

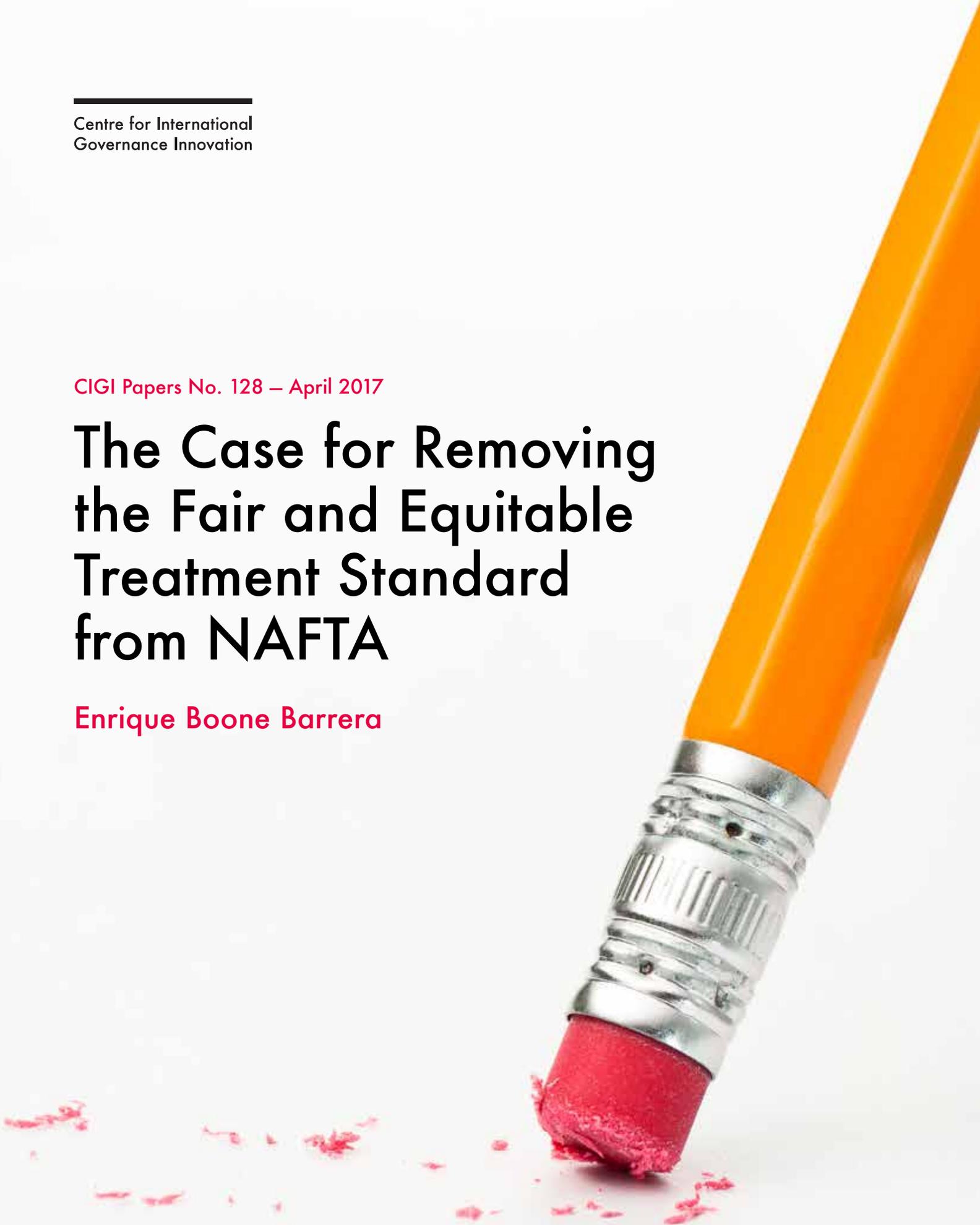
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Centre for International  
Governance Innovation

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# The Case for Removing the Fair and Equitable Treatment Standard from NAFTA

Enrique Boone Barrera





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## About the Author

**Enrique Boone Barrera** is a post-doctoral fellow with CIGI's International Law Research Program. At CIGI, he researches international investment governance and how to make investment law more responsive to the rights and concerns of all interested parties, organizes conferences on investor-state arbitration and writes opinions and commentaries. Prior to joining CIGI, Enrique was a teaching fellow at McGill University's Faculty of Law and a research assistant on several projects regarding trade law and democracy, comparative law and legal education. Enrique holds an LL.M. from Queen's University and a D.C.L. from McGill University.

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## About the International Law Research Program

The International Law Research Program (ILRP) at CIGI is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions between international and transnational law, Indigenous law and constitutional law.

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## Acronyms and Abbreviations

<b>CETA</b>	Comprehensive Economic and Trade Agreement
<b>FET</b>	fair and equitable treatment
<b>FTC</b>	Free Trade Commission
<b>IIL</b>	international investment law
<b>IAs</b>	international investment agreements
<b>ISA</b>	investor-state arbitration
<b>MST</b>	minimum standard of treatment
<b>NAFTA</b>	North American Free Trade Agreement
<b>TPP</b>	Trans-Pacific Partnership
<b>TTIP</b>	Transatlantic Trade and Investment Partnership
<b>UNCTAD</b>	United Nations Conference on Trade and Development



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## Executive Summary

The fair and equitable treatment (FET) standard has long been considered an indispensable part of international investment protection agreements and is often invoked in investor-state arbitration (ISA). Particularly after the North American Free Trade Agreement (NAFTA) came into effect in 1994, the standard went through a transformation from a little-known clause to being subject to ever expanding interpretations by arbitral tribunals. Although states have taken steps to rein in the use of the FET standard, these efforts have come undone in arbitral tribunals. The result of this situation has been some controversial awards in which both supporters and critics of ISA see a problematic development. Just as NAFTA propelled the FET standard to new heights, NAFTA parties can also send an important message to the arbitral community by removing it from this watershed agreement. This paper argues that this step will reduce instances of creative interpretations by arbitral tribunals and help improve the integrity of ISA.

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## Introduction

NAFTA<sup>1</sup> turned 23 years old this year; it is an old agreement in need of urgent updates. The wording of the FET standard (discussed in the first section of this paper, "The Scope of the FET Standard") in the investment chapter is a clear example of how outdated the agreement is. Recent developments in both trade and investment have made a revision of this clause not a matter of if, but when. NAFTA's FET standard may hinder progress in newer agreements such as the Comprehensive Economic and Trade Agreement (CETA)<sup>2</sup> and the Trans-Pacific Partnership (TPP).<sup>3</sup> It is still too early to know how

these three agreements will interact with each other. To date, CETA's investment chapter remains in limbo while the TPP seems doomed in its present form. However, NAFTA is still in force and the use and abuse of the FET standard, as currently drafted, remains a possibility. After the election of President Donald Trump in the United States, both Canada and Mexico are now gearing up to revisit the old agreement. While the anti-trade rhetoric of Trump is problematic, it nonetheless presents an excellent opportunity to update NAFTA clauses. There have been many developments since NAFTA was signed, including regarding the FET standard. While NAFTA quickly became a template for trade and investment agreements that followed, it has now become an example of what not to do.

The FET standard is one of the most commonly used principles in international investment law (IIL) and also one of the most controversial in NAFTA. The main problem with the FET standard is that it lacks core meaning, leading tribunals to expand investment protection to levels never imagined by states. In the NAFTA context, the states parties, through the Free Trade Commission (FTC) established under NAFTA, issued a Note of Interpretation<sup>4</sup> (the FTC note) to clarify what they meant by the FET clause, but arbitral tribunals have slowly eroded its meaning. In addition to the FTC note, NAFTA parties have introduced clearer language into recent international investment agreements (IIAs). It is unlikely that these changes will produce different results in the way that tribunals interpret the clause. As shown below, even with clearer instructions, tribunals arrive at the same conclusions. The best solution to this problem is to remove the FET clause from NAFTA altogether.

Removing the FET clause from NAFTA reconciles the text with the intent of the parties. This proposal is radical in the sense that it goes to the root of the problem regarding the interpretation of the FET clause. In short, this paper argues that once the FTC limited the scope of the FET clause to no more than what customary international law required, it made this concept redundant and a source of conflicting interpretations. The FTC note was not enough to eliminate the confusion caused by the reference to the FET standard in NAFTA.

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1 *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2, 32 ILM 289, 605 (entered into force 1 January 1994) [NAFTA].

2 *Comprehensive Economic and Trade Agreement between Canada, of the one part, and the European Union [and its Member States...]*, 29 February 2016 [CETA], online: <[http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154329.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf)>.

3 4 February 2016, [TPP], online: Global Affairs Canada <[www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/toc-tdm.aspx?lang=eng](http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/toc-tdm.aspx?lang=eng)>.

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4 FTC, "Notes of Interpretation of Certain Chapter 11 Provisions" (31 July 2001) [FTC, "Notes"], online: Global Affairs Canada <[www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/NAFTA-Interpr.aspx?lang=eng](http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/NAFTA-Interpr.aspx?lang=eng)>.

