

Chapter 10

Protection against Arbitrary or Discriminatory Measures

Christoph H. Schreuer

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I. GENERAL REMARKS

Clauses protecting investors from arbitrary or discriminatory measures are common in investment treaties.¹ For instance, Article II(2)(b) of the Argentina-United States BIT provides in part that “[n]either Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.” The precise wording varies between “arbitrary or discriminatory”, “unjustified or discriminatory”, and “unreasonable or discriminatory.” Article 10(1) of the Energy Charter Treaty refers to “unreasonable or discriminatory measures.” There does not appear to be a relevant distinction between the terms “arbitrary”, “unjustified”, and “unreasonable” in this context. Rather, the terms seem to be used interchangeably.

¹ V. Heiskanen, *Arbitrary and Unreasonable Measures*, in A. Reinisch (ed.) *STANDARDS OF INVESTMENT PROTECTION*, p. 87 (2008).

The words “arbitrary” and “discriminatory” are typically separated by the word “or.” This would indicate that the standard is a twofold one: (1) protection against arbitrary measures and (2) protection against discriminatory measures. In order to violate these standards, a particular measure need not be unreasonable as well as discriminatory. A violation of either standard is sufficient.

The tribunal in *Azurix v. Argentina*,² interpreting the BIT between Argentina and the United States, adopted this approach. It said:

391. The Tribunal agrees with the interpretation of the Claimant that a measure needs only to be arbitrary to constitute a breach of the BIT. This interpretation has not been contested by the Respondent and it follows from the alternative way in which the term “measures” is qualified by the adjectives “arbitrary or discriminatory.”³

II. ARBITRARY MEASURES

A. The Meaning of Unreasonable/Arbitrary Measures

The definition of “unreasonable” in the Oxford English Dictionary⁴ includes: “not acting in accordance with reason or good sense; claiming or expecting more than is reasonable . . . Going beyond what is reasonable or equitable; excessive.” The definition of “arbitrary” in the same dictionary includes: “dependent upon will or pleasure”, “based on mere opinion or preference”, “capricious”, “unrestrained in the exercise of will.” Black’s Law Dictionary⁵ includes the following definitions for “arbitrary”: “irrational or capricious”, “depending on individual discretion”, and “founded on prejudice or preference rather than on reason or fact.”

The International Court of Justice gave an often-cited definition of the term “arbitrary” in the *ELSI* case.⁶ The case concerned the temporary requisitioning by the Mayor of Palermo of an industrial plant belonging to an Italian company that was owned by United States shareholders. The court had to apply a provision in an FCN treaty between the two countries guaranteeing that the nationals of the two countries “shall not be subjected to arbitrary or discriminatory measures.” The International Court said with respect to arbitrariness:

Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. . . . It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.⁷

2 *Azurix Corp. v. The Argentine Republic*, Award, 14 July 2006.

3 At ¶ 391.

4 SHORTER OXFORD ENGLISH DICTIONARY (1973) pp. 98, 2428.

5 BLACK’S LAW DICTIONARY 100, 1537 (7th ed.1999).

6 *Elettronica Sicula SpA (ELSI) (United States of America v. Italy)*, International Court of Justice, Judgment, 20 July 1989, ICJ Reports 1989, p.15.

7 At ¶ 128. The court found that, on the facts of the particular case, the temporary requisitioning of the industrial plant had not violated this standard.

The tribunal in *Genin v. Estonia*⁸ gave a restrictive description of the term “arbitrary.” The case concerned the withdrawal of a banking license. The applicable BIT provided that the governments would not impair investments by acting in an arbitrary or discriminatory way. The tribunal found that under the evidence before it, the withdrawal of the licence was justified. The tribunal made the following statement about the issue of arbitrariness as a consequence of a procedural irregularity: “in order to amount to a violation of the BIT, any procedural irregularity that may have been present would have to amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action.”⁹

The tribunal in *Azurix v. Argentina*¹⁰ took issue with this description and pointed out that the *Genin* tribunal, in including the requirement of bad faith, had failed to take notice of the changes that had taken place.¹¹ It gave the following definition:

In its ordinary meaning, “arbitrary” means “derived from mere opinion”, “capricious”, “unrestrained”, “despotic.” Black’s Law Dictionary defines the term, *inter alia*, as “done capriciously or at pleasure”, “not done or acting according to reason or judgment”, “depending on the will alone.” . . . The Tribunal finds that the definition in *ELSI* is close to the ordinary meaning of arbitrary since it emphasizes the element of wilful disregard of the law.¹²

On that basis, the tribunal found that certain actions of provincial authorities were “arbitrary actions without base on the Law or the Concession Agreement and impaired the operation of Azurix’s investment.”¹³

Other tribunals have followed an approach similar to *Azurix* in their descriptions of the term “arbitrary” or “unreasonable.” In *CME v. The Czech Republic*,¹⁴ the Media Council, a regulatory authority, had created a legal situation that enabled the investor’s local partner to terminate the contract on which the investment depended. The applicable BIT contained a provision granting protection against “unreasonable or discriminatory measures.” The tribunal applied this provision in the following terms:

On the face of it, the Media Council’s actions and inactions in 1996 and 1999 were unreasonable as the clear intention of the 1996 actions was to deprive the foreign investor of the exclusive use of the Licence under the MOA and the clear intention of the 1999 actions and inactions was collude with the foreign investor’s Czech business partner to deprive the foreign investor of its investment. The behaviour of the Media Council also smacks of discrimination against the foreign investor.¹⁵

8 *Genin, Eastern Credit Ltd. Inc. and AS Baltoil v. Republic of Estonia*, Award, 25 June 2001.

