Award, August 30, 2000 (*Metalclad Award*). The distinguished panel in *Metalclad* included: Professor Sir Elihu Lauterpacht, as President, Mr. Benjamin Civiletti, and Mr. Jose Luis Siqueiros.

¹⁶ *Metalclad Award* at para. 1.

¹⁷ *Metalclad Award* at paras. 99-101.

- the denial of a right to a fair hearing;¹⁸
- lack of sufficient evidence on the record;¹⁹
- breach of legitimate expectations;²⁰
- absence of clear rules and transparency;²¹
- acting on the basis of irrelevant considerations;²² and
- acting beyond the scope of lawful authority.²³

The Metalclad Tribunal based its decision on the fundamental reason for the existence of international investment and trade agreements such as the NAFTA - to provide predictability and certainty to foreign investors or importers when they invest or operate in a foreign country. The

¹⁸ Metalclad Award at paras. 54 and 91. A great deal of the Metalclad case concerning NAFTA Article 1105 turned on the award of a construction permit by the local municipality. In the facts, Metalclad was not notified of the town council meeting at which the permit application was discussed and rejected, nor was Metalclad permitted to participate in that process.

¹⁹ Metalclad Award at paras. 52 and 92. When the local municipality made its decision to deny Metalclad its construction permit, the Tribunal acknowledged that not only was there no established practice or rules for such a decision, but there was "no evidence of inadequacy of performance by Metalclad of any legal obligation." (At para. 52) As the Tribunal summarized: "None of the reasons [for the denial of the permit] included a reference to any problems associated with the physical construction of the landfill or to any physical defects therein." (at para. 92)

²⁰ Metalclad Award at paras. 36, 41, 76, 80, and 85-87. Metalclad was led to believe that the federal and state permits were all that was required to construct and operate a landfill, and that the municipality had no authority except with respect to construction permits.

²¹ Metalclad Award at 88: "The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure transparency required by the NAFTA." The Tribunal refers to the NAFTA interpretive principle of "transparency", as noted at NAFTA Article 102(1), as including this idea that: "... all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of the another Party. There is no room for doubt or uncertainty on such matters." (at para. 76).

²² Metalclad Award at para. 92. The construction permit was denied entirely on reasons unrelated to construction of a landfill.

²³ Metalclad Award at para. 86: "The denial of the permit by the Municipality by reference to environmental impact considerations in the case of what was basically a hazardous waste disposal landfill, was improper, as was the denial of the permit for any reason other than those related to the physical construction or defects on the site."

President of the Tribunal, Sir Eli Lauterpacht, clearly understood the fair and equitable treatment standard to be contingent on the facts of the particular case in the context of the NAFTA. The Metalclad Tribunal's interpretation and application of the fair and equitable treatment obligation is consistent with the plain meaning approach. Clearly this is why the NAFTA Parties took such great exception to the decision.

S.D. Myers

The Tribunal in *S.D. Myers, Inc. and Canada (Myers)* followed shortly after the Metalclad Award with its Partial Award on the merits on November 13, 2000. The merits award in the Myers arbitration will be best remembered as the first Chapter 11 decision on national treatment.²⁴ Although the Tribunal made an award in relation to Article 1105, it was not crucial to the final result of that case. However, Article 1105 decision of the Tribunal clearly had an impact on the NAFTA Parties who drafted part of the FTC Note of Interpretation to counter Article 1105 decision of the Tribunal.

In the view of the Tribunal, the *S.D. Myers* case was a clear-cut instance of nationalist protectionism by Canada. Under the guise of an emergency measure based on health and environmental rationale, the Canadian Minister of the Environment banned the export of PCB wastes to the United States. As found by the Myers tribunal, the intent of the government in closing the border was to protect and promote the Canadian market share of domestic competitors.

S.D. Myers was one of the leading remediators of PCB waste in the US at the time of the Canadian border closure. *S.D. Myers'* US operations were located in Ohio, just south of Cleveland. It was well placed to service the large and mostly untouched PCB waste market in the Quebec City to Windsor, Ontario industrial corridor. Prior to the closure of the border by Canada, *S.D. Myers* had expended a great deal of resources in securing a pipeline of orders and contracts. The major competitor of *S.D. Myers* in Canada, and the main proponent of the border being closed, was an incineration facility located in Swan Hills, in northern Alberta. The suspected intent of the border closure was to guarantee the Canadian market to the local competitor.

²⁴ *S.D. Myers, Inc. and Government of Canada, Partial Award, November 13, 2000 (Myers Award)*. The Tribunal included Prof. Martin Hunter, as president, Edward Chiasson and Prof. Bryan Schwartz.

Online: <<http://naftalaw.org/>> and <<http://www.appletonlaw.com/4b2myers.htm>>, respectively.