The most important consequence of keeping the reference to the FET standard was the expansion, in application and interpretation, of the nebulous concept of legitimate expectations, which is not part of customary international law. Eliminating the reference to the FET standard in NAFTA should have no further consequence than giving full force to the FTC note and removing a source of confusion.

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## The Scope of the FET Standard

In ISA, investors can sue host states directly, without any intervention from their home states. Tribunals are usually composed of three members: one arbitrator is appointed by the investor; one is appointed by the state; and a third, who is also the president of the tribunal, is chosen by the two other arbitrators. In most IIAs, the applicable law is the IIA itself and international law. NAFTA contains the following core investment protection clauses: national treatment; most-favoured-nation treatment; minimum standard of treatment (MST); limitations on performance requirements; and compensation in case of expropriation.<sup>5</sup> The FET standard is mentioned in passing in NAFTA's article 1105(1), which describes the MST obligation: "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, *including fair and equitable treatment* and full protection and security."<sup>6</sup>

According to the United Nations Conference on Trade and Development (UNCTAD), the FET standard evolved as part of the MST.<sup>7</sup> In IIL, the MST protects the economic interests of foreign investors by assuring access to justice.<sup>8</sup> In this regard, the MST is said to encompass the denial of justice doctrine, which requires that states grant aliens substantive rights and fair procedures to access justice.<sup>9</sup> The MST was given its most concrete expression in the

*Neer v Mexico*<sup>10</sup> case, in which the commission found that, for a denial of justice to occur, authorities must have acted "in an outrageous way, in bad faith, in wilful neglect of their duties, or in a pronounced degree of improper action."<sup>11</sup> In a similar vein, in the *Chattin v Mexico*<sup>12</sup> case, the commission also found that acts of the judiciary were not liable "unless the wrong committed amounts to an outrage, bad faith, wilful neglect of duty, or insufficiency of action apparent to any unbiased man."<sup>13</sup> A major departure from customary international law was that IIAs granted this protection directly to private actors. This development collapsed the traditional distinction between protection of aliens and human rights.<sup>14</sup> Substantially, IIL uses the jurisprudence of protection of aliens to shield economic interests from government policies. Procedurally speaking, IIL enables foreign investors to directly sue the state, as in the human rights field.

The MST is considered part of customary international law and, as such, it applies regardless of its inclusion in IIAs.<sup>15</sup> The FET standard, which is described as part of the MST in NAFTA, may or may not be tied to customary international law. As a result, a "qualified" FET clause — one that was directly linked to the MST and international customary law — in an IIA was considered to set a very high benchmark for proving that a denial of justice had occurred.<sup>16</sup> On the other hand, with an "unqualified" FET provision — one that is not linked to the MST or described in much more detail — the threshold was said to be lower, which exposed the state to more liability.<sup>17</sup>

This is not a distinction that may be applicable to the NAFTA version of the FET standard, according to Patrick Dumberry. In a detailed analysis of NAFTA case law in relation to article 1105(1), Dumberry argues that arbitral tribunals have been applying a qualified FET standard ever since the parties issued the FTC note.<sup>18</sup> The FTC was established by NAFTA's article 2001 and is comprised of Cabinet-level

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5 NAFTA, *supra* note 1, arts 1102–1103, 1105–1106, 1110.

6 *Ibid*, art 1105(1) [emphasis added].

7 UNCTAD, *Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II* (New York, NY, and Geneva, Switzerland: United Nations, 2012) at xiv [UNCTAD 2012], online: <[http://unctad.org/en/Docs/unctaddiaieia2011d5\\_en.pdf](http://unctad.org/en/Docs/unctaddiaieia2011d5_en.pdf)>.

8 Francesco Francioni, "Access to Justice, Denial of Justice and International Law" (2009) 20:3 *Eur J Intl L* 729 at 730–31.

9 Andrea K Bjorklund, "Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims" (2005) 45:4 *Va J Intl L* 810 at 837.

10 (1926), 4 RIAA 60 (Mexico-United States Claims Commission) [*Neer*]. See Margaret Clare Ryan, "Glamis Gold, Ltd. v. The United States and the Fair and Equitable Treatment Standard" (2011) 56:4 *McGill LJ* 919 at 929.

11 *Neer*, *supra* note 10 at 62.

12 (1927), 4 RIAA 282 (Mexico-United States Claims Commission).

13 *Ibid* at 286–87.

14 Francioni, *supra* note 8 at 732.

15 Patrick Dumberry, *The Fair and Equitable Treatment Standard: A Guide to NAFTA Case Law on Article 1105* (Alphen aan den Rijn, Netherlands: Kluwer Law International, 2013) at 23.

16 UNCTAD 2012, *supra* note 7 at 13.

17 *Ibid*.

18 Dumberry, *supra* note 15 at 79.

representatives of the parties (or other designees). Among other prerogatives, the FTC is in charge of elaborating the agreement and resolving disputes regarding its interpretation and application.<sup>19</sup>

In terms of article 1105, the FTC clarified that “[t]he 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.”<sup>20</sup> The parties made clear that the FET clause should be tied to customary international law. As a result, Dumberry noted that “NAFTA tribunals should look solely to custom as a source of international law in their interpretation of Article 1105.”<sup>21</sup> He argued further that “awards rendered by tribunals outside NAFTA that interpret *unqualified* FET clauses are simply not relevant for the analysis of Article 1105 which belongs to a different species of FET clauses.”<sup>22</sup>

This has important consequences for the level of protection that tribunals are able to afford investors.<sup>23</sup> By Dumberry’s account, NAFTA’s FET only incorporates “the prohibition of arbitrary conduct, denial of justice and the obligation of due process.”<sup>24</sup> Other concepts, such as an investor’s legitimate expectations and transparency as stand-alone obligations, are not part of the FET. Much of this protection is already incorporated in the access to justice doctrine. What this doctrine does not do is guarantee access to arbitral tribunals or the application of an IIA.<sup>25</sup> In this regard, justifying an IIA clause by reference to the MST becomes problematic and unnecessary. While there is a case for international custom to inform the interpretation of a specific clause,<sup>26</sup> it is a different matter to use custom to flesh out an otherwise hollow clause.

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## Interpreting the FET Standard

The terms “fair” and “equitable” do not convey any precise meaning and sometimes are used interchangeably.<sup>27</sup> According to Roland Kläger, the main purpose of the emergence of the FET standard was to bypass the indeterminacy of the MST.<sup>28</sup> However, the link between the MST and the sort of protection that IIAs provided has been disputed, first by developing countries<sup>29</sup> and, as this section will explain, also by some arbitral tribunals. As a result, whether the FET standard is considered as part of the MST or as offering more protections, its contour is far from certain. This principle has become a catch-all for investors’ complaints that do not fall within more specific categories. Outside of the NAFTA context, the tribunal in *PSEG Global, Inc v Turkey*<sup>30</sup> admitted as much by stating that “[b]ecause the role of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable. Yet, it clearly does allow for justice to be done in the absence of the more traditional breaches of international law standards.”<sup>31</sup> It is not surprising, then, that most investor complaints have included a reference to a violation of the FET.<sup>32</sup>

In addition to the unpredictable nature of the FET standard, ISA relies on ad hoc tribunals that, technically speaking, are not bound by precedent. Thus, transient tribunals apply a vague clause with few constraints on their interpretative powers and even fewer opportunities for disputing parties to challenge the award. According to Martins Paporinskis, the FET standard should be interpreted “in particular by considering

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19 NAFTA, *supra* note 1, art 2001(2).

20 FTC, “Notes”, *supra* note 4.

21 Dumberry, *supra* note 15 at 98.

22 *Ibid* at 94 [emphasis in original].

23 Dumberry also notes that article 1105 “offers protection to ‘investments of investors’ and not to investors themselves.” *Ibid* at 56 [emphasis in original]. While this is an important distinction, it is still the case that the investor herself is the party in the dispute and not the investment.

24 *Ibid* at 270.

25 Francioni, *supra* note 8 at 731.

26 See e.g. Philippe Sands & Jeffery Commission, “Treaty, Custom and Time: Interpretation/Application?” in Malgosia Fitzmaurice & Phoebe Okowa, eds, *Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years On* (Leiden, Netherlands: Martinus Nijhoff, 2010) 39.

27 Roland Kläger, “Fair and Equitable Treatment: A Look at the Theoretical Underpinnings of Legitimacy and Fairness” (2010) 11:3 J World Investment & Trade 435 at 435-455. See also Ryan, *supra* note 10 at 925.

28 Kläger, *supra* note 27 at 437.

29 Andreas F Lowenfeld, *International Economic Law*, 2nd ed (Oxford, UK: Oxford University Press, 2008) at 493.

30 (2007), Award, 19 January 2007, ICSID Case No ARB/02/5, online: <[www.italaw.com/sites/default/files/case-documents/ita0695.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0695.pdf)>.

31 *Ibid* at para 239.