9 At ¶ 371 (quoting the ICJ in *ELSI*). The tribunal found that on the facts of the case before it, the standard had not been violated.

10 *Azurix Corp. v. The Argentine Republic*, Award, 14 July 2006.

11 At ¶ 392.

12 *Loc cit.* (footnote omitted).

13 At ¶ 393.

14 *CME v. The Czech Republic*, Partial Award, 13 September 2001.

15 At ¶ 612.

Under this interpretation, the intention to deprive the investor of its investment under the pretext of a decision based on law was the decisive criterion for the application of this standard.

*Lauder v. The Czech Republic*¹⁶ concerned the same set of facts. The BIT between the Czech Republic and the United States provides protection against “arbitrary and discriminatory measures.” The tribunal pointed out that under the terms of that BIT, a measure had to be arbitrary *and* discriminatory in order to violate the BIT. As to the meaning of arbitrary measures, the tribunal said:

The Treaty does not define an arbitrary measure. According to Black’s Law Dictionary, arbitrary means “*depending on individual discretion; (. . .) founded on prejudice or preference rather than on reason or fact*” (Black’s Law Dictionary 100 (7th ed. 1999)).¹⁷

The tribunal found that the Czech Republic had taken a discriminatory and arbitrary measure when it changed its position, from allowing the investor’s direct participation in the company that was the license holder, to requiring the creation of a third company.¹⁸ The tribunal said that “[t]he measure was arbitrary because it was not founded on reason or fact, nor on the law which expressly accepted “*applications from companies with foreign equity participation*” . . . , but on mere fear reflecting national preference.”¹⁹

In a different context, the *Lauder* tribunal denied that the measures taken were arbitrary and discriminatory “[a]s they were based on an objective ground, i.e. the efforts to create a clear legal situation in compliance with the Media Law, and as there is no sufficient evidence that they were specifically targeted against foreign investment. . . .”²⁰ Ultimately, the claim was dismissed since the tribunal found that any treaty violations by the host state were not the proximate cause of the damage inflicted on the claimant.²¹

In *Pope & Talbot*,²² the tribunal discussed the concept of arbitrary action in the context of its interpretation of fair and equitable treatment. After quoting the International Court of Justice in *ELSI*, the tribunal said: “That formulation leaves out any requirement that *every* reasonable and impartial person be dissatisfied and perhaps permits a bit less injury to the psyche of the observer, who need no longer be outraged, but only surprised by what the government has done.”²³

*Occidental v. Ecuador*²⁴ concerned inconsistent practice by the host state concerning the reimbursement of value-added tax. The claimant relied, *inter alia*, on the provision of the BIT between Ecuador concerning impairment by arbitrary and discriminatory measures. The tribunal found that the BIT’s guarantee against arbitrariness had been

16 *Ronald S. Lauder v. The Czech Republic*, Award, 3 September 2001.

17 At ¶ 221 (emphasis in original). The Awards in *Occidental v. Ecuador*, 1 July 2004, at ¶ 162, and in *CMS v. Argentina*, 12 May 2005, at ¶ 291, note the use of this definition with approval.

18 At ¶¶ 222, 230.

19 ¶ 232 (emphasis in original).

20 At ¶ 270.

21 At ¶¶ 234, 235, 274, 288.

22 *Pope & Talbot v. Canada*, Award in Respect of Damages, 31 May 2002.

23 At ¶ 64 (emphasis in original).

24 *Occidental Exploration and Production Co. v. Ecuador*, Award, 1 July 2004.

breached “to an extent.”²⁵ The tribunal went on to note that “[i]n the context of the present dispute, the decisions taken by SRI [the tax authority] do not appear to have been founded on prejudice or preference rather than on reasons of fact.”²⁶

After referring to the confusing legal situation in the host state, the tribunal added: “However, it is that very confusion and lack of clarity that resulted in some form of arbitrariness, even if not intended by the SRI.”²⁷

*Noble Ventures v. Romania*²⁸ arose from a privatization agreement concerning the acquisition of a steel mill. The tribunal applied the provision on arbitrary or discriminatory measures in the BIT between Romania and the United States. The claimants argued that “judicial reorganization proceedings”, which led to the loss of control by the investor over the steel mill, violated the standard.