After many years of lobbying by S.D. Myers, the US Environmental Protection Agency (EPA) finally agreed to permit the import of PCB waste into the United States in October, 1995. This was important for S.D. Myers as Canadian regulations already permitted such export to the US subject to the agreement of US authorities. However, for well documented protectionist reasons, within one month of the US border opening, Canada instituted a ban against the export of PCB wastes in November, 1995 that lasted until February, 1997. The border was then opened again for a five month period, but was finally closed by the EPA in July, 1997 and remains closed as of the date of writing.

The Tribunal characterized the export ban instituted by Canadian officials as an act which violated the fair and equitable treatment standard as follows:

- the export ban was the result of protectionist and discriminatory intent;²⁵
- the export ban favoured nationals over non-nationals;²⁶ and
- S.D. Myers was directly prevented from "carrying out the business they planned to undertake..."²⁷

The Tribunal unanimously concluded that this intentionally discriminatory conduct was a breach of the NAFTA Article 1102 obligation of national treatment. Without classifying each example of conduct as a violation of Article 1105, the majority of the Tribunal concluded that the above conduct also violated Article 1105. In arriving at its Article 1105 decision, the Tribunal described the content of the Article 1105 standard as follows:

The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in

²⁵ *S.D. Myers, Inc. v. Canada, Partial Award*, November 13, 2000 (Myers Partial Award) at para. 162: "The evidence establishes that CANADA's policy was shaped to a very great extent by the desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals. Other factors were considered, particularly at the bureaucratic level, but the protectionist intent of the lead minister in this matter was reflected in decision-making at every stage that led to the ban." Also see para. 194. Online: <<http://naftalaw.org/>> and <<http://www.appleton-law.com/cases/Myers>>, respectively.

²⁶ Myers Partial Award at para. 193.

²⁷ Myers Partial Award at para. 193.

such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. The determination must also take into account any specific rules of international law that are applicable to the case.²⁸

The Tribunal further notes, with respect to the fair and equitable treatment standard, that:

In some cases, the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied "*fair and equitable treatment*", but the fact that a host Party has breached a rule of international law that is specifically designed to protect investors will tend to weigh heavily in favour of finding a breach of Article 1105.²⁹

On its face, it would not seem contentious that the type of intentional and openly protectionist and discriminatory conduct faced by S.D. Myers could also be characterized as a breach of the fair and equitable treatment obligation. S.D. Myers relied on Canadian regulations which stated clearly that if the US EPA permitted imports of PCB waste, Canada would permit those exports. Local competitors were clearly aware that S.D. Myers was in a position to secure a large share of the market, much as it did in the US, and the Canadian competitors were successful in convincing government officials to close the border for illegitimate reasons. The Myers case is an example, much like Metalclad, of a breach of the legitimate expectations of a foreign investor in establishing and operating its investment, as well as arbitrary and discriminatory conduct by government officials.

However, there was clearly a division in the Myers Tribunal concerning whether the conduct of the Canadian officials rose to the level that would also breach Article 1105. The majority concluded that "on the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well."³⁰

²⁸ Myers Partial Award at para. 263.

²⁹ Myers Partial Award at para. 264.

³⁰ Myers Partial Award at para. 266.

In its analysis of Article 1105, the majority of the Myers Tribunal adopted the views of F.A. Mann concerning the "breadth" of the fair and equitable treatment standard as going "...much further than the right to most-favoured-nation and to national treatment." The F.A. Mann quote relied on by the majority goes on to state, with respect to the fair and equitable standard, that:

... so general a provision is likely to be almost sufficient to cover all conceivable cases, and it may well be that provisions of the Agreements affording substantive protection are not more than examples of specific instances of this overriding duty.³¹

Although not quoted by the Myers Tribunal, it is important to note that F.A. Mann expands in his description of the scope of the standard by stating that:

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.³²

Even though the Myers Tribunal acknowledged that the statement by F.A. Mann may be an over-generalization, the majority accepted this statement in support of their view that, in the specific facts of the case, the overt and intentional national treatment breach could be construed to also be a breach of the fair and equitable treatment obligation.

In a direct response to this element of the Myers Partial Award, the NAFTA FTC Note of Interpretation included the interpretation that (at para. B(3)):

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agree-

³¹ Myers Partial Award at para. 265 quoting F.A. Mann, "British Treaties for the Promotion and Protection of Investments" (1981) 52 BYIL 241 at 243-244.

³² Mann at 244.

ment, does not establish that there has been a breach of Article 1105(1).