32 UNCTAD, *World Investment Report 2015: Reforming International Investment Governance* (New York, NY, and Geneva, Switzerland: United Nations, 2015) at 137 [UNCTAD 2015], online: <[http://unctad.org/en/PublicationsLibrary/wir2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf)>; José A Alvarez, *The Public International Law Regime Governing International Investment* (Leiden, Netherlands: Hague Academy of International Law, 2011) at 177; Christoph Schreuer, “Fair and Equitable Treatment in Arbitral Practice” (2005) 6:3 J World Investment & Trade 357 at 357.

its accepted meaning in pre-investment law State practice.”<sup>33</sup> In terms of content of the FET, Paparinskis describes three broad streams of meaning of the FET standard: FET provisions that refer to customary rules on the treatment of aliens; FET as an element that allows flexibility in the law and extra-legal protection; and FET provisions as treaty clauses that “address different types of MFN treatment” in commercial treaties.<sup>34</sup>

While Paparinskis’ analysis is well researched and interesting, it is not clear that this approach provides much guidance for tribunals when applying the FET.<sup>35</sup> Further, it does not address some of the most systemic problems of IIL and ISA that also affect the interpretation of the FET. The criticism against the FET is not isolated and forms part of a wider movement against IIL. According to Jürgen Kurtz, “[t]he system of international investment law and arbitration sits uncomfortably close to a precipice.”<sup>36</sup> Among other criticisms,<sup>37</sup> the most contentious aspect of IIL is the dispute resolution mechanism embedded in most IIAs. IIAs are usually drafted in vague terms that allow too much interpretative discretion for arbitrators.<sup>38</sup> This discretion is evidenced in two seemingly contradictory developments: inconsistency and a de facto rule of precedent. Inconsistency refers to tribunals arriving at conflicting decisions on similar issues<sup>39</sup> and the de facto rule of precedent refers to the emerging practice of arbitrators to interpret IIAs and decide cases following previous ISA awards. As there is no rule of precedent in IIL, the weight that each tribunal gives to previous cases varies greatly. All arbitral tribunals at least inform their decisions by previous outcomes, but the results are not necessarily predictable.

Given the wide range of possible outcomes, arbitrators may have no choice but to resort to several mechanisms to give legitimacy to their decisions, even if these are not strictly provided by the treaty. This is because IIAs contain general standards rather than clearly defined rules to resolve investment disputes.<sup>40</sup> This combination of the lack of a rule of precedent and vague treaties is aggravated by the nature of ad hoc tribunals that are assembled to resolve only a particular dispute and not to develop policy. The result has been controversial awards and a severe lack of legitimacy for ISA in general.

Stephan W. Schill has noted that “the interpretation and application of these standards of treatment is driven and normatively influenced more by arbitral precedent than by the texts of the treaties or state practice.”<sup>41</sup> Establishing what FET means through an erudite study does not anticipate what an arbitral tribunal might end up deciding. The practice of arbitral tribunals referencing each other has led to some extraordinary developments. On one hand, tribunals rely on the force of customary law to support their interpretations but, on the other hand, they also resist being limited by customary international law and justify novel interpretations of it by reference to how previous tribunals have applied IIL standards.

Arbitral tribunals, thus, claim that the FET standard both reflects customary international law but is also context-specific and responsive to new developments. Paparinskis explains this complicated logic as follows: “the result of the interpretative process is similar to that achieved by treating fair and equitable treatment as a reference to custom, even if the intellectual justification for prioritizing custom relies on the considerable weight that context can play in the interpretation of vague terms, rather than direct reference to custom by the term itself.”<sup>42</sup> The FET is tied to custom because otherwise it would have no meaning, but the justification to use custom is tied to the context and not to the FET clause itself.

This is an important distinction because what it reveals is that the function of the FET standard is to be a licence for expansive investment

33 Martins Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (Oxford, UK: Oxford University Press, 2013) at 262.

34 *Ibid.*

35 *Ibid.* at 264–265.

36 Jürgen Kurtz, “Building Legitimacy through Interpretation in Investor-State Arbitration: On Consistency, Coherence, and the Applicable Law” in Zachary Douglas, Joost Pauwelyn & Jorge E Viñuales, eds, *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford, UK: Oxford University Press, 2014) 257 at 259.

37 See e.g. David Schneiderman, “Investment Rules and the New Constitutionalism” (2000) 25:3 L & Soc Inquiry 757; Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitution and Administrative Law in the BIT Generation* (Portland, OR: Hart Publishing, 2009); Susan D Franck, “The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions” (2005) 73:4 Fordham L Rev 1521.

38 Olivia Chung, “The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration” (2007) 47:4 Va J Int’l L 953 at 959.

39 Franck, *supra* note 37 at 1545–46.

40 Andrés Rigo Sureda, *Investment Treaty Arbitration: Judging Under Uncertainty* (Cambridge, UK: Cambridge University Press, 2012) at 9.

41 Stephan W Schill, *The Multilateralization of International Investment Law* (Cambridge, UK: Cambridge University Press, 2009) at 332.

42 Paparinskis, *supra* note 33 at 167.

protection and creative interpretation, rather than to be a standard with a specific purpose. Tribunals may or may not make use of this licence, but as long as there is an FET clause in the IIA, the FET clause can be considered as a delegation of authority from states to tribunals to expand investment protection if they wish to do so. This is a discretionary power that states transfer to tribunals through the FET clause.

An early example of how the FET reference would overshadow the MST clause itself in NAFTA was in the *Metalclad Corp v Mexico*<sup>43</sup> tribunal's determination that Mexico was in breach of article 1105(1) because the investment "was not accorded fair and equitable treatment in accordance with international law."<sup>44</sup> There was no express mention of any violation of customary international law or MST jurisprudence in the section analyzing the breach of article 1105(1). Soon after, in the *SD Myers, Inc v Canada* award, the majority of the tribunal similarly argued that a violation of another NAFTA clause also constituted a violation of article 1105(1).<sup>45</sup> This was the case although the alleged violation did not constitute a breach of customary international law. The *Pope & Talbot Inc v Canada* award continued the expansion of the FET by rejecting the need for a high threshold to determine a breach of article 1105(1).<sup>46</sup>

The NAFTA parties issued the FTC note shortly after this series of awards. As mentioned above, the parties were trying to limit the expansive arbitral interpretations of the FET. However, the effects of the FTC note were far from straightforward. The *Pope & Talbot* tribunal expressed reservations regarding the intent of the parties issuing the FTC note and asked Canada to explain its intentions.<sup>47</sup> More generally, the effects of the FTC note were limited by the interpretative inclinations of arbitral tribunals. In particular, the development of the concept of legitimate expectations created a new principle of international law where

none had existed before.<sup>48</sup> As will be explained below, with this development, the tribunals essentially nullified the FTC note without explicitly recognizing that they were doing so.

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## Legitimate Expectations and the Unbounded FET Standard

The FET clause aims at protecting foreign investors against state abuse. But if states want to protect foreign investors from denial of justice, breach of due process and arbitrariness, turning to the FET clause is unnecessary and potentially confusing. UNCTAD recommends replacing a general FET with the more limited "qualified FET," as was described above.<sup>49</sup> NAFTA's FET clause is qualified. If the drafting of the clause was not clear enough, the FTC note should have clarified the point. Thus, NAFTA's FET is more restrictive than an unqualified FET clause, that is, an FET clause that is not expressly tied to customary international law. In practice, this may be a distinction without a difference.<sup>50</sup> Over the years, many ISA tribunals interpreting FET clauses that are worded differently — and are grounded in different conceptions of the principle — have nevertheless started to converge in a single interpretation.<sup>51</sup> ISA tribunals, rather than the wording of the treaties, determine the meaning of the FET principle.<sup>52</sup>

Dumberry disagrees with the conclusion of the UNCTAD report that supports the "convergence" approach by arbitral tribunals.<sup>53</sup> UNCTAD found that tribunals interpret qualified FET clauses as

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43 Award, 30 August 2000, ICSID Case No ARB(AF)/97/1.

44 *Ibid* at para 74.

45 *SD Myers, Inc v Canada*, Partial Award, 13 November 2000 (UNCITRAL) at para 266, online: <[www.italaw.com/sites/default/files/case-documents/ita0747.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0747.pdf)>.

46 Award on the Merits Phase 2, 10 April 2001 (UNCITRAL) at para 118, online: <[www.italaw.com/sites/default/files/case-documents/ita0678.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0678.pdf)>.

47 *Pope & Talbot Inc v Canada*, Award in Respect of Damages, 31 May 2002 (UNCITRAL) at para 12, online: <[www.italaw.com/sites/default/files/case-documents/ita0686.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0686.pdf)>.

48 Trevor Zeyl, "Charting the Wrong Course: The Doctrine of Legitimate Expectations in Investment Treaty Law" (2011) 49:1 *Alta L Rev* 203 at 208.

49 UNCTAD 2012, *supra* note 7 at 32.

50 Matthew C Porterfield, "A Distinction Without a Difference? The Interpretation of Fair and Equitable Treatment Under Customary International Law by Investment Tribunals" (22 March 2013), *International Institute for Sustainable Development* (blog), online: <<https://www.iisd.org/itn/2013/03/22/a-distinction-without-a-difference-the-interpretation-of-fair-and-equitable-treatment-under-customary-international-law-by-investment-tribunals/>>.

