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# Introduction: Interrelationship of Standards

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The upsurge of investment arbitration in the last 10 years or so has made a strong impact on the substantive standards provided by investment treaties. Practice has shifted remarkably. Some standards have gained importance while others have waned. Some have proved their autonomy while others often appear in tandem with other standards. Some appear fairly straightforward while the meaning of others is multifaceted and had to evolve through practice. Some are central to practically every case while others are rarely invoked.

By way of introduction, it is worth considering the interrelationship of some of the standards that are discussed in this book. Traditionally, the most important standard was expropriation. In fact, there was a time when investor protection was virtually synonymous with protection against uncompensated expropriation. Recently, the practical relevance of expropriation in investment disputes has receded. Direct expropriations have become rare. Cases involving claims for indirect expropriations through regulatory measures are much more prevalent. But practice indicates that it is an uphill struggle for an investor to convince a tribunal that a regulatory expropriation has occurred. I have found 15 awards since the beginning of 2006 in which the claimant argued that it had been expropriated. Of these, the tribunals only found in three cases that there had, in fact, been an expropriation, one involving the rare situation of a direct expropriation.<sup>1</sup> That leaves only two instances of a successful invocation of indirect expropriation in the last two years.<sup>2</sup>

I believe that there are two reasons for this development. One is the requirement that for an indirect expropriation the investor must be deprived of the economic benefits of its investment entirely or in substantial part. If any commercial value remains it becomes extremely difficult to argue expropriation. The other

<sup>1</sup> *ADC v Hungary*, Award, 2 October 2006.

<sup>2</sup> *Siemens v Argentina*, Award, 6 February 2007; *Compañía de Aguas del Aconquija, S.A. & Vivendi Universal v Argentina*, Award, 20 August 2007.

reason is a growing sympathy on the part of tribunals for regulatory measures in the public interest. In order to avoid the undesirable consequence of a finding of expropriation, which entails full compensation, some tribunals have declared that if only the public interest is clear and due process is followed there is no expropriation.<sup>3</sup> The consequence is that the investor gets nothing. This unsatisfactory state of affairs has led to calls for a more balanced approach that would abandon the current 'all or nothing' situation between full compensation and zero compensation. The two are divided by a thin line that is increasingly difficult to make out in the shifting sands of arbitral practice. A suggestion on how to remedy this situation was made by Ursula Kriebaum.<sup>4</sup>

It is no exaggeration to say that the current law on expropriation is in a state of crisis. The fact that two contributors to this book address the topic, Anne Hoffmann at Chapter 8 and August Reinisch at Chapter 9, attests to its complexity.

The pivotal position, once occupied by protection from expropriation, has been taken over by fair and equitable treatment (FET). For the period since the beginning of 2006 I have been able to make out 13 awards dealing with FET. In eight of these the claimants have successfully convinced the tribunals that there had indeed been violations of that standard. We get a fuller exposition of this standard and its many facets by Katia Yannaca-Small at Chapter 6.

It is clear that FET is currently the most promising standard of protection from the investor's perspective. In an investment dispute the burden of proof for an investor to demonstrate a violation of FET is lighter than to establish an expropriation. Not to invoke FET where it is available under an applicable treaty would probably have to be considered as amounting to malpractice.

The tribunal in *PSEG v Turkey*<sup>5</sup> described this relationship in the following terms:

238. The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.<sup>6</sup>

A look at decisions rendered over the last couple of years shows that tribunals frequently find a violation of the FET standard but simultaneously deny that there has been an expropriation. At the same time, it is difficult to envisage an

<sup>3</sup> *Methanex v United States*, Award, 3 August 2005, Part IV, D, paras 7, 15; *Saluka v Czech Republic*, Partial Award, 17 March 2006, para. 255.

<sup>4</sup> U. Kriebaum, 'Regulatory Takings, Balancing the Interests of the Investor and the State', 8 *The Journal of World Investment and Trade* (2007) 717.

<sup>5</sup> *PSEG v Turkey*, Award, 19 January 2007.

<sup>6</sup> *Ibid.*, para. 238.

uncompensated expropriation that would not also involve a violation of the FET standard.