The FTC Note of Interpretation appears to be an over-reaction by the NAFTA Parties to the Myers Partial Award. A close reading of the award makes it clear that the majority of the Tribunal sought merely to confirm the fairly obvious conclusion that the facts that support a breach of another investment obligation "will tend to weigh heavily in favour of finding a breach of Article 1105."³³ In particular, in the case of an overtly discriminatory measure such as the PCB waste export ban, such a conclusion is clearly within the criteria contemplated under the general conception of fair and equitable treatment. In other words, it is not the national treatment breach itself that establishes the breach of Article 1105, but the facts leading to the national treatment breach that support both breaches.

It is difficult to definitively characterize the Myers Partial Award. On the one hand, because the Tribunal relied upon a number of cases commonly cited in relation to the minimum standard, the award can be characterised as adopting the minimum standard approach of Canada.³⁴ However, by relying on F.A. Mann's views of the fair and equitable treatment standard, one can argue that in the end result the Myers Tribunal adopted a position squarely in the plain meaning interpretative approach. In either case, it is clear that the conduct of the respondent was such a patent and serious form of discrimination that the application of either interpretive approach would have yielded the same result.

Pope & Talbot

Of all the Chapter 11 cases related to Article 1105, the Pope & Talbot, Inc. v. Canada (Pope & Talbot) arbitration is of particular interest as its merits and damages awards were made before and after the announcement of the FTC Note of Interpretation, respectively.³⁵

The awards of the Pope & Talbot Tribunal concerning Article 1105

³³ Myers Partial Award at para. 236

³⁴ As the Pope & Talbot Tribunal assessed in its second Merits Award at para. 113, footnote 108.

³⁵ *Pope & Talbot v. Canada, Award on the Merits of Phase 2*, April 10, 2001 (Pope Merits Award), and *Award in Respect of Damages*, May 31, 2002 (Pope Damages Award). The Tribunal members included: Lord Dervaird, as president, Murray Belman and Judge Benjamin Greenberg.

were made in relation to acts of government officials that arose in the context of the arbitration process. The Tribunal found that, in reaction to the submission of the Investor's NAFTA claim, Canada initiated a process that resulted in an extensive audit of the financial and operational records related to its export of softwood lumber under the softwood lumber export control regime established by Canada in response to the Softwood Lumber Agreement (SLA). Pope & Talbot was in the business primarily of exporting softwood lumber to the United States and the quota allocation provided to it under the regime was critical to its ongoing operations. The fundamental basis of the Investor's NAFTA claim was its concern about its inexplicable reduction of its quota over the first three years of the SLA. The conduct of Canada with respect to what was called the "verification episode" appears to have justified those concerns.

In the Tribunal's assessment, government officials made specific efforts to intimidate the claimant through threats and misrepresentation concluding that the actions of officials "would shock and outrage every reasonable citizen of Canada; they did shock and outrage the Tribunal."³⁶ The following types of conduct by Canada concerning the "verification episode"³⁷ were deemed to breach the fair and equitable treatment obligations of Article 1105:

- acting beyond the scope of lawful authority;³⁸
- repeated threats to reduce or cancel softwood lumber quota that would have effectively closed the Investment's operations in Canada;³⁹
- denial of reasonable requests for pertinent information;⁴⁰ and

³⁶ Pope Damages Award at 68-69.

³⁷ Pope Merits Award at paras. 156-181.

³⁸ When requested by the Investor to provide the legal basis of its authority to require verifications in the first place, Canada "refused to provide any kind of legal justification, relying instead on naked assertions of authority..." Pope Merits Award at para. 174.

³⁹ Canada relied on "threats that the Investment's allocation could be cancelled, reduced or suspended for failure to accept verification." Pope Merits Award at para. 174. The Tribunal also notes that officials made recommendations to the Minister to cancel or reduce Pope & Talbot's quota based on numerous misrepresentations as to the conduct of Pope & Talbot. At one point, officials even suggested to the Minister that Pope & Talbot had acted criminally. Pope & Talbot Merits Award at paras. 177-179.

⁴⁰ After conducting the verification review, Canada refused to provide the report arising out of the verification process to the Investor. The Tribunal concluded that Canada appeared to be "... more devoted to catching the Investment in further errors than to its professed aim of assuring that accurate data be used by the [government officials] in administering the Regime." Pope Merits Award at para. 179.

- misrepresentations to the investor.⁴¹

The Pope & Talbot Tribunal's decision on Article 1105 was controversial, not only because the Tribunal adopted a subjective plain meaning interpretative approach in complete rejection of the submissions of the NAFTA Parties, but it also reinterpreted Article 1105 as providing obligations equivalent to an additive provision based on an application of the most-favoured-nation principle. It was the Pope & Talbot Tribunal's conclusion that the additive provision provided a higher standard of treatment than the inclusive construction of Article 1105. In the Tribunal's view, the additive construction supported the plain meaning approach that the fair and equitable treatment standard was free of any threshold that might be applicable to the evaluation of measures under the minimum standard of treatment. The standard to be applied was the idea of fairness under ordinary standards applied in the NAFTA countries.