51 Kläger, *supra* note 27 at 439; Kenneth J Vandevelde, "A Unified Theory of Fair and Equitable Treatment" (2010) 43:1 *NYUJ Intl L & Pol* 43 at 47–48; Rudolf Dolzer, "Fair and Equitable Treatment: Today's Contours" (2013) 12:1 *Santa Clara J Intl L* 7 at 13.

52 UNCTAD 2012, *supra* note 7 at 62.

53 Dumberry, *supra* note 15 at 270.

unqualified, regardless of the wording in the IIA.<sup>54</sup> Dumberry considers that NAFTA's FET has been, for the most part, properly interpreted by tribunals as a qualified FET. While Dumberry recognizes that NAFTA tribunals have a fair amount of discretion, he considers that this discretion is "limited by the requirement to apply the minimum standard of treatment existing under custom."<sup>55</sup> Schill, on the other hand, does not believe that this is the case. Indeed, he notes that NAFTA's case law made clear that "the strategy to domesticate arbitral tribunals by linking the interpretation of fair and equitable treatment to customary international law in the NAFTA context can therefore hardly be considered successful."<sup>56</sup> The problem, according to Schill, was that NAFTA tribunals "[i]nstead of interpreting the fair and equitable treatment directly as a flexible standard...now make the notion of customary international law itself more flexible and re-introduce their original standard of decision-making through the back door."<sup>57</sup>

Dumberry accepts that some NAFTA tribunals have adopted this evolutionary approach to the MST and also admits that these tribunals have provided little evidence regarding the evolution of customary international law. However, he argues that this interpretation did not impact the actual outcome of the cases in question.<sup>58</sup> The fact that tribunals interpret the FET clause expansively, even if ultimately not affecting the result, confirms rather than denies UNCTAD's conclusion that arbitral tribunals have blurred the distinction between a qualified and an unqualified FET. If, in 2013, when Dumberry published his book, this was not evident, the *Bilcon of Delaware, Inc v Canada (Bilcon)*<sup>59</sup> award decided in 2015 should leave no doubts that these tribunals' interpretations do matter in a substantive way.

The majority in the *Bilcon* tribunal considered that the encouragement by public officials to invest created a "reasonable expectation" that the environmental impact assessment was going to be conducted as in past occasions.<sup>60</sup> The tribunal considered that the focus on "community

values" distracted attention from mitigation measures that could have changed the ultimate environmental impact of the project.<sup>61</sup> However, as Arbitrator Donald McRae explained in the dissenting opinion, an investor should expect the proper application of the law without the need to invoke the concept of legitimate expectations.<sup>62</sup> Given that there were conflicting reports from experts regarding the conduct of the environmental review, a Canadian court, and not the tribunal, McRae stated, should have determined what constituted a proper application of Canadian law.<sup>63</sup>

McRae went on to observe that this result goes beyond applying article 1105(1) to the particular circumstances of the case. According to him, "the majority has in effect introduced the potential for getting damages for what is a breach of Canadian law, where Canadian law does not provide damages for such a breach."<sup>64</sup> The FET is not only flexible, but it is a door for creating state obligations that were not initially contemplated in the IIAs. The *Bilcon* award is an instance of an ever-expanding FET clause, notwithstanding the FTC note. The majority of the *Bilcon* tribunal considered the FET to be equal to the MST and legitimate expectations as an element only for determining whether the FET had been breached<sup>65</sup> and, yet, that seemed to impose little constraint.

To justify its evolutionary approach to customary international law, the tribunal relied on the *ADF Group Inc v United States*<sup>66</sup> and the *Merrill & Ring Forestry LP v Canada*<sup>67</sup> awards.<sup>68</sup> The first of these awards is among those cited by Dumberry as having used an expansive FET interpretation with "no practical import on the outcome of these cases in terms of liability."<sup>69</sup> However, even if in those cases the tribunals did not find the state liable, their interpretations of customary international law affect how future tribunals approach similar issues. The majority of the *Bilcon* tribunal checked all the boxes that a careful reading of the FET

54 UNCTAD 2012, *supra* note 7 at 90.

55 Dumberry, *supra* note 15 at 128.

56 Schill, *supra* note 41 at 274.

57 *Ibid* at 275.

58 Dumberry, *supra* note 15 at 123.

59 Award on Jurisdiction and Liability, 17 March 2015, PCA Case No 2009-04 (UNCITRAL) [*Bilcon* Award].

60 *Ibid* at paras 448-50.

61 *Ibid* at para 452.

62 *Bilcon of Delaware, Inc v Canada*, Dissenting Opinion of Professor Donald McRae, 10 March 2015, PCA Case No 2009-04 (UNCITRAL) at para 33 [*Bilcon* Dissent].

63 *Ibid* at para 34.

64 *Ibid* at para 43.

65 *Bilcon* Award, *supra* note 59 at paras 282, 433.

66 Award, 9 January 2003, ICSID Case No ARB(AF)/00/1, 6 ICSID Rep 470.

67 Final Award, 31 March 2010 (UNCITRAL).

68 *Bilcon* Award, *supra* note 59 at para 435.

69 Dumberry, *supra* note 15 at 123.

standard should entail by clarifying that, among other things: other sources of international law were relevant only to the extent that they inform the MST; states must have flexibility when responding to complex regulatory problems; and errors — even the improper application of domestic law — do not constitute a breach of the MST.<sup>70</sup> Yet, for all that acknowledgement of the limitations of the MST, the majority still found a way to expand investment protection.

The *Bilcon* case illustrates how the FET principle has evolved in the NAFTA context.<sup>71</sup> The result of this case is particularly troubling taking into consideration the *Glamis Gold, Ltd v United States (Glamis)*<sup>72</sup> award, in which the tribunal explicitly refused to follow how other tribunals were interpreting the FET clause. In a lengthy award, the *Glamis* tribunal found that determining the content of the FET standard and discovering the current state of customary international law were two different endeavours.<sup>73</sup> The problem had been that tribunals often confused the two processes, claiming to discover customary international law by way of treaty interpretation and the application of arbitral precedent. Given the insularity of the arbitral community,<sup>74</sup> it is, in fact, not surprising that tribunals are converging in a single interpretation of different FET clauses.

The *Glamis* tribunal determined that for customary law to evolve it must be reflected in state practice that is accepted as law.<sup>75</sup> This is, of course, a long-standing and well-known concept in international law<sup>76</sup> that somehow was transformed in arbitral tribunals with amazing speed. The decision reached by the majority in the *Bilcon* case showcases how tribunals manage to expand the FET clause in spite of the FTC note. The tribunal agreed that the FTC note equated the FET with the MST and narrowed the question to establishing the current state of the MST.<sup>77</sup> The main question was whether the MST

established a high standard to prove its breach, as it customarily had done, or whether the standard was now lower. Without much explanation, the tribunal quickly pointed out that the *Glamis* award was not being followed by recent NAFTA tribunals, which had decided that the MST had evolved and was now tied to the looser concept of legitimate expectations.<sup>78</sup> It is not surprising that the *Bilcon* tribunal ended up deciding that “there is a high threshold for the conduct of a host state to rise to the level of a NAFTA Article 1105 breach, but there is no requirement in all cases that the challenged conduct reaches the level of shocking or outrageous behaviour.”<sup>79</sup>

Commentators seem to offer different interpretations regarding the relationship between legitimate expectations and the FET. Paparinskis, for instance, argues that even assuming there is a general principle of legitimate expectations, “in the absence of contrary treaty language it is not obvious that it can be taken into account in interpreting the treaty rules on fair and equitable treatment or the customary standard.”<sup>80</sup> Similarly, Dumberry notes that NAFTA tribunals have not demonstrated “the customary nature of the concept of legitimate expectations.”<sup>81</sup> Notwithstanding that, Dumberry finds that the *Mobil Investments Canada Inc v Canada*; *Waste Management, Inc v Mexico*; and *Cargill Inc v Mexico* tribunals<sup>82</sup> have convincingly determined that the concept of legitimate expectations can be used to determine whether other elements of the FET have been violated.<sup>83</sup>

At the other end of the spectrum, Kläger considers the concept of legitimate expectations to be part of FET but he concedes that “well-defined criteria designed to determine whether the investor had, in fact, legitimate expectations that the investment framework would remain unchanged are still non-existing.”<sup>84</sup> Finally, Schill argues that the debate about FET and its relation to the MST is of little practical importance since “arbitral

70 *Bilcon* Award, *supra* note 59 at 436–437.

71 See e.g. Ryan, *supra* note 10 at 934–943.

72 Award, 8 June 2009, 48 ILM 1039 (International Centre for Settlement of Investment Disputes) [*Glamis* Award]

73 *Ibid* at para 20.

74 Moshe Hirsch, “The Sociology of International Investment Law” in Zachary Douglas, Joost Pauwelyn & Jorge E Viñuales, eds, *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford, UK: Oxford University Press, 2014) 143 at 147.

75 *Glamis* Award, *supra* note 72 at para 607.

76 James Anaya, “Customary International Law” (1998) 92 Proceedings of the Annual Meeting, American Society of International Law 41 at 42.