Does this mean that we can happily accept that the central role once played by protection against expropriation has simply been taken over by the FET standard? I believe this would be a mistake. Protection against expropriation has by no means become superfluous through the introduction of FET. At times, reliance on FET may not be possible. Most but not all treaties provide protection against unfair and inequitable treatment. Investment insurance typically covers expropriation but not the violation of FET. Under some treaties, jurisdiction for investor-State arbitration exists only with respect to expropriation, sometimes only for the amount of compensation due, but not for violations of FET. In order to establish the tribunal's jurisdiction the claimant will have to base its claim on expropriation.

Other treaties contain carve-outs for tax matters. This means that the treaty is inapplicable, in principle, to matters of taxation. However, the carve-out does not apply if an expropriation is involved.<sup>7</sup> Therefore, in order to obtain protection the claimant would have to prove expropriation by way of a tax measure.

Just to make things even more complicated, some treaties, including NAFTA, in their provisions on expropriation, contain references to FET.<sup>8</sup> For instance the Argentina/US BIT not only provides that any expropriation must be for a public purpose, non-discriminatory, and against prompt, adequate and effective compensation, it also requires that any expropriation must be in accordance with due process of law and FET as well as other principles of treatment.<sup>9</sup> In this way the FET standard gets imported into the provision on expropriation.<sup>10</sup>

Therefore, FET and protection against expropriation, while clearly separate standards, are still connected. FET may be part of the requirements for a legal

<sup>7</sup> Article XII Argentina/US BIT provides in relevant part: '1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investments of nationals and companies of the other Party. 2. Nevertheless, the provisions of this Treaty, and in particular Article VII and VIII, shall apply to matters of taxation only with respect to the following: (a) expropriation, pursuant to Article IV; (b) transfers, pursuant to Article V; (c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VII(1)(a) or (b), [...].'

<sup>8</sup> Article 1110(1) NAFTA.

<sup>9</sup> Article IV(1) Argentina/US BIT provides in relevant part: 'Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(2).' The principles of treatment in Article II(2) of the BIT are: fair and equitable treatment, full protection and security, treatment no less than required by international law, no arbitrary or discriminatory measures, and observance of obligations entered into with regard to investments.

<sup>10</sup> For cases on provisions of this type see *Link-Trading v Moldova*, Award, 18 April 2002, para. 64; *Enron v Argentina*, Decision on Jurisdiction, 14 January 2004, para. 66; *Pan American v Argentina*, Decision on Preliminary Objections, 27 July 2006, para. 136.

expropriation. Even where jurisdiction extends only to claims based on expropriation, the tribunal may have to look at the FET standard to establish whether the expropriation was legal.

The practical difference between a successful claim based on expropriation and one based on a violation of FET, or for that matter of any of the other standards, manifests itself in the calculation of compensation and damages. Anyone who still believes that there is no relevant distinction at the *quantum* stage between compensation for an otherwise legal expropriation and damages for an illegal act should read Irmgard Marboe's article on this topic.<sup>11</sup>

The interrelationship of other standards of treatment is less clear. As Giuditta Cordero Moss explains in Chapter 7, tribunals are at odds as to whether full protection and security is an autonomous standard or a subspecies of fair and equitable treatment. Some tribunals regard the two standards as more or less equivalent,<sup>12</sup> while others emphasize their distinction.<sup>13</sup> One would think that the texts of the relevant treaties would give some indication of that relationship. Some of these treaties do indeed treat the two standards in conjunction while others offer them separately. But rather surprisingly, arbitral practice on this question, while diverse, does not seem to be determined by the wording and context of the respective provisions.

The view that the two standards, FET and protection and security, are to be seen as different obligations strikes me as the better one. As a matter of interpretation, it appears unconvincing to assume that two standards, listed separately in the same document, have the same meaning. An interpretation that deprives a treaty provision of its independent meaning is implausible to say the least. As a matter of substance, I believe that the content of the two standards is distinguishable. The FET standard consists mainly of an obligation on the host State's part to desist from a certain course of action. By contrast, by promising full protection and security the host State assumes an obligation to actively create a framework that grants security.