The tribunal quoted from the Judgment of the ICJ in *ELSI* and found that, considering the economic circumstances of the steel mill, there were sufficient grounds not to regard the proceedings as arbitrary: “Their initiation can neither be regarded as shocking or surprising in the sense understood by the ICJ in *ELSI*.”²⁹ This conclusion was supported by comparative considerations:

Such proceedings are provided for in all legal systems and for much the same reasons. One therefore cannot say that they were “opposed to the rule of law.” Moreover, they were initiated and conducted according to the law and not against it. . . . [The steel mill] was in a situation that would have justified the initiation of comparable proceedings in most other countries. Arbitrariness is therefore excluded.³⁰

In *LG&E v. Argentina*,³¹ the tribunal adopted the following description of arbitrary measures: “measures that affect the investments of nationals of the other party without engaging in a rational decision-making process. Such process would include a consideration of the effect of a measure on foreign investments and a balance of the interests of the State with any burden imposed on such investments.”³²

In *Siemens v. Argentina*³³, the tribunal attempted a comprehensive definition of the term “arbitrary.” It said:

In its ordinary meaning, “arbitrary” means “derived from mere opinion”, “capricious”, “unrestrained”, “despotic.” *Black’s Law Dictionary* defines this term as “fixed or done capriciously or at pleasure; without adequate determining principle”, “depending on the will alone”, “without cause based upon the law.” . . . The Tribunal considers that the definition in *ELSI* is the most authoritative interpretation of international law and it is close to the ordinary meaning of the term emphasizing the willful disregard of the law. The element of bad faith added by *Genin* does not

25 Dispositif, ¶ 5.

26 At ¶ 163.

27 *Loc. cit.*

28 *Noble Ventures, Inc. v. Romania*, Award, 12 October 2005.

29 At ¶¶ 176, 177.

30 At ¶ 178.

31 *LG&E v. Argentina*, Decision on Liability, 3 October 2006.

32 At ¶ 158.

33 *Siemens v. Argentina*, Award, 6 February 2007.

seem to find support either in the ordinary concept of arbitrariness or in the definition of the ICJ in *ELSI*.³⁴

In *Enron v. Argentina*³⁵ and in *Sempra v. Argentina*,³⁶ the tribunals introduced a subjective element into their understanding of arbitrariness:

They were not, however, arbitrary in that they responded to what the Government believed and understood to be the best response to the unfolding crisis. Irrespective of the question of intent, a finding of arbitrariness requires that some important measure of impropriety be manifest. This is not found in a process which, although far from desirable, is nonetheless not entirely surprising in the context in which it took place.³⁷

The above authority suggests that the following categories of measures can be described as arbitrary:

- a measure that inflicts damage on the investor without serving any apparent legitimate purpose. The decisive criterion for the determination of the unreasonable or arbitrary nature of a measure harming the investor would be whether it can be justified in terms of rational reasons that are related to the facts. Arbitrariness would be absent if the measure is a reasonable and proportionate reaction to objectively verifiable circumstances;
- a measure that is not based on legal standards but on discretion, prejudice, or personal preference;
- a measure taken for reasons that are different from those put forward by the decision-maker. This conclusion applies, in particular, where a public interest is put forward as a pretext to take measures that are designed to harm the investor;
- a measure taken in wilful disregard of due process and proper procedure.

B. The Relationship of Unreasonable/Arbitrary Measures to Customary International Law

There is authority to suggest that arbitrary action against a foreigner is in violation of international law, even without a pertinent treaty provision. In this respect, Alfred Verdross wrote as early as 1931:

Un Etat viole, par conséquent, le droit des gens s'il porte *arbitrairement* atteinte aux droits acquis des étrangers, . . . Tout ce que le droit international prescrit à cet égard, c'est que l'Etat ne doit pas violer *arbitrairement* les droits privés des étrangers, fût-ce même par un acte du législateur.³⁸ [The State, therefore, violates international law

34 At ¶ 318 (footnote omitted).

35 *Enron v. Argentina*, Award, 22 May 2007.

36 *Sempra v. Argentina*, Award, 28 September 2007.

37 *Sempra*, at ¶ 318. The corresponding passage in *Enron* is at ¶ 281.

38 A. Verdross, *Les règles internationales concernant le traitement des étrangers*, 37 *Recueil des Cours*, Académie de Droit International (1931-III) 323, 358/59 (emphasis in original).

if it *arbitrarily* impairs the acquired rights of aliens, . . . All that international law prescribes in this respect is that the State may not *arbitrarily* violate the private rights of aliens even by legislative action.]