77 *Bilcon* Award, *supra* note 59 at paras 433–35.

78 The tribunal uses the term “reasonably relied-on expectations.” *Ibid* at paras 444–45.

79 *Ibid* at para 444.

80 Paparinskis, *supra* note 33 at 256.

81 Dumberry, *supra* note 15 at 265.

82 *Mobil Investments Canada Inc v Canada*, ICSID Case No ARB(AF)/07/4; *Waste Management, Inc v Mexico*, Award, 30 April 2004, ICSID Case No ARB(AF)/00/3, 43 ILM 967; *Cargill, Inc v Mexico*, Award, 18 September 2009, ICSID Case No ARB(AF)/05/2. See appendix 2 for a description of these cases in relation to the FET, MST and legitimate expectations.

83 Dumberry, *supra* note 15 at 265.

84 Kläger, *supra* note 27 at 441.

tribunals only rarely take a principled approach to interpretation of fair and equitable treatment.”<sup>85</sup>

Whether the concept of legitimate expectations is considered as part of the FET, or as a concept useful to determine a violation of other FET elements, is a distinction with little practical importance. If the concept of legitimate expectations lacks a core normative criteria, it can erase the boundaries of the FET, either directly or by lowering the standard for considering a breach of other elements of the FET clause which is, in itself, already fairly flexible.

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## Why the New Generation of IIAs Will Not Solve the Problems with the FET Standard

Newer-generation IIAs have responded to this challenge by rewording the FET clause to include more restrictions.<sup>86</sup> The FET has traditionally been considered part of the MST.<sup>87</sup> As mentioned above, this meant that the FET was closely associated with the customary law on the treatment of aliens. As Paparinskis has documented, the MST itself has been controversial from the start. Developed and developing countries have never completely agreed on the sort of protection that the standard provided.<sup>88</sup> As result, to say that the FET is tied to the MST does not exempt it from controversy but simply changes the terms of the discussion. A case in point is NAFTA’s article 1105(1), which subsumes the FET clause within what is already demanded by international law.<sup>89</sup> Yet tribunals still seem ambivalent about the scope of the FET in the NAFTA context.

CETA, the TPP and the proposed Transatlantic Trade and Investment Partnership (TTIP)<sup>90</sup> have introduced limitations and clarifications to both

the MST and the FET.<sup>91</sup> In CETA, a treaty between Canada and the European Union, there is no reference to the MST. There is only reference to a qualified FET that reflects the core concepts identified by Dumberry: prohibitions of denial of justice, of breach of due process and of arbitrariness (discrimination and harassment can be included here).<sup>92</sup> The doomed TPP, for its part, had an even more restrictive MST clause, tied to customary international law, and an FET clause that emphasized the prohibition of denial of justice. The only additional qualification was that the standard to determine whether a denial of justice had occurred was assessed by looking into “the principle of due process embodied in the principal legal systems of the world.”<sup>93</sup> Finally, the TTIP between the United States and the European Union does not include a stand-alone MST clause. The TTIP’s FET clause, however, also contains the core elements described above.<sup>94</sup>

If this new wording were to solve the problems with the FET, then it could be adopted in other agreements. However, there are reasons to be cautious when predicting how these new clauses will be interpreted. The first obstacle is the way in which arbitral tribunals make use of international law. Arbitral tribunals use other IIAs, customary international law<sup>95</sup> and case law<sup>96</sup> in order to interpret IIA provisions and settle disputes. Kurtz argues that tribunals lack consistency and discipline in interpreting treaties and international law since they tend to “simply choose and move between different interpretative schools without rational explanation and analysis.”<sup>97</sup> Even when it comes to case law from the International Court of Justice, tribunals pick and choose when they want to follow it.<sup>98</sup> There is no consistency regarding when an arbitral tribunal would

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85 Schill, *supra* note 41 at 79.

86 For a detailed comparison, see appendix 1.

87 Ryan, *supra* note 10 at 929.

88 Paparinskis, *supra* note 33 at 62; Kläger, *supra* note 27 at 438.

89 NAFTA, *supra* note 1, art 1105(1).

90 Commission Draft Text TTIP – Investment [TTIP], online: <[http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc\\_153807.pdf](http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf)>.

91 For a detailed comparison, see appendix 1.

92 CETA, *supra* note 2.

93 TPP, *supra* note 3, art 9.6(2)(a).

94 TTIP, *supra* note 90, art 3(1)(2). The TTIP FET clause does include a reference to transparency, but it is mentioned in the context of a breach of due process and not as a stand-alone obligation as Dumberry determined should be the case with transparency in the NAFTA context.

95 Florian Grisel, “The Sources of Foreign Investment Law” in Zachary Douglas, Joost Pauwelyn & Jorge E Viñuales, eds, *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford, UK: Oxford University Press, 2014) 213 at 217.

96 Hirsch, *supra* note 74 at 158.

97 Kurtz, *supra* note 36 at 275.

98 Alain Pellet, “The Case Law of the ICJ in Investment Arbitration” (24 February 2014), *Oxford University Press’s Academic Insights for the Thinking World* (blog), online: <<http://blog.oup.com/2014/02/icj-case-law-investment-arbitration-pil/>>.

turn to different international law sources and what weight each source would receive.

The second obstacle is this: even when a tribunal makes its approach clear in a particular case, the way that the law is applied is heavily influenced by extra-legal factors. Two of the most recent cases interpreting article 1105(1) (the *Bilcon* and *Mesa Power Group LLC v Canada* [*Mesa*]<sup>99</sup> cases) illustrate this point. In the *Mesa* award, the tribunal rejected the idea that it needed to apply anything more than customary international law to interpret the FET clause.<sup>100</sup> The *Mesa* tribunal also confirmed that the concept of legitimate expectations was not part of the FET under NAFTA, but only an element for determining a violation of other elements of the standard.<sup>101</sup> One interesting aspect of this award is that, in its interpretation of article 1105(1), it is very similar to the *Bilcon* tribunal findings. The actual outcomes in the two awards are very different. The *Mesa* case involved a procurement process, while the *Bilcon* case involved a permission to build a quarry.

In *Bilcon*, as described above, the tribunal found that Canada had breached article 1105(1) whereas, in the *Mesa* award, the tribunal did not.<sup>102</sup> While the details of each case are different, what both reveal is that what determines a breach of article 1105(1) is the perception of the tribunal regarding how the investor was treated. The dissenting opinion in *Bilcon* considered that the majority of the tribunal was too influenced by the narrative of mistreatment that the investor advanced.<sup>103</sup> In the *Mesa* award, the dissenting opinion considered that the tribunal was too indifferent to the mistreatment of the investor. In fact, Judge Charles N. Brower called the consequences of Ontario's actions "grotesque" and accused the province of purposely making a "mockery" of its own programs.<sup>104</sup> Perhaps unsurprisingly, Arbitrator McRae considered that Canada had not breached article 1105(1) in the *Bilcon* case,<sup>105</sup> while Judge Brower considered that it had in the *Mesa* case.<sup>106</sup>

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99 Award, 24 March 2016, PCA Case No 2012-17.

100 *Ibid* at para 503.

101 *Ibid* at para 502.

102 *Ibid* at para 682.

103 *Bilcon* Dissent, *supra* note 62 at para 6.

104 *Mesa Power Group LLC v Canada*, Concurring and Dissenting Opinion of Judge Charles N Brower, 25 March 2016, PCA Case No 2012-17 at paras 4-5 [*Mesa* Dissent].

105 *Bilcon* Dissent, *supra* note 62 at para 46.

106 *Mesa* Dissent, *supra* note 104 at para 23.

Mistreatment is, of course, not irrelevant in the analysis of whether the state has or has not violated article 1105(1). Mistreatment can take the form of arbitrariness or lack of due process. However, as mentioned above, in the *Bilcon* award, the majority of the tribunal spent much time narrating an atmosphere of antagonism against the investor. Compare, for instance, the extensive borrowing of adjectives in describing how the investor perceived it was being treated with the dry description of the state's rebuttal.<sup>107</sup> Likewise, it is hard to ignore the heavy use of adjectives in the *Mesa* dissenting opinion. In this regard, it is not mistreatment in the legal sense that permeates the *Bilcon* award and the dissenting opinion in the *Mesa* award. Rather, what we observe is the weaving of a narrative of victimhood of the investor that culminates with the finding of the state's violation of article 1105(1).

These are not just two isolated incidents; as mentioned above, the FET clause is devoid of clear normative content and is very context specific. The result is that the FET relies heavily on how tribunals perceive the conduct of both the investor and the state. The FET is structurally impressionistic and susceptible to different narratives. As the *Bilcon* and *Mesa* awards illustrate, this quality does not give certainty to either party and damages the perception of ISA as an efficient mechanism for settling investment disputes.

Tying the FET to customary international law has done little to reduce the uncertainty. In an extraordinary feat of arbitral jiu-jitsu, tribunals claim that it is precisely because customary law has evolved since the *Neer* case that they are giving the FET principle an expansive interpretation. As the majority in the *Bilcon* case stated, "Many NAFTA tribunals have shared the emerging consensus that the *Neer* standard of indisputably outrageous misconduct is no longer applicable, but there is no consensus yet on a formulation that best suits the modern evolution of the standard."<sup>108</sup> It is precisely because tribunals are following customary international law that they have gone beyond it.