Clauses protecting investors from arbitrary and unreasonable measures are common in investment treaties. Veijo Heiskanen tells us all about them in Chapter 5. These clauses vary in their wording. Sometimes 'arbitrary' or 'unjustified' is coupled with 'discriminatory'. The relationship of this standard to other standards, especially FET, is also far from clear.

In a number of cases the tribunals dealt with the prohibition of unreasonable or arbitrary measures in close conjunction with the FET standard. This tendency is particularly pronounced with tribunals applying the NAFTA.

<sup>11</sup> I. Marboe, 'Compensation and Damages in International Law, The Limits of "Fair Market Value"', 7 *The Journal of World Investment and Trade* (2006) 723.

<sup>12</sup> *Wena Hotels Ltd v Arab Republic of Egypt*, Award, 8 December 2000, paras 84–95; *Occidental Exploration and Production Co v Ecuador*, Award, 1 July 2004, para. 187; *PSEG v Turkey*, Award, 19 January 2007, paras 257–259.

<sup>13</sup> *Azurix Corp v The Argentine Republic*, Award, 14 July 2006, paras 407, 408.

It may be explained, at least in part, by the fact that the NAFTA does not contain a separate provision on arbitrary treatment.<sup>14</sup> But a number of cases concerned BITs that contained specific references to a prohibition of arbitrary and unreasonable or discriminatory treatment in addition to the FET standard. Nevertheless, the tribunals applied these two standards in close conjunction.<sup>15</sup>

Despite this tendency of some tribunals to amalgamate the prohibition of arbitrary or discriminatory measures with FET, there are good reasons for treating the two standards as conceptually different. Again, it is unclear why treaty drafters would use two different terms when they mean one and the same thing. Equally, it is difficult to see why one standard should be part of the other when the text of the treaties lists them side by side as two standards without indicating that one is merely an emanation of the other. Of course, this does not deny that there may be considerable overlap and that one particular set of facts may violate both the FET standard and the rule against arbitrary or discriminatory treatment.

A number of tribunals have, in fact, examined compliance with the standards of FET and unreasonable or arbitrary treatment separately.<sup>16</sup> Although there is often no explicit discussion of the relationship of the two concepts,<sup>17</sup> their sequential and separate treatment in awards indicates that the tribunals regarded them as distinct standards.

The tendency to fuse the prohibition of arbitrariness with FET is probably more a consequence of the insecurity of tribunals confronted with two relatively novel and unspecific standards. As the case law evolves, it may be expected that tribunals develop a clearer perception of the precise implications of each of these principles.

<sup>14</sup> For the use of the concept of arbitrariness in the context of interpreting the fair and equitable treatment standard under Article 1105(1) NAFTA, see *S.D. Myers v Canada*, Award on Liability, 13 November 2000, para. 263; *Mondev Int'l Ltd v United States of America*, Award, 11 October 2002, para. 127; *Waste Management, Inc. v United Mexican States*, Award, 30 April 2004, para. 98; *Pope & Talbot v Canada*, Award in Respect of Damages, 31 May 2002, paras 63, 64; *ADF Group Inc v United States of America*, Award, 9 January 2003, paras 188, 191; *Loewen Group Inc. and Raymond L. Loewen v United States of America*, Award, 26 June 2003, paras 131–133.

<sup>15</sup> *CMS Gas Transmission Co. v Argentina*, Award, 12 May 2005, para. 290; *Impregilo v Pakistan*, Decision on Jurisdiction, 22 April 2005, paras 264–270; *MTD Equity Sdn Bhd and MTD Chile S.A. v Republic of Chile*, Award, 25 May 2004, para. 196; *Saluka Investments BV (The Netherlands) v The Czech Republic*, Partial Award, 17 March 2006, para. 460; *PSEG v Turkey*, Award, 19 January 2007, para. 261.

<sup>16</sup> See *Occidental Exploration and Production Co v Ecuador*, Award, 1 July 2004, paras 159–166; *Ronald S. Lauder v The Czech Republic*, Award, 3 September 2001, paras 214–288; *Genin, Eastern Credit Ltd Inc and AS Baltoil v Republic of Estonia*, Award, 25 June 2001, paras 368–371; *Noble Ventures v Romania*, Award, 11 October 2005, paras 175–180; *Azurix Corp v The Argentine Republic*, Award, 14 July 2006, paras 385–393; *Siemens v Argentina*, Award, 6 February 2007, paras 310–321.