The American Law Institute's Restatement (Third) of the Foreign Relations Law of the United States of 1986³⁹ states:

**§ 712 State Responsibility for Economic Injury to Nationals
of Other States**

A State is responsible under international law for injury resulting from:

* * *

(3) other arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests of a national of another state.⁴⁰

Note 11 on this section explains "arbitrary" in the following terms: "It refers to an act that is unfair and unreasonable, and inflicts serious injury to established rights of foreign nationals, though falling short of an act that would constitute an expropriation. . . ."⁴¹

Under this theory, measures directed against a foreign investor that are unreasonable or arbitrary would also violate the minimum standard under traditional international law. Even if the concept of arbitrariness has roots in customary international law that go back to the times before investment treaties, this does not mean that the treaty term is necessarily restricted to the traditional concept as developed in customary international law. The available evidence suggests that the standard, as used in BITs and other treaties, is undergoing a dynamic evolution in arbitral practice.

C. The Relationship of Unreasonable/Arbitrary Measures to Fair and Equitable Treatment

Fair and equitable treatment (FET) is another standard that is contained in most treaties for the protection of foreign investment. FET has become the most important standard in investment disputes.⁴² It is undeniable that the prohibition of arbitrary or discriminatory measures is related to the fair and equitable treatment standard. Vasciannie explains the interrelationship of the two standards in the following terms: "if there is discrimination on arbitrary grounds, or if the investment has been subject to arbitrary or capricious treatment by the host State, then the fair and equitable standard has been violated.

39 RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (Am. L. Inst. 1986).

40 Vol. 2, pp. 196-97.

41 Vol. 2, pp. 215-16.

42 For general treatment see S. Vasciannie, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, 70 BRIT. Y.B INT'L L. 99 (1999); C. Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. OF WORLD INV. & TRADE 357 (2005); R. Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, 39 INT'L LAWYER (2005) 87; I. TUDOR, *THE FAIR AND EQUITABLE TREATMENT STANDARD IN INTERNATIONAL FOREIGN INVESTMENT LAW* (2008).

This follows from the idea that fair and equitable treatment inherently precludes arbitrary and capricious actions against investors.⁴³

In a number of cases, tribunals have dealt with the prohibition of unreasonable or arbitrary measures in close conjunction with the fair and equitable treatment standard. This tendency is particularly pronounced with tribunals applying the NAFTA. It may be explained, at least in part, by the fact that the NAFTA does not contain a separate provision on arbitrary or discriminatory treatment.⁴⁴

In *S.D. Myers v. Canada*,⁴⁵ the tribunal used the concept of “arbitrary” as a definitional element of the fair and equitable treatment standard in Article 1105(1) of the NAFTA. The tribunal said that it “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.”⁴⁶

In *Mondev v. United States*,⁴⁷ the tribunal also discussed the concept of arbitrariness as part of the standard of fair and equitable treatment in Article 1105(1) of the NAFTA, in the context of its investigation into a possible denial of justice. In doing so, it relied on the ICJ’s definition of arbitrariness in *ELSI*.

In the *ELSI* case, a Chamber of the Court described as arbitrary conduct that which displays “a wilful disregard of due process of law, . . . which shocks, or at least surprises, a sense of judicial propriety”. It is true that the question there was whether certain administrative conduct was “arbitrary”, contrary to the provisions of an FCN treaty. Nonetheless (and without otherwise commenting on the soundness of the decision itself) the Tribunal regards the Chamber’s criterion as useful also in the context of denial of justice, and it has been applied in that context, as the Claimant pointed out.⁴⁸

The Award in *Waste Management*⁴⁹ also dealt with the obligation not to take arbitrary action as an element of FET. In its examination of the standard under Article 1105 of the NAFTA, it stated that the case authority suggests 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.”⁵⁰

43 Vasciannie, *supra* note 41, at p. 133.

44 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 also *Pope & Talbot v. Canada*, Award in Respect of Damages, 31 May 2002, ¶¶ 63, 64; *ADF Group Inc. v. United States of America*, Award, 9 January 2003, ¶¶ 188, 191; *Loewen Group Inc. and Raymond L. Loewen v. United States of America*, Award, 26 June 2003, ¶¶ 131–133.

45 *S.D. Myers v. Canada*, Award on Liability, 13 Nov. 2000.

46 At ¶ 263.

47 *Mondev Int’l Ltd. v. United States of America*, Award, 11 October 2002.

48 At ¶ 127 (footnotes omitted).

49 *Waste Management, Inc. v. United Mexican States*, Award, 30 April 2004.

50 At ¶ 98. The tribunal found that in this particular case, the city had not violated this standard. See ¶ 115.

Another group of cases concerned BITs that contained specific references to a prohibition against arbitrary or discriminatory treatment in addition to the FET standard. Nevertheless, the tribunals applied these two standards in close conjunction.