It can be said that the certain amount of damage that the FET has already done will not be reversed easily or quickly. This is the case even if the reference to the FET in NAFTA is left unchanged. However, the fact remains that a reference to the

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107 *Bilcon* Award, *supra* note 59 at paras 361-426.

108 *Ibid* at para 439.

FET in NAFTA is redundant once it has been tied to the MST. Further, as explained above, even after the FTC note was issued, the reference to the FET continues to be a problem for tribunals. There is no reason to keep a reference to the FET in NAFTA. It is interesting that CETA and the TTIP retained FET clauses that are essentially MST clauses with another name. This is further evidence of how the FET has overshadowed the MST. Ultimately, there is no express reason to justify renaming MST clauses as FET clauses. If the original intention was to clarify the content of the MST through the FET, it just did not work. Moreover, the FET introduced new uncertainties in the emerging consensus regarding the content of the MST.

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## Conclusion

Both Canada and Mexico are getting ready to renegotiate NAFTA after Donald Trump made international trade, and NAFTA in particular, an important part of his agenda. This is an excellent opportunity to update the investment chapter, which has fallen behind newer treaties. There is no question that the NAFTA parties aimed at curbing the expansive interpretation of the FET principle. Some tribunals acknowledge the will of the parties only to end up giving the FET clause the same pre-FTC note interpretation. The main problem is that the FET principle itself has no fixed meaning<sup>109</sup> and was developed by arbitral tribunals. Equating the FET with the MST only adds to the confusion. A second problem is the lack of adherence of some tribunals to basic principles of international law. As the short description above illustrates, tribunals are deriving changes in customary international law by analyzing previous arbitral awards. Such a development, as widespread as it is, has no basis in international law. Finally, current arbitral interpretative practices and the lack of a rule of precedent amplify the problems of the FET principle.

The trend has been to keep FET clauses in newer agreements while diminishing references to the MST. In CETA and the TTIP, countries have abandoned the MST in favour of the FET standard.

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<sup>109</sup> Stephen Vasciannie, "The Fair and Equitable Treatment Standard in International Investment Law and Practice" (2000) 70:1 *Brit YB Intl L* 99.

A contradiction is seen when one compares the FET wording in the different treaties; the FET clauses are defined essentially as MST clauses, although they are no longer called that. This is an odd development considering that, once the FET clause is defined as an MST clause, it does not offer any extra protection to investors and, as argued above, it only increases uncertainty in the process for both parties.

Awards already settled should remain the same, regardless of whether the treaty changes or the NAFTA parties decide to abandon the treaty altogether, as Trump has suggested he might do. It should be stressed once more that the proposal to reform article 1105(1) is only meant to bring consistency and coherence to the treaty. It is not a departure from the actual text but a way to clearly communicate to arbitral tribunals the sort of protection that the article is meant to provide. The FTC note should have done that but, as discussed above, that was not enough.

It could be argued that, given that two of the three newest regional agreements (CETA and the TPP) involve Canada, fixing the FET clause in NAFTA makes little sense when investors could have recourse to these other agreements. However, the investment chapter in CETA has become embroiled in controversy in Europe, and the new US administration has withdrawn from the TPP. It is too soon to know how these new investment chapters will work, if and when they come into effect. In the meantime, NAFTA parties, in particular Canada and Mexico, could send a strong signal to arbitral tribunals and academics by insisting on removing the FET clause from NAFTA. It is true that, in some instances, eliminating it will lower the level of protection that investors currently have.<sup>110</sup> It should be noted that this high level of protection comes at the expense of the legitimacy and consistency of IIL. Among other countries, Singapore and Brazil normally do not include FET clauses in their IIAs<sup>111</sup> and they are,

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<sup>110</sup> UNCTAD 2015, *supra* note 32 at 138.

<sup>111</sup> UNCTAD 2012, *supra* note 7 at 18. See also Fabio Morosini & Michelle Raton Sanchez Badin, "The Brazilian Agreement on Cooperation and Facilitation of Investments (ACFI): A New Formula for International Investment Agreements?" (4 August 2015), *International Institute for Sustainable Development* (blog), online: <[https://www.iisd.org/itm/2015/08/04/the-brazilian-agreement-on-cooperation-and-facilitation-of-investments-acfi-a-new-formula-for-international-investment-agreements/#\\_ednref9](https://www.iisd.org/itm/2015/08/04/the-brazilian-agreement-on-cooperation-and-facilitation-of-investments-acfi-a-new-formula-for-international-investment-agreements/#_ednref9)>. It has to be noted that Singapore is part of the TPP, which includes an FET clause. If the agreement comes into effect, Singapore would be bound by the clause.

respectively, the fifth- and sixth-largest recipients of foreign direct investments inflows in the world.<sup>112</sup>

This is not to say that carefully drafted agreements are not an essential part of proper investment protection. IIAs should promote international investment by providing security for the investor's rights. State negotiators should consider more carefully what aspects the FET principle was meant to protect. The idea of having a catch-all clause that could potentially cost a country billions of dollars is not advisable. In addition, the MST would still exist in customary international law and provide protection against a variety of actions that are not necessarily listed in an IIA.

Finally, in relation to the last point, it is necessary that arbitrators do not revive the FET through the MST. When the NAFTA parties tried to curb the abuse of the FET by tying it to the MST, many tribunals reacted by simply lowering the MST threshold to encompass what an unqualified FET would do. It is necessary that states break this cycle by widening the pool of arbitrators and requiring that they abide by well-established international law principles. A permanent investment appeals court, such as the one proposed for CETA, could also help to establish more consistency.

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112 UNCTAD 2015, *supra* note 32 at 5.

# Appendix 1

## Comparison of FET and MST Clauses in NAFTA and Newer Investment Agreements

Treaty	FET Clause	MST Clause
NAFTA	Included in the MST clause.	Article 1105(1): “Each Party shall accord to investments of investors of another Party treatment in accordance with international law, <i>including fair and equitable treatment</i> and full protection and security.” [emphasis added]
CETA	<p>Article 8.10.2: “A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 if a measure or series of measures constitutes:</p> <p>(a) denial of justice in criminal, civil or administrative proceedings;</p> <p>(b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings.</p> <p>(c) manifest arbitrariness;</p> <p>(d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;</p> <p>(e) abusive treatment of investors, such as coercion, duress and harassment; or</p> <p>(f) a breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.”</p> <p>Article 8.10.3: “The Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment. The Committee on Services and Investment...may develop recommendations in this regard and submit them to the CETA Joint Committee for decision.”</p> <p>Article 8.10.4: “When applying the above fair and equitable treatment obligation, the Tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated.”</p>	No separate MST clause.

Treaty	FET Clause	MST Clause
TPP	<p>Article 9.6.2: “For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the 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 obligations in paragraph 1 to provide:</p> <p>(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</p> <p>(b) ‘full protection and security’ requires each Party to provide the level of police protection required under customary international law.”</p> <p>Article 9.6.4: “For greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.”</p>	<p>Article 9.6.1: “Each Party shall accord to covered investments treatment in accordance with applicable customary international law principles, including fair and equitable treatment and full protection and security.”</p>
TTIP	<p>Article 3:</p> <p>“2. A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or a series of measures constitutes:</p> <p>(a) denial of justice in criminal, civil or administrative proceedings; or</p> <p>(b) fundamental breach of due process, including a fundamental breach of transparency and obstacles to effective access to justice, in judicial and administrative proceedings; or</p> <p>(c) manifest arbitrariness; or</p> <p>(d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; or</p> <p>(e) harassment, coercion, abuse of power or similar bad faith conduct; or</p> <p>(f) a breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.</p> <p>3. The Parties shall, upon request of a Party, review the content of the obligation to provide fair and equitable treatment. The [...] Committee (reference to article on Services and Investment Committee) may develop recommendations in this regard and submit them to the [...] Committee (reference to article on Trade Committee). The [...] Committee (reference to article on Trade Committee) shall consider whether to recommend that the Agreement is amended, in accordance with Article [relevant procedures for the amendment of the Agreement].</p> <p>4. When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated.”</p>	<p>No separate MST clause.</p>

## Appendix 2

### FET, MST and Legitimate Expectations in Relevant NAFTA Awards (2000–2016)

<i>Eli Lilly &amp; Co v Canada, Final Award, 16 March 2017, ICSID Case No UNCT/14/2 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“It follows, in the Tribunal’s view, that a claimed breach of the customary international law minimum standard of treatment requirement of NAFTA Article 1105(1) may be properly a basis for a claim under NAFTA Article 1105 notwithstanding that it is not cast in denial of justice terms. As noted above, the conduct of the judiciary will in principle be attributable to the State by reference to uncontroversial principles of State responsibility. As a matter of principle, therefore, having regard to the content of the customary international law minimum standard of treatment, the Tribunal is unwilling to shut the door to the possibility that judicial conduct characterized other than as a denial of justice may engage a respondent’s obligations under NAFTA Article 1105, within the standard articulated in the award in <i>Glamis</i>.” [para 223]</p>	<p>“The Tribunal is mindful of the role of the judiciary in common law jurisdictions. Claimant’s position in this proceeding rests on an implicit premise that common law decisions must follow in a reasonably foreseeable and predictable channel, without significant or material changes. Yet evolution of the law through court decisions is natural, and departures from precedent are to be expected.” [para 310]</p>	<p>No breach of article 1105 [paras 388, 389, 418, 442]</p>