As suggested above, it was not necessary for the Pope & Talbot Tribunal to conflate the additive type provision with a plain meaning interpretive approach in light of the fairly flexible inclusive construction of Article 1105. But by merely adopting the plain meaning approach, the Pope Tribunal was heading for more controversy. The NAFTA Parties reacted in dramatic fashion to the Pope & Talbot April 2001 merits decision on Article 1105 with the FTC Note of Interpretation two months later. Directly mirroring the wording of the Pope Tribunal, the FTC Note of Interpretation indicated the displeasure of NAFTA Parties stating (at para. B(2)):

2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

⁴¹ One of the "sticking points" of the verification process was that Canadian officials refused to conduct the review at the head offices of Pope & Talbot in Portland, Oregon. Although officials asserted repeatedly that they had no authority to conduct verifications outside Canada, no "regulation, policy or other credible basis for that proposition" was produced to the Tribunal. The Tribunal assessed that "...what comes through the communications is, instead, [Canada's] imperious insistence on having its way." Pope Merits Award at para. 172, 173. Also, as noted by the Tribunal, at the same time Canada asserted its legal authority to require a verification review, internal memoranda were provided to the Minister indicating that officials had doubts as to this legal authority. Pope Merits Award at para. 175.

Not only did the NAFTA Parties reject the Pope Tribunal's additive interpretation of Article 1105, they made it clear that fair and equitable treatment in future cases would have to be interpreted as being the same as the minimum standard of treatment of aliens, presumably as found in the pre-World War II standard applied in cases like *Neer*.

Although the issue of retroactivity was clearly a matter before the Pope Tribunal because of the unusual timing of the FTC Note of Interpretation during the damages phase of the arbitration, the Tribunal accepted that it was obliged to assess the impact of the Note of Interpretation on its prior findings under Article 1105.

The other issue that provided an additional irritation to the NAFTA Parties was the Pope Tribunal's *obiter dicta* decision that the FTC Note of Interpretation was in form and substance an amendment of Article 1105, and not a proper interpretation. The Pope Tribunal arrived at this conclusion primarily as a result of its review of some forty negotiating drafts of Article 1105.⁴²

In the end result, for the purposes of its Damage Award, the Pope Tribunal applied Canada's 1926 *Neer* minimum standard test to the facts already established in the Merits Award. In the Pope Tribunal's view, whether you applied the additive interpretation with its implicit plain meaning approach or the customary minimum standard approach of the FTC Note of Interpretation, the serious character of the facts supported the conclusion that Article 1105 had been breached.⁴³

2. Post-FTC Note of Interpretation

Since the announcement of the FTC Note of Interpretation, the Chapter 11 Tribunals in the *Mondev* and *ADF* arbitrations have adjusted to the shifting of Article 1105 from an inclusive provision to one explicitly based on the customary international minimum standard of treatment. Although none of these Tribunals have followed the lead of the Pope & Talbot Tribunal in questioning the legitimacy of the FTC Note of Interpretation, there has been an implicit challenge to the NAFTA Parties' attempt to narrow the scope of Article 1105.

Although both Tribunals dismissed the claims of the investor, the

⁴² Pope Damages Award at para. 47.

⁴³ Note that again by way of *dicta*, the Pope Tribunal rejected Canada's "static conception of customary international law," and its reliance on the *Neer* decision, concluding that the customary international minimum standard had evolved since 1926 to include the modern fair and equitable treatment standard. This evolution of customary law has occurred through state practice, such as in the practice of states now represented in the now over 1,800 BITs in existence. Pope Damages Award at paras. 58-65.

Mondev and ADF Tribunals refused to adopt the NAFTA Party position and equate the fair and equitable treatment standard with the *Neer* and other pre-World War II "minimum standard of treatment" decisions. The flexibility inherent in the plain meaning interpretive approach has been preserved in these subsequent awards in the face of the FTC Note of Interpretation. However, these post-FTC Note of Interpretation awards have attempted to accommodate the position of the NAFTA Parties by insisting on a more objective basis for the plain meaning approach.

Mondev

Although decided on the basis of Article 1105, the October 11, 2002 decision of the Tribunal in *Mondev International Ltd. v. United State of America (Mondev)*⁴⁴ is the first Chapter 11 award decided on a classic customary international law denial of justice claim. The facts of the case concern an investment in a commercial real estate development in Boston made by a Canadian investor and the subsequent judicial treatment related to the breach of the development contract by the City of Boston. Although the Tribunal did not find a violation of Article 1105, the award is valuable for its analysis of the *Pope & Talbot* decision and its general comments about the fair and equitable treatment standard.