In *CMS v. Argentina*,⁵¹ the claimant invoked Article II(2) of the Argentina-U.S. BIT, which protects the investor from “arbitrary or discriminatory measures” in addition to the FET standard. The tribunal said: “The standard of protection against arbitrariness and discrimination is related to that of fair and equitable treatment. Any measure that might involve arbitrariness or discrimination is in itself contrary to fair and equitable treatment.”⁵²

Similarly, in *Impregilo v. Pakistan*⁵³ the tribunal applied a provision in the BIT between Italy and Pakistan that provides for the standards of FET and protection against unjustified and discriminatory measures in the same paragraph. The tribunal dealt with these two standards jointly, without articulating any distinction between them.⁵⁴

In *MTD v. Chile*,⁵⁵ a foreign investment contract signed on behalf of Chile had been frustrated by an inconsistent zoning regulation. The tribunal held that the host state’s behavior had violated the FET standard. Additionally, the claimant invoked a provision in the Chile-Malaysia BIT protecting it against “unreasonable or discriminatory measures.” The tribunal said: “To a certain extent, this claim has been considered by the Tribunal as part of the fair and equitable treatment. The approval of an investment against the Government urban policy can be equally considered unreasonable.”⁵⁶

The tribunal in *Saluka v. Czech Republic*⁵⁷ also declined to distinguish the two standards. It had to apply a provision in the Netherlands-Czech BIT, which provided that the host state “shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal” of investments. The tribunal further stated:

The standard of “reasonableness” has no different meaning in this context than in the context of the “fair and equitable treatment” standard with which it is associated; and the same is true with regard to the standard of “non-discrimination”. The standard of “reasonableness” therefore requires, in this context as well, a showing that the State’s conduct bears a reasonable relationship to some rational policy, whereas the standard of “non-discrimination” requires a rational justification of any differential treatment of a foreign investor.⁵⁸

51 *CMS Gas Transmission Co. v. Argentina*, Award, 12 May 2005.

52 At ¶ 290.

53 *Impregilo v. Pakistan*, Decision on Jurisdiction, 22 April 2005.

54 At ¶¶ 264–270. For similarly undifferentiated treatment of the two standards, see *M.C.I. v. Ecuador*, Award, 31 July 2007, ¶¶ 366, 367, 371.

55 *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, Award, 25 May 2004.

56 At ¶ 196.

57 *Saluka Investments BV (The Netherlands) v. The Czech Republic*, Partial Award, 17 March 2006.

58 At ¶ 460. See also ¶¶ 461, 465, 503. Interestingly, the tribunal discussed the issue of discrimination primarily under the heading of fair and equitable treatment rather than under the heading of unreasonable or discriminatory measures. See ¶¶ 312–347.

In a similar way, the tribunal in *PSEG v. Turkey*,⁵⁹ having examined the applicability of FET, did not think there was any merit in examining the facts before it separately under the heading of arbitrariness. It held that “the anomalies that took place in connection with the conduct just referred to are included in the breach of fair and equitable treatment and that there is no ground for a separate heading on liability on account of arbitrariness.”⁶⁰

Despite this tendency of some tribunals to amalgamate the prohibition of arbitrary or discriminatory measures with FET, there are strong arguments in favor of treating the two standards as conceptually different. There is no good reason to assume that treaty drafters used two different terms when they meant one and the same thing. 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 some overlap and that one particular set of facts may violate both the fair and equitable treatment standard and the rule against arbitrary or discriminatory treatment.

A number of tribunals have, in fact, examined compliance with the standards of FET and arbitrary or discriminatory treatment separately.⁶¹ Although there is often no explicit discussion of the relationship of the two concepts, their sequential and separate treatment in awards indicates that the tribunals regarded them as distinct standards.

The tribunal in *LG&E v. Argentina*⁶² not only examined compliance with the two standards separately, but also considered their relationship. It found that it was possible to violate one standard without violating the other: “characterizing the measures as not arbitrary does not mean that such measures are characterized as fair and equitable. . . .⁶³ [I]t was not arbitrary, though unfair and inequitable, not to restore the Gas Law or the other guarantees related to the gas distribution sector and to implement the contract renegotiation policy.”⁶⁴

The criteria developed for the arbitrariness of measures may to some extent overlap with those that have been developed for FET. But they are sufficiently distinct to form the basis of a separate standard of treatment. 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 will develop a clearer perception of the precise implications of each of these principles.

59 *PSEG v. Turkey*, Award, 19 January 2007.

60 At ¶ 261.

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

62 *LG&E v. Argentina*, Decision on Liability, 3 October 2006.

63 At ¶ 162.

64 At ¶ 163.

III. DISCRIMINATORY MEASURES

A. The Meaning of Discriminatory Measures

Discrimination can take a number of forms. It can be based on race, religion, political affiliation, disability, and a number of other criteria. In the context of the treatment of foreign investment, the most frequent problem is discrimination on the basis of nationality. Consequently, most of the practice dealing with discrimination focuses on nationality. But this does not mean that the issue of discrimination is necessarily restricted to nationality.