<i>Mesa Power Group LLC v Canada, Award, 24 March 2016, PCA Case No 2012-17</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“The Tribunal disagrees with the Claimant’s submissions that the ‘autonomous’ fair and equitable treatment provisions in other treaties impose additional requirements on Canada beyond those deriving from the minimum standard. As was already discussed above, the FTC Note is clear that the Tribunal must apply the customary international law standard of the international minimum standard of treatment, and nothing else. There is thus no scope for autonomous standards to impose additional requirements on the NAFTA Parties. This was the conclusion in <i>Bilcon</i> as well.” [para 503, footnotes omitted]</p>	<p>“[T]he Tribunal shares the view held by a majority of NAFTA tribunals that the failure to respect an investor’s legitimate expectations in and of itself does not constitute a breach of Article 1105, but is an element to take into account when assessing whether other components of the standard are breached.” [para 502, footnotes omitted]</p>	<p>No breach of article 1105 [para 682].</p>

<i>Bilcon of Delaware, Inc v Canada, Award on Jurisdiction and Liability, 17 March 2015, PCA Case No 2009-04 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“NAFTA Article 1105 is, then, identical to the minimum international standard. The crucial question — on which the Parties diverge — is what is the content of the contemporary international standard that the tribunal is bound to apply. NAFTA awards make it clear that the international minimum standard is not limited to conduct by host states that is outrageous. The contemporary minimum international standard involves a more significant measure of protection.” [para 433]</p>	<p>“The legitimate expectations of an investor — a factor that may be part of an overall analysis of whether treatment has breached the minimum standard of fairness — may depend crucially on contracts, assurances or the legal landscape, including existing statutes and judicial and administrative precedents, that existed before an alleged breach took place.” [para 282]</p>	<p>Breach of article 1105 [para 604].</p>

<i>Apotex Holdings Inc v United States, Award, 25 August 2014, ICSID Case No ARB(AF)/12/1</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“[T]he Tribunal considers that the Claimants have not presented sufficient evidence of state practice or <i>opinio juris</i> indicating that States recognise an obligation to extend the specific procedural rights claimed here [those listed in section 181 of the Second Restatement] to aliens in connection with regulators’ decisions affecting the importation of drug products manufactured abroad in the aliens’ foreign facilities. Nor have the Claimants, in the Tribunal’s view, identified any prior decisions of NAFTA and other international tribunals recognising the asserted principles of customary international law in circumstances comparable to those presented in the present case.” [para 9.17]</p>	<p>Claimant did not argue that there was a breach of legitimate expectations and the Tribunal did not address it.</p>	<p>No breach of article 1105 [para 9.65].</p>

<i>Grand River Enterprises Six Nations, Ltd v United States, Award, 12 January 2011 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“As the basis of the fair and equitable treatment standard of Article 1105, the customary standard of protection of alien investors’ investments does not incorporate other legal protections that may be provided investors or classes of investors under other sources of law. To hold otherwise would make Article 1105 a vehicle for generally litigating claims based on alleged infractions of domestic and international law and thereby unduly circumvent the limited reach of Article 1105 as determined by the Free Trade Commission in its binding directive.” [para 219]</p>	<p>“The Tribunal understands the concept of reasonable or legitimate expectations in the NAFTA context to correspond with those expectations upon which an investor is entitled to rely as a result of representations or conduct by a state party. As the tribunal in <i>Thunderbird Gaming</i> explained, the ‘concept of “legitimate expectations” relates...to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.’ The question of reasonable expectations, therefore, is not equivalent to whether or not an investor is ultimately right on a contested legal proposition that would favor the investor.” [para 140, footnote omitted]</p>	<p>No breach of article 1105 [paras 204, 216, 221, 228].</p>

FET and MST	Legitimate Expectations	Outcome
<p>"[T]he Tribunal notes that it is not disputed that the scope of Article 1105 of NAFTA must be determined by reference to customary international law. Such determination cannot overlook the evolution of customary international law, nor the impact of BITs on this evolution." [para 121]</p>	<p>The Tribunal dismissed the claim of a violation of legitimate expectations but it refrained from formulating an approach to the term. [see para 179]</p>	<p>No breach of article 1105 [paras 163, 180, 193, 225].</p>

<i>Merrill &amp; Ring Forestry LP v Canada, Award, 31 March 2010 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>"As the Investor has argued, the FTC Interpretation seems in some respect to be closer to an amendment of the treaty, than a strict interpretation. In any event, the Tribunal is mindful of the evolutionary nature of customary international law, as discussed below, which provides scope for the interpretation of Article 1105(1), even in the light of the Free Trade Commission's 2001 interpretation." [para 192]</p>	<p>"[A]ny investor will have an expectation that its business may be conducted in a normal framework free of interference from government regulations which are not underpinned by appropriate public policy objectives. Emergency measures or regulations addressed to social well-being are evidently within the normal functions of a government and it is not legitimate for an investor to expect to be exempt from them. Yet, regulations which end-up creating benefits for a certain industry, to the detriment of an investor, might be incompatible with what that investor might reasonably expect from a government." [para 233]</p>	<p>No breach of article 1105 [para 266].</p>

<i>Cargill, Inc v Mexico, Award, 18 September 2009, ICSID Case No ARB(AF)/05/2</i>		
FET and MST	Legitimate Expectations	Outcome
<p>"In summation, the Tribunal finds that the obligations in Article 1105(1) of the NAFTA are to be understood by reference to the customary international law minimum standard of treatment of aliens. The requirement of fair and equitable treatment is one aspect of this minimum standard. To determine whether an action fails to meet the requirement of fair and equitable treatment, a tribunal must carefully examine whether the complained of measures were grossly unfair, unjust or idiosyncratic; arbitrary beyond a merely inconsistent or questionable application of administrative or legal policy or procedure so as to constitute an unexpected and shocking repudiation of a policy's very purpose and goals, or to otherwise grossly subvert a domestic law or policy for an ulterior motive; or involve an utter lack of due process so as to offend judicial propriety. The Tribunal observes that other NAFTA tribunals have expressed the view that the standard of fair and equitable treatment is not so strict as to require 'bad faith' or 'willful neglect of duty.' The Tribunal agrees. However, the Tribunal emphasizes that although bad faith or willful neglect of duty is not required, the presence of such circumstances will certainly suffice." [para 296]</p>	<p>"The Tribunal notes that there are at least two [bilateral investment treaty] awards, both involving a clause viewed as possessing autonomous meaning, that have found an obligation to provide a predictable investment environment that does not affect the reasonable expectations of the investor at the time of the investment. No evidence, however, has been placed before the Tribunal that there is such a requirement in the NAFTA or in customary international law, at least where such expectations do not arise from a contract or quasi-contractual basis." [para 290, footnote omitted]</p>	<p>Breach of article 1105 [para 305].</p>

<i>Glamis Gold, Ltd v United States, Final Award, 8 June 2009 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“The Tribunal therefore holds that there is an obligation of each of the NAFTA State Parties inherent in the fair and equitable treatment standard of Article 1105 that they do not treat investors of another State in a <i>manifestly</i> arbitrary manner. The Tribunal thus determines that Claimant has sufficiently substantiated its arguments that a duty to protect investors from arbitrary measures exists in the customary international law minimum standard of treatment of aliens; though Claimant has not sufficiently rebutted Respondent’s assertions that a finding of arbitrariness requires a determination of some act far beyond the measure’s mere illegality, an act so manifestly arbitrary, so unjust and surprising as to be unacceptable from the international perspective.” [para 626, emphasis in original]</p>	<p>“The Tribunal therefore agrees with <i>International Thunderbird</i> that legitimate expectations relate to an examination under Article 1105(1) in such situations ‘where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct...’ In this way, a State may be tied to the objective expectations that it creates <i>in order to induce</i> investment.” [para 621, emphasis in original, footnote omitted]</p>	<p>No breach of article 1105 [paras 824–829].</p>

<i>International Thunderbird Gaming Corp v Mexico, Arbitral Award, 26 January 2006 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“The content of the minimum standard should not be rigidly interpreted and it should reflect evolving international customary law. Notwithstanding the evolution of customary law since decisions such as <i>Neer Claim</i> in 1926, the threshold for finding a violation of the minimum standard of treatment still remains high, as illustrated by recent international jurisprudence. For the purposes of the present case, the Tribunal views acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards.” [para 194, footnotes omitted]</p>	<p>“Having considered recent investment case law and the good faith principle of international customary law, the concept of ‘legitimate expectations’ relates, within the context of the NAFTA framework, to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.” [para 147, footnotes omitted]</p>	<p>No breach of article 1105 [para 195].</p>