For example, with respect to NAFTA Parties' reliance on the *Neer* decision as the basis of the international minimum standard, the Mondev Tribunal distinguished *Neer* as a case relating to the "duty of protection against acts of private parties affecting the physical security of aliens" and as not providing a standard of treatment "where the issue is the treatment of foreign investment by the state itself."⁴⁵ In addition, the Mondev Tribunal concurred with the *Pope* Tribunal that Article 1105, and in particular the fair and equitable treatment standard, is evolutionary and not restricted to the historical conception of the minimum standard of treatment. The Tribunal stated:

To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a state may treat foreign investments unfairly and inequitably without necessarily acting in bad faith.⁴⁶

⁴⁴ *Mondev International Ltd. and the United State of America*, Award, October 11, 2002 (Mondev Award). The panel included: Sir Ninian Stephen (President), Professor James Crawford, and Judge Stephen M. Schwebel.

⁴⁵ Mondev Award at para. 115. The ADF Tribunal agreed with this conclusion, see: ADF Award at para. 181.

⁴⁶ Mondev Award at para. 116. Also see para. 123.

In its Damages Award, the Pope Tribunal suggested that the state practice evidenced by over 1,800 BITs supported the conclusion that the fair and equitable treatment standard has become customary international law and has evolved since 1926.⁴⁷ The Mondev Tribunal supported and added to that analysis by pointing to the positions of the NAFTA Parties as evidence of the *opinio juris* sufficient to confirm that the fair and equitable treatment standard is indeed an existing element of customary international law.⁴⁸

With respect to the content of this customary international law, the Mondev Tribunal confirmed the fact dependent nature of a determination of what is unfair and inequitable, but that a Tribunal “may not simply adopt its own idiosyncratic standard of what is “fair” or “equitable”, without reference to established sources of law.”⁴⁹ Although the fair and equitable treatment standard was not at issue in the final result of the Mondev Award, the observations of the Tribunal were cited with approval and adopted by the Tribunal in ADF, as discussed below.

ADF

The January 9, 2003 award of the Tribunal in ADF Group Inc. and United States of America (ADF Award) is the most recent final award of a NAFTA Tribunal addressing the fair and equitable treatment standard.

The facts of the ADF case relate to a highway interchange construction project in Virginia, approximately 20 miles south of Washington D.C.. ADF, a Canadian company, was the successful bidder for the sub-contract to provide custom-built steel girders for the project. ADF proposed to use US steel for its contract but carry out some of the fabrication work on the steel at its Canadian facilities. The contractors were advised by the Virginia Department of Transport that the steel would not, as a result of the Canadian fabrication work, conform with Buy America requirements under Federal US law. At great expense to ADF, the steel was fabricated elsewhere and ADF met the terms of its contract.⁵⁰

ADF made claims against the US, challenging the Buy America requirements pursuant to the NAFTA Articles 1102, 1103, 1106 and 1105. In the end the Tribunal rejected all of ADF's claims. The arguments

⁴⁷ Pope Damages Award at para. 62.

⁴⁸ Mondev Award at paras. 110-113, 122.

⁴⁹ Mondev Award at paras. 118-119.

⁵⁰ ADF Group Inc. and United States of America, Award, January 9, 2003 at 20-26 (ADF). The panel include distinguished arbitrators Carolyn B. Lamm, Professor Armand deMestral with Judge Florentino P. Feliciano as the President of the Tribunal, online: <<http://www.state.gov/documents/organization/16586.pdf>>.

of ADF concerning Article 1105 fell squarely in the camp of those claimants advocating a broad plain meaning of international law and that "fair and equitable treatment" is a general obligation found under international law. The Investor claimed that the Buy America provisions at issue were "*per se* unfair and inequitable within the context of NAFTA". Other arguments included allegations of failure to control the discretion of the relevant government agency, arbitrary government conduct from ignoring "legitimate expectations" derived from court decisions and decisions of agencies on Buy America policies, and a direct challenge of the manner in which the measure itself was adopted by the government.⁵¹

Contemporaneously with the disputing parties' written submissions, the FTC Note of Interpretation was issued in the summer of 2001. In its response to the FTC Note of Interpretation, ADF argued that the Interpretation was in fact an amendment and could be disregarded by the Tribunal, despite its admitted binding nature.⁵² They also adopted an interpretation similar to that of the Pope & Talbot Tribunal by making arguments under NAFTA Article 1103 concerning most-favoured nations treatment and the effect of other investment treaties on the interpretation of Article 1105. ADF argued that, since the provisions equivalent to Article 1105 in the US BITS with Estonia and Albania provided separate obligations of fair and equitable treatment from "international law", the NAFTA Article 1103 would ensure that ADF also receive this better level of treatment.⁵³

The US argued in response that the Investor's position rested on the premise that Article 1105 is a "subjective and intuitive standard unknown to customary international law"⁵⁴ and that a claim of a violation of Article 1105 must demonstrate that the measures in question are incompatible with "a specific rule of customary international law."⁵⁵ After much discussion, the ADF Tribunal concluded that the Investor had not sustained its claim under Article 1105, but also did not accept the position of the United States that a Article 1105 claim must be based on a

⁵¹ ADF Award at para. 72, citing para. 249-255 of the Investor's Memorial. Also, see ADF Award paras. 187-192 where the Tribunal rejects each of these arguments.