Not every differential treatment on the basis of nationality is illegal under general international law, but most BITs contain specific standards of non-discrimination. These are contained in provisions that guarantee national treatment and most-favored nation (MFN) treatment. Often these two standards are combined. NAFTA tribunals have dealt with this question in a number of cases when interpreting the provision of Article 1102 of the NAFTA on national treatment. That Article requires host states to accord to an investor and to investments treatment that is not less favorable than it accords its own investors and investments "in like circumstances."⁶⁵

In *Genin v. Estonia*,⁶⁶ the tribunal confirmed that under general international law, there is no universal obligation to treat all aliens equal or to treat them as favorably as nationals. Such an obligation may, however, be established by treaty. The *Genin* tribunal stated:

Article II(3)(b) of the BIT further requires that the signatory governments not impair investment by acting in an arbitrary or discriminatory way. In this regard, the Tribunal notes that international law generally requires that a state should refrain from "discriminatory" treatment of aliens and alien property. Customary international law does not, however, require that a state treat all aliens (and alien property) equally, or that it treat aliens as favourably as nationals. Indeed, "even unjustifiable differentiation may not be actionable." In the present case, of course, any such discriminatory treatment would not be permitted by Article II(1) of the BIT, which requires treatment of foreign investment on a basis no less favourable than treatment of nationals.⁶⁷

A finding of discrimination is independent of a violation of domestic law. In fact, domestic law may be the cause for a violation of the international standard. In *Lauder v. The Czech Republic*,⁶⁸ the applicable BIT offered protection against "arbitrary and discriminatory measures." The tribunal said that "[f]or a measure to be discriminatory, it does not need to violate domestic law, since domestic law can contain a provision

65 For cases dealing with this issue see *S.D. Myers v. Canada*, Award on Liability, 13 November 2000, ¶ 250; *Pope and Talbot v. Canada*, Award on the Merits, 10 April 2001, ¶¶ 45–63, 68–69, 78; *Marvin Feldman v. Mexico*, Award, 16 December 2002, ¶ 171; *Methanex v. United States*, Award, 3 August 2005, Part IV, Chapter B, ¶¶ 17–37.

66 *Genin, Eastern Credit Ltd. Inc. and AS Baltoil v. Republic of Estonia*, Award, 25 June 2001.

67 ¶ 368 (footnote omitted).

68 *Ronald S. Lauder v. The Czech Republic*, Award, 3 September 2001.

that is discriminatory towards foreign investment, or can lack a provision prohibiting the discrimination of foreign investment.”⁶⁹

Practice dealing with discrimination has concentrated on two key issues. One concerns the basis of comparison for the alleged discrimination. The other concerns the question whether discriminatory intent is a requirement for a finding of discrimination or whether the fact of unequal treatment is sufficient.

B. The Basis of Comparison for Discrimination

The basis of comparison is a crucial question in applying provisions dealing with non-discrimination. If the investor is entitled to non-discrimination, what group must be looked at for comparison? Only businesses engaged in the same activity? Also businesses engaged in similar activities? Or businesses engaged in any economic activity?⁷⁰ In some cases, questions about the basis for comparison never arose since the tribunals were able to pinpoint unjustifiable differential treatment among businesses within the same area of activity.

*Nycomb v. Latvia*⁷¹ was decided under the Energy Charter Treaty, which provides in Article 10(1) that states shall not impair the use, enjoyment, or disposal of investments by “unreasonable or discriminatory measures.” The investor in *Nycomb* had undertaken to construct a power plant. In turn, a state entity had promised a higher than usual price for the electricity generated there. When the state entity refused to pay the agreed price, the claimant argued, *inter alia*, that it had been subject to discriminatory measures in light of the fact that the state entity had paid the higher price to two other electricity generation companies. The tribunal found that this constituted a discriminatory measure:

The *Arbitral Tribunal* accepts that in evaluating whether there is discrimination in the sense of the Treaty one should only “compare like with like.” . . . [A]ll of the information available to the Tribunal suggests that the three companies are comparable, and subject to the same laws and regulations. . . . In such a situation, and in accordance with established international law, the burden of proof lies with the Respondent to prove that no discrimination has taken or is taking place.⁷²

*Saluka v. Czech Republic*⁷³ concerned an ailing bank that was first put under forced administration and whose business was subsequently transferred to another bank by a regulatory authority. The tribunal found that there had been four banks of comparable size and market position. The other three banks, which were domestically owned at the relevant times, had received massive state aid. The fourth, in which the claimant had

⁶⁹ At ¶ 220.

⁷⁰ NAFTA tribunals have dealt with a similar question in a number of cases when interpreting the provision of Article 1102 of the NAFTA on national treatment. See *S.D. Myers v. Canada*, Award on Liability, 13 November 2000, ¶ 250; *Pope and Talbot v. Canada*, Award on the Merits, 10 April 2001, ¶¶ 45–63, 68–69, 78; *Marvin Feldman v. Mexico*, Award, 16 December 2002, ¶ 171; *Methanex v. United States*, Award, 3 August 2005, Part IV, Chapter B, ¶¶ 17–19, 25–37.

⁷¹ *Nycomb v. Latvia*, Award, 16 December 2003, STOCKHOLM INT’L ARB. REV. 2005:1, p. 53.