<i>Methanex Corp v United States, Final Award, 3 August 2005 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“As to the question of whether a rule of customary international law prohibits a State, in the absence of a treaty obligation, from differentiating in its treatment of nationals and aliens, international law is clear. In the absence of a contrary rule of international law binding on the States parties, whether of conventional or customary origin, a State may differentiate in its treatment of nationals and aliens. As the previous discussion shows, no conventional rule binding on the NAFTA Parties is to the contrary with respect to the issues raised in this case. Indeed, the text of NAFTA indicates that the States parties explicitly excluded a rule of non-discrimination from Article 1105.” [Part IV, Chapter C, para 25]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105 [Part IV, Chapter C, para 27].</p>

FET and MST	Legitimate Expectations	Outcome
<p>“Four implications of <i>Waste Management II</i> 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 a 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.” [para 97]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105 [para 85].</p>

<i>Waste Management, Inc v Mexico, Final Award, 30 April 2004, ICSID Case No ARB(AF)/00/3, 43 ILM 967</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“Taken together, the <i>S.D. Myers, Mondev, ADF and Loewen</i> cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety — as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.” [para 98]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105 [paras 104, 117, 130, 140].</p>

<i>Loewen Group, Inc v United States, Final Award, 26 June 2003, ICSID Case No ARB(AF)/98/3</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“The effect of the Commission’s interpretation is that ‘fair and equitable treatment’ and ‘full protection and security’ are not free-standing obligations. They constitute obligations only to the extent that they are recognized by customary international law. Likewise, a breach of Article 1105(1) is not established by a breach of another provision of NAFTA. To the extent, if at all, that NAFTA Tribunals in <i>Metalclad Corp v United Mexican States</i> ICSID Case No. ARB(AF)/97/1 (Aug 30, 2000), <i>S.D. Myers, Inc. v Government of Canada</i> (Nov 13, 2000) and <i>Pope &amp; Talbot, Inc. v Canada, Award on the Merits, Phase 2, (Apr 10, 2001)</i> may have expressed contrary views, those views must be disregarded.” [para 128]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105 [para 189].</p>

FET and MST	Legitimate Expectations	Outcome
<p>“We do not address the question of the power of the Tribunal to examine the Interpretation of the Free Trade Commission. Rather, we agree in any event with its conclusion that the obligation to accord fair and equitable treatment is not in addition to or beyond the minimum standard. Our reasons in brief are, first, that that reading accords with the ordinary meaning of article 1105. That obligation is ‘included’ within the minimum standard. Secondly, the many bilateral treaties for the protection of investments on which the argument depends vary in their substantive obligations; while they are large in number their coverage is limited; and, as we have already said, in terms of opinio juris there is no indication that they reflect a general sense of obligation. The failure of efforts to establish a multilateral agreement on investment provides further evidence of that lack of a sense of obligation. Thirdly, the very fact that many of the treaties do expressly create a stand-alone obligation of fair and equitable treatment may be seen as giving added force to the ordinary meaning of article 1105(1) and particularly the word ‘including’ (‘notamment’ and ‘incluido’). And the likely availability to the investor of the protection of the most favoured nation obligation in article 1103, by reference to other bilateral investment treaties, if anything, supports the ordinary meaning.” [para 97]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105; <i>United Parcel Service of America Inc v Canada</i>, Award on the Merits, 24 May 2007 (UNCITRAL) at para 187.</p>

<i>Mondev International Ltd v United States</i> , Final Award, 11 October 2002, ICSID Case No ARB(AF)/99/2		
FET and MST	Legitimate Expectations	Outcome
<p>“The Tribunal has no difficulty in accepting that an arbitral tribunal may not apply its own idiosyncratic standard in lieu of the standard laid down in Article 1105 (1). In light of the FTC’s interpretation, and in any event, it is clear that Article 1105 was intended to put at rest for NAFTA purposes a long-standing and divisive debate about whether any such thing as a minimum standard of treatment of investment in international law actually exists. Article 1105 resolves this issue in the affirmative for NAFTA Parties. It also makes it clear that the standard of treatment, including fair and equitable treatment and full protection and security, is to be found by reference to international law, i.e., by reference to the normal sources of international law determining the minimum standard of treatment of foreign investors.” [para 120, footnote omitted]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105 [paras 154, 156].</p>

FET and MST	Legitimate Expectations	Outcome
<p>“[T]he Tribunal interprets Article 1105 to require that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in the NAFTA countries, without any threshold limitation that the conduct complained of be ‘egregious,’ ‘outrageous’ or ‘shocking,’ or otherwise extraordinary.” [para 118, footnote omitted]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>No breach of article 1105 [paras 154, 156].</p>

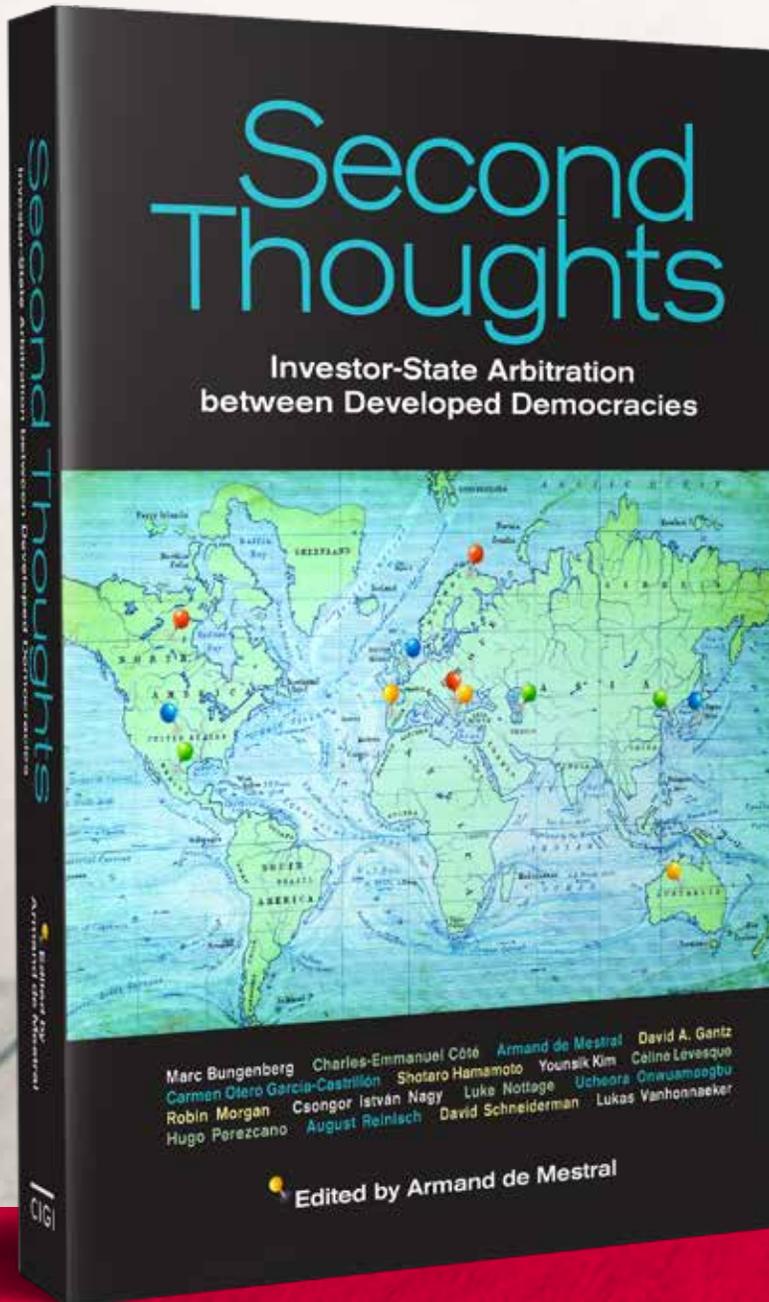
<i>SD Myers, Inc v Canada, Partial Award, 13 November 2000 (UNCITRAL)</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the 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.” [para 263]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>Breach of article 1105 [para 268].</p>

<i>Metalclad Corp v Mexico, Award, 30 August 2000, ICSID Case No ARB(AF)/97/1</i>		
FET and MST	Legitimate Expectations	Outcome
<p>“The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the 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.” [para 263]</p>	<p>No mention of legitimate expectations in the award on merits.</p>	<p>Breach of article 1105 [para 101].</p>

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## Second Thoughts

### Investor-State Arbitration between Developed Democracies

Edited by Armand de Mestral

Since the first international investment agreement was negotiated nearly six decades ago, developed countries have sought to protect their investors against the possible failure of host countries (usually a developing country) to respect treaty standards. The North American Free Trade Agreement and the European Energy Charter, both dating from 1994, marked the first instances of developed countries signing an agreement containing provisions for investor-state arbitration (ISA) between themselves. Since then, ISA has become a standard feature of international investment agreements, even as the chorus of protest against ISA from civil society groups (and some nations) has grown louder.

*Second Thoughts* gathers the reflections of 16 international investment experts, examining experiences of ISA in Canada and various parts of the world, and asking whether ISA is appropriate between developed democracies.

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