⁵² ADF Award at para. 177.

⁵³ ADF Award at paras. 75-80.

⁵⁴ ADF Award at para. 102, citing the Respondent's Counter-Memorial at 34-35. Note that the US did not say that such a standard is unknown to treaty law as clearly many BITS include additive provisions that are open to the application of a subjective plain meaning interpretive approach.

⁵⁵ ADF Award at para. 103, citing the Respondent's Counter-Memorial at 51.

specific rule of international law.

The ADF Tribunal carefully addressed the issue of whether there exists in current customary international law,

... a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited, contexts) to accord fair and equitable treatment and full protection and security to foreign investments.⁵⁶

The ADF Tribunal did not accept that an “autonomous requirement ... to accord fair and equitable treatment” existed, but seemed to accept the existence of a general customary obligation. It based this conclusion partly on the observation that:

... the structure and content of the customary international law minimum standard of treatment has not been adequately litigated, and neither the Investor nor the Respondent has been able persuasively to demonstrate the correctness of their respective contentions.⁵⁷

While agreeing with the *Mondev* Tribunal that the proliferation of BITs with Article 1105 type clauses could certainly support a view that this area of customary international law has expanded beyond the *Neer* case, the ADF Tribunal did not go so far as to say what that expansion entails. The ADF Tribunal cited *Mondev* as follows:

... *Mondev* went on to say that:

“x x x. At the same time, Article 1105(1) did not give a NAFTA Tribunal an unfettered discretion to decide for itself, on a subjective basis, what was “fair” or “equitable” in the circumstances of each particular case. While possessing a power of appreciation, the United States stressed, the Tribunal is bound by the minimum standard as established in State practice and in the jurisprudence of arbitral Tribunals. It may not simply adopt its own idiosyncratic standard of

⁵⁶ ADF Award at para. 183. In addition, the ADF Tribunal indicated it was not prepared to address the issue of whether the FTC Note of Interpretation was an “interpretation” or an “amendment”. Unlike the *Pope & Talbot* Tribunal, the ADF panel found the assures of the NAFTA Parties that the Note of Interpretation was not an amendment to be sufficient. See ADF Award at para. 177.

⁵⁷ ADF Award at para. 183.

what is 'fair' and 'equitable' without reference to established sources of law." (Emphasis added)

We understand *Mondev* to be saying - and we would respectfully agree with it - that any general requirement to accord "fair and equitable treatment" and "full protection and security" must be disciplined by being based upon State practice and judicial or arbitral caselaw or other sources of customary or general international law.⁵⁸

The important conclusion of the ADF and *Mondev* Tribunals is the recognition of the existence of a general requirement to accord fair and equitable treatment under customary international law. However, both Tribunals recognized that such a general requirement cannot be an excuse for subjective discretion by a Tribunal. A claim of fair and equitable treatment is not autonomous and must be made based on arguments grounded in the accepted sources of international law, including judicial and arbitral caselaw.

In assessing the various claims of the Investor, the ADF Tribunal set out the following test of this general requirement to provide fair and equitable treatment:

... are the U.S. measures here involved inconsistent with a general customary international law standard of treatment requiring a host State to accord "fair and equitable treatment" and "full protection and security" to foreign investments in its territory?⁵⁹

Following that test, the ADF Tribunal outlined certain types of conduct that could result in a breach of the general fair and equitable treatment standard obligation, such as:⁶⁰

- if a measure can be characterized as "idiosyncratic or aberrant and arbitrary" in the context of similar measures in other countries' domestic laws;⁶¹

⁵⁸ ADF Award at para. 184.

⁵⁹ ADF Award at para. 186.

⁶⁰ ADF Award at paras. 187-192.

⁶¹ In ADF, the Tribunal observed that the domestic content and requirements for performance in governmental procurement are common to all three of the NAFTA Parties, as well being found in the internal legal systems of many states. ADF Award at para. 188.

- a breach of legitimate expectations;⁶²
- acting beyond scope of lawful authority;⁶³ and
- an administrative decision that is “flawed by arbitrariness”.⁶⁴

The ADF and Mondev Tribunals’ objective version of the plain meaning approach is a clear rejection of the NAFTA Parties’ attempts to read down the fair and equitable treatment standard as part of an historical minimum standard rooted in caselaw from another era. The ADF Tribunal has sought to assure that the general requirement to accord fair and equitable treatment under customary international law is based on objective examples of such conduct from case law and the sources of international law.