⁷² Section 4.3.2 at p. 99.

⁷³ *Saluka Investments BV (The Netherlands) v. The Czech Republic*, Partial Award, 17 March 2006.

invested, had not received similar aid. The tribunal treated the issue of discrimination as part of the fair and equitable treatment standard and found that “State conduct is discriminatory, if (i) similar cases are (ii) treated differently (iii) and without reasonable justification.”⁷⁴ The tribunal found that the four banks had been in a comparable position, that there had been differential treatment regarding state assistance, and that there was no reasonable justification for this. It followed that there had been a discriminatory response.⁷⁵

Nycomb and *Saluka* are of limited significance for the issue of whether and to what extent the basis of comparison for a finding of discrimination may be expanded beyond the claimant’s immediate competitors. In these two cases, the tribunals were able to diagnose discrimination even on the narrowest conceivable basis.

By contrast, *Occidental v. Ecuador*⁷⁶ did raise the issue of whether comparators are only to be sought in the same economic sector. The case concerned a dispute about the reimbursement of value added tax paid by the claimant on purchases required for its activities, including export, in the field of oil production. The tribunal had to apply a provision in a BIT that provided for national treatment “in like situations.” The claimant argued that Ecuador had breached this obligation because a number of other companies involved in the export of other goods, particularly flowers, mining, and seafood products, had received VAT refunds. The tribunal rejected the contention that national treatment would apply only to those industries or companies involved in the same sector of activity.⁷⁷ The tribunal said that “in like situations” cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken.⁷⁸ The tribunal added that it found the practice concerning “like products” developed within GATT/WTO not specifically pertinent.⁷⁹ The tribunal found that Ecuador had breached its obligation under the provision guaranteeing national treatment.⁸⁰

In *Enron v. Argentina*⁸¹ and in *Sempra v. Argentina*,⁸² the tribunals indicated that improper differentiation between different sectors of the economy may amount to discrimination. The claim of discrimination was based on the view that the contested measures fell disproportionately on the largely foreign-owned gas sector. The tribunals found that some degree of differentiation between different sectors was permissible as long as it was rational:

There are quite naturally important differences between the various affected sectors, so it is not surprising that different solutions might have been or are being sought for each. It could not be said, however, that any such sector has been particularly

74 At ¶ 313.

75 At ¶¶ 314–347, 466.

76 *Occidental Exploration and Production Co. v. Ecuador*, Award, 1 July 2004.

77 At ¶¶ 167–176.

78 At ¶ 173.

79 At ¶¶ 174–176.

80 At ¶ 179.

81 *Enron v. Argentina*, Award, 22 May 2007.

82 *Sempra v. Argentina*, Award, 28 September 2007.

singled out either to have applied to it measures harsher than in respect of others, or conversely to be provided with a more beneficial remedy to the detriment of another. The Tribunal does not find that there has been any capricious, irrational or absurd differentiation in the treatment accorded to the Claimant as compared to other entities or sectors.⁸³

It would seem that a tribunal, in applying a provision that prohibits discrimination, will have to start by looking at a narrow circle of comparators that are closest to the case at hand. In other words, the treatment of other investors in the same line of business will have to be looked at first. If there are clear indications of discrimination already on that basis, the matter may be regarded as settled. But the absence of discrimination within this narrow group is not necessarily conclusive. For instance, if the particular sector of the economy is small or is strongly dominated by foreign interests, it would not be sufficient for the tribunal to satisfy itself that no discrimination has occurred within that group of investors. The circle may be widened to a broader sector of activity that includes a variety of economic actors until a workable basis for comparison can be found.

C. Discriminatory Intent or *de facto* Discrimination

A further question concerns the objective or subjective nature of discrimination. Put differently: is the fact of differential treatment a sufficient basis for a finding of discrimination, or is it necessary to prove discriminatory intent? In general, tribunals seem to favor an objective approach that looks at the discriminatory consequences of a particular measure. An intention to discriminate appears to be secondary. Tribunals interpreting Article 1102 of the NAFTA on national treatment came to the conclusion that what mattered was a measure's practical effect and not an intent to discriminate.⁸⁴

In *Occidental v. Ecuador*,⁸⁵ the tribunal said:

In the present dispute the fact is that OEPC has received treatment less favourable than that accorded to national companies. The Tribunal is convinced that this has not been done with the intent of discriminating against foreign-owned companies. . . . However, the result of the policy enacted and the interpretation followed by the SRI in fact has been a less favourable treatment of OEPC.⁸⁶

The tribunal in *Siemens v. Argentina*⁸⁷ also expressed a clear preference for the impact of the measure over any intention to discriminate. "The Tribunal concurs that intent is not decisive or essential for a finding of discrimination, and that the impact of

83 *Sempra* at ¶ 319. The corresponding passage in *Enron* is at ¶ 282.