<sup>17</sup> But see explicit treatment of this question in *LG&E v Argentina*, Decision on Liability, 3 October 2006, paras 162, 163.

Some tribunals have found that FET was an overarching principle that embraces the other standards.<sup>18</sup> The tribunal in *Noble Ventures v Romania*,<sup>19</sup> a case decided on the basis of the Romania/US BIT, seemed to think that the FET standard was just a more general label for a number of standards:

Considering the place of the fair and equitable standard at the very beginning of Art. II(2), one can consider this to be a more general standard which finds its specific application in *inter alia* the duty to provide full protection and security, the prohibition of arbitrary and discriminatory measures and the obligation to observe contractual obligations towards the investor.<sup>20</sup>

National treatment has a long pedigree and is older than FET. Andrea Bjorklund provides the details at Chapter 3. National treatment is clearly an independent standard. Yet, it also has its connections to FET and other standards. It is difficult to imagine that a tribunal would not regard a case of clear discrimination on grounds of nationality as a violation of FET. In addition, it would most probably regard discrimination of foreign investors as arbitrary. After all, arbitrary treatment is often coupled with discriminatory treatment in BITs. Of course, when it comes to expropriation, discrimination on grounds of nationality would make the expropriation illegal.

Most-favoured-nation clauses (MFN clauses) are also designed to avoid discrimination. Their potential for interaction with other standards of treatment is undeniable. Here we are talking not about the relationship of two or several standards all appearing in one treaty. Rather, the issue is to what extent standards not provided for in a treaty may be imported by way of an MFN clause in that treaty. For instance, where an applicable treaty lacks reference to the FET standard it is possible to import that standard from another treaty of the respondent by way of an MFN clause.<sup>21</sup> Andreas Ziegler enlightens the reader in this respect in Chapter 4.

Surprisingly, the most contentious issues with respect to MFN clauses have not arisen in relation to the substantive standards of treatment. Rather, the action and excitement is on a different front. It concerns the question to what extent MFN clauses also cover dispute settlement, in particular jurisdictional provisions in investment treaties.

Anna Joubin-Bret's contribution at Chapter 2 deals with admission. In a way admission is the threshold that investors must cross before they begin to enjoy the substantive standards that are the subject matter of this volume.<sup>22</sup> But admission

<sup>18</sup> *Petrobart v The Kyrgyz Republic*, Award, 29 March 2005, 2005: 3 *Stockholm Int'l Arbitration Rev.* 45, at 82.

<sup>19</sup> *Noble Ventures Inc v Romania*, Award, 12 October 2005.

<sup>20</sup> *Ibid.*, para. 182.

<sup>21</sup> See *ADF v United States*, Award, 9 January 2003, paras 193–198; *MTD v Chile*, Award, 25 May 2004, paras 100–104, 197–206; *Bayindir v Pakistan*, Decision on Jurisdiction, 14 November 2005, paras 227–232.

<sup>22</sup> *Mihaly v Sri Lanka*, Award, 15 March 2002, 6 *ICSID Reports* 310.

is not always a simple one-step process. As the investment gets under way, the investor often needs a number of permits. Several cases show that this process can be hazardous if not fatal to the investment. Failure to grant the necessary permits may amount to a violation of FET or even an expropriation.<sup>23</sup>

Some treaties actually link admission to other standards. For instance, many BITs of the United States and Canada, as well as the US Model BIT of 2004, extend national treatment as well as MFN treatment to admission and establishment, at least in principle.

The last topic of this book is transfers. Guarantees of money transfers in and out of the host State appear in many if not most BITs. These guarantees have attracted little attention in recent years and may be regarded as the stepchild of investment arbitration practice. The editor of this book has acted wisely in inviting Thomas Wälde to write on this topic. His ability to speak and write incisively and extensively on any topic of investment law is legendary.

<sup>23</sup> *Metalclad v Mexico*, Award, 30 August 2000, 5 *ICSID Reports* 212; *MTD v Chile*, Award, 25 May 2004.