CME and Lauder

A brief mention of the CME⁶⁵ and Lauder⁶⁶ arbitrations is useful because these two cases followed closely on the heels of the FTC Note of Interpretation and were part of the context in which the Pope, Mondev

⁶² For example, if authorized officials made misleading representations, relied upon by an investor, concerning the relevance or applicability of prior judicial or administrative rulings; or if such officials refused in a “grossly unfair or unreasonable” manner to follow or apply such rulings. ADF Award at para. 189.

⁶³ ADF Award at 190: “... something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1).” The ADF Tribunal made this statement in the context of the Investor’s claim that the agency in question acted without or in excess of its authority. The Tribunal confirmed that it was not sitting as a court of appeal of domestic law, citing similar comments made by Tribunals in other NAFTA Chapter arbitrations: Mondev, Azinian, Myers and Karpa. See: ADF Award at footnote 182.

⁶⁴ ADF Award at para. 191. For example in the granting of a waiver. Such arbitrariness could be shown if:

- other companies receive such a waiver while the investor does not, or
- the requirements of the law are finely “tailored” so that only a particular domestic competitor could comply with legal requirements; and
- the “application” of the domestic measure imposes “extraordinary costs or other burdens on the Investor” not also imposed on others in the application of the measures.

⁶⁵ Online: <http://www.cetv-net.com/ne/articlefiles/439-lauder-cr_eng.pdf>

⁶⁶ Online: <http://www.cetv-net.com/ne/articlefiles/439-cme-cr_eng.pdf>

and ADF Tribunals made their decisions on the fair and equitable treatment standard. The two decisions also provide an interesting contrast to the Chapter 11 awards.

Both the CME and Lauder arbitrations related to the same fact pattern but were brought under two separate BITs. In each case, a claim alleging a breach by the Czech government of fair and equitable treatment obligations was at the forefront. Interestingly, on the same facts, the Tribunal in *CME v. Czech Republic (CME)*, with its place of arbitration in Stockholm, found for the claimant and the other Tribunal, in the *Lauder v. Czech Republic* case (*Lauder*), with its base in London, rejected the Investor's claims.

The BITs in both cases included typical additive clauses of the fair and equitable treatment standard. Both Tribunals appear to have applied a fairly basic view of the plain meaning approach to the fair and equitable treatment standard. The *Lauder* Tribunal, which rejected the Investor's claims of unfair treatment, goes on to explain that: "... in the context of bilateral investment treaties, the 'fair and equitable' standard is subjective and depends heavily on a factual context."⁶⁷ Moreover, the Tribunal recognized that:

Fair and equitable treatment is related to the traditional standard of due diligence and provides a 'minimum international standard which forms part of customary international law'.⁶⁸

In its rejection of the Investor's claims, the *Lauder* Tribunal cited three examples of government conduct that could be considered to be a breach of the fair and equitable treatment standard:

- 1) discrimination against the claimant in favour of nationals;
- 2) reversal of prior express permissions; and
- 3) malicious misapplication of the law.⁶⁹

Not dissimilarly to *Lauder*, the *CME* Tribunal states that:

The standard for actions being assessed as fair and equitable are not to be determined by the acting authority in accordance with the standard used for its own nationals. Standards acceptable under international law apply...⁷⁰

⁶⁷ *Lauder* at para. 292.

⁶⁸ *Lauder* at para. 292.

⁶⁹ *Lauder* at para. 291.

⁷⁰ *CME* at para. 611.

The CME Tribunal refers specifically to two basic types of conduct as breaching the fair and equitable treatment obligations of the BIT:

- the “intentional undermining of the claimant’s investment”;⁷¹ and
- the “...evisceration of the arrangements in reliance upon... [which] the foreign investor was induced to invest.”⁷²

Even though the CME and Lauder Tribunals made their awards in the midst of the interpretation controversies involving Article 1105, there appears to have been no acknowledgement of the battle lines that had been drawn between the two interpretive approaches to fair and equitable treatment - plain meaning versus the historical minimum standard. Perhaps this is due to the fact that the relevant fair and equitable treatment provisions followed the additive model and the Tribunals seemed to both implicitly recognize that the subjective plain meaning approach applied to that type of provision. Although the two Tribunals arrived at different decisions, both of their conceptions of the fair and equitable treatment obligation appear grounded in a conception of the standard consistent with other authorities and the notion that governments have an obligation to honour the legitimate expectations of foreign investors when they make their investments.