84 *S.D. Myers v. Canada*, Award on Liability, 13 November 2000, ¶¶ 252–254; *Marvin Feldman v. Mexico*, Award, 16 December 2002, ¶¶ 173–187.

85 *Occidental Exploration and Production Co. v. Ecuador*, Award, 1 July 2004.

86 At ¶ 177.

87 *Siemens v. Argentina*, Award, 6 February 2007.

the measure on the investment would be the determining factor to ascertain whether it had resulted in non-discriminatory treatment.”⁸⁸

Similarly, the tribunal in *Eastern Sugar v. Czech Republic*⁸⁹ found that the decree under scrutiny was a discriminatory and unreasonable measure “[e]ven if the intent was not to punish Eastern Sugar specifically but more generally to favor newcomers.”⁹⁰

However, there are cases that indicate that discriminatory intent is not entirely irrelevant. In some cases, the tribunals looked at the question whether measures had been taken in view of the investors’ foreign nationality.⁹¹

In *Lauder v. The Czech Republic*,⁹² the tribunal found that the Media Council’s decision to compel the investor to operate through a newly created company rather than invest directly in the license holder amounted to an arbitrary and discriminatory measure. The motive for this step was evidently of a political nature and was based on the investor’s foreign nationality.

The measure was discriminatory because it provided the foreign investment with a treatment less favorable than domestic investment. It indeed results from the above mentioned circumstances that the Media Council changed its mind because of its fear that the strong and rising political opposition to the granting of the License to an entity with significant foreign capital could lead to an attack on the entire selection process. It is probable that if CEDC had been a Czech investor, there would have been no political outcry, and the original plan of becoming a shareholder in CET 21 could have been carried out.⁹³

In *LG&E v. Argentina*,⁹⁴ the tribunal held that either discriminatory intent or discriminatory effect would suffice. In the end, it relied on the effect of the acts in question.

In the context of investment treaties, and the obligation thereunder not to discriminate against foreign investors, a measure is considered discriminatory if the intent of the measure is to discriminate or if the measure has a discriminatory effect.⁹⁵

Even though it was not proved that these measures had been adopted with the purpose of causing Claimants’ foreign investments damage, discrimination against gas distribution companies vis-à-vis other companies, such as water supply and electricity companies, is evident.⁹⁶

88 *Id.* at ¶ 321.

89 *Eastern Sugar v. Czech Republic*, Award, 27 March 2007.

90 *Id.* at ¶ 338.

91 In *Methanex v. United States*, Award, 3 August 2005, the tribunal appears to have adopted a contradictory attitude on this question. At Part IV, Chapter B, ¶ 1, it states that an affirmative finding under NAFTA Article 1102 does not require the demonstration of malign intent. At ¶ 12 of the same chapter it states that in order to sustain its claim under Article 1102(3), the claimant must demonstrate that California *intended* to favor domestic investors.

92 *Ronald S. Lauder v. The Czech Republic*, Award, 3 September 2001.

93 ¶ 231.

94 *LG&E v. Argentina*, Decision on Liability, 3 October 2006.

95 At ¶ 146 (footnote omitted).

96 At ¶ 148.

It would seem to follow from the above authorities that the primary criterion for discrimination under a treaty clause protecting the investor against arbitrary or discriminatory treatment is whether the investor has, in fact, been treated less favorably than other investors, especially on the basis of nationality. Despite some cases pointing to discriminatory intent, the preponderant view in arbitral practice is that discrimination need not be based on an intention by the host state's authorities to discriminate or on an explicitly discriminatory rule of its domestic law. *De facto* discrimination is enough. This means that the investor does not bear the burden of proof that the differential treatment was motivated by its foreign nationality. The fact of discrimination and the existence of the foreign nationality are enough.

IV. CONCLUSION

The standard of protection against arbitrary or discriminatory measures, although widely used in the texts of treaties, has only generated a limited amount of case law interpreting it. Its conceptual contours are still somewhat sketchy. In practice, measures are arbitrary if they inflict damage on the foreign investor without serving a legitimate purpose, if they are not based on legal standards but on discretion, if the reasons put forward are merely a pretext to harm the investor, and if they are taken in wilful disregard of proper procedure.

The standard of protection against arbitrary or discriminatory measures has its roots in the international minimum standard under customary international law. But on the basis of provisions in numerous BITs and the ECT, it has evolved into an independent treaty standard. In many of the cases, the standard of protection against arbitrary or discriminatory measures has been overshadowed by the standard of fair and equitable treatment. But there are indications of its separate and independent application.

The non-discrimination leg of the protection against arbitrary or discriminatory measures is closely related to the standards of national treatment and MFN treatment. Tribunals have grappled with the basis of comparison, especially whether the treatment of businesses in other sectors of the economy provides a viable comparator. The primary criterion for the existence of discrimination is the fact of unequal treatment and not any intention to discriminate.

It may be expected that the development of practice, over time, will shed more light on a number of questions that are still unclear today.