IV. CONCLUSION

ALTHOUGH THE NAFTA PARTIES persistently argued their position that the fair and equitable treatment standard should be equated to the historical international minimum standard of treatment,

⁷¹ CME at para. 611. The CME Tribunal concludes at para. 558: “The Czech Republic, acting through its broadcasting regulator, the Media Council, massively supported Dr. Pelezny in his efforts to destroy CME’s investment in the Czech Republic by eliminating CNTS as the exclusive service provider for CET 21.”

⁷² CME at para. 611. For example, the Tribunal notes evidence of threats by Czech regulatory authority to take away the television license of CME if it did not comply with the forced revision of its license and to remove what the Tribunal termed the investment’s “safety net”. See CME at paras. 505-508, 515-516, 520. At para. 538 the Tribunal summarizes: “The Media Council, acting on behalf of the Czech Republic, in 1996 breached the Treaty by coercing CME and CNTS into giving up legal security for CME’s investment in the Czech Republic.” At para. 572 the Tribunal concludes that the state Media Council had an obligation to “protect the legal arrangement which was the basis for CME’s investment in the Czech Republic.” Then goes on to further state that “The Media Council ... was obligated to re-establish and secure the legal protection for CME’s investment.” (at 573)

none of the Chapter 11 Tribunals ruling on the fair and equitable treatment standard accepted those arguments. Although some will discount the pre-FTC Note of Interpretation awards in *Metalclad*, *Pope & Talbot* and *S.D. Myers*, the post-FTC awards have effectively arrived at similar conclusions and applied the modified plain meaning interpretive approach.

Not unexpectedly, the interpretive approach taken in *ADF* and *Mondev* differs from, and builds on, the approaches taken in *Metalclad*, *Myers* and *Pope & Talbot*. In *ADF* and *Mondev*, the Tribunals recognized the evolution of the fair and equitable treatment standard as a modern international law principle and have sought to articulate a more objective standard. The present status of the development of that standard can be summed up as follows:

- there is a general requirement to accord “fair and equitable treatment” for investments under customary international law;
- such a standard must be disciplined in its application by being based upon the established sources of international law, such as those found in Article 38 of the *Statute of the International Court of Justice*;⁷³
- the fair and equitable treatment standard is evolutionary. The international law standard is not a static one rooted in case law from the 1920’s. One point of agreement that can safely be identified in the arbitral case law is that, in the words of the *UPS* Tribunal:

... the obligations imposed by customary international law may and do evolve. The law of state responsibility of the 1920s may well have been superseded by subsequent developments. It would be remarkable were that not so.⁷⁴

Similar decisions confirming the evolutionary nature of international law have been made by the Tribunals

⁷³ The Statute of the International Court of Justice is a part of the United Nations Charter and the Court is the principal judicial organ of the United Nations according to Article 92 of the U.N. Charter (*ICJ Statute*).

⁷⁴ *UPS v. Canada, Award on Jurisdiction*, November 22, 2002, at para. 84

in Pope & Talbot,⁷⁵ ADF,⁷⁶ and Mondev;⁷⁷ and

- fair and equitable treatment is fact dependent. As stated by the Mondev Tribunal: "... a judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of a particular case."⁷⁸

Finally, the main conclusion that can be made about the fair and equitable treatment standard is that we are still in the early days of its development. The substantive content has yet to coalesce, however, we now have many more case examples of government conduct that Tribunals believe may violate the general fair and equitable treatment standard. The common thread that has been winding its way through the arbitral awards discussed here is the fundamental obligation of state parties to honour the legitimate expectations of investors with respect to their investments. This is consistent with the objectives of trade agreements and BITs to ensure, as stated for example in the Preamble of the NAFTA, "a predictable commercial framework for business planning and investment". The fair and equitable treatment standard goes to the heart of the promise of international law to apply the rule of law to international governmental conduct. Although we are still in the early days, one can certainly conclude that the modern fair and equitable treatment standard, regardless of the type of clause in which it is found, must be interpreted and applied with this objective in mind.

⁷⁵ Pope Award at para. 59:

... as admitted by one of the NAFTA Parties, and even by counsel for Canada, there has been an evolution in customary international law concepts since the 1920's. It is a facet of international law that customary international law evolves through state practice.

and at para. 65:

... the Tribunal rejects Canada's contention on the present content of customary international law concerning the protection of foreign property. Those standards have evolved since 1926, and, were the issue necessary to the Tribunal's decision here, it would propose a formulation more in keeping with the present practice of states.

⁷⁶ ADF Award at paras. 179-181.

⁷⁷ Mondev Award at 114-116. At para. 123 the Mondev Tribunal concludes that: "In these circumstances, the content of the minimum standard today cannot be limited to the content of customary international law as recognized in arbitral decisions in the 1920s."

⁷⁸ Mondev Award at para. 118.