

# **CLASS 5**

**FAIR AND EQUITABLE TREATMENT**

**FULL PROTECTION AND SECURITY**

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# FAIR AND EQUITABLE TREATMENT

Definition?

Function?

- Fill the gaps of the treaty
- Similar to good faith standard in customary international law
- overarching principle that embraces all the other protective standards contained in the treaty OR autonomous standard?

## FAIR AND EQUITABLE TREATMENT AND IMS

International minimum standard?

**Article 1105(1) NAFTA** provides that 'each party shall accord...treatment in accordance with international law, including fair and equitable treatment'. What does this mean?

**Pope & Talbot v. Canada, Free Trade Commission**, which issued authoritative interpretation of the provision stating that: '*article 1105(1) reflects the customary international law minimum standard and does not require treatment in addition to or beyond that which is required by customary international law.*'

'fair and equitable treatment, which shall be no less favourable than international law'. Meaning?

## FAIR AND EQUITABLE TREATMENT AND IMS

NAFTA tribunals thus focused on the scope of IMS

Is IMS frozen in time or an evolving standard?

- Evolving standard (Mondev case)
- Textual differences matter. How?

## FAIR AND EQUITABLE TREATMENT AS AUTONOMOUS STANDARD

If parties wished to have IMS they would refer to IMS specifically

Hence, FET is an **autonomous standard**, that goes beyond a mere restatement of customary law. In fact, in contrast to NAFTA practice, many Tribunals applying other treaties have tended to interpret FET autonomously

**Vivendi v. Argentina** - the Tribunal held that it “*sees no basis for equating principles of international law with the minimum standard of treatment...reference to principles of international law supports a broader reading that invites consideration of a wider range of international law principles...the wording of Article 3 [FET] requires that the FER conform to the principles of international law but the requirement of conformity can just as readily set a floor as a ceiling on the Treaty's FET standard.*”

Is this distinction even important?

## METHODOLOGY

(1) the first, relies on a **deductive reasoning**, that tries to give an all-encompassing definition or, derives the essential elements of FET on the basis of an abstract reasoning.

(2) the second, **relies on an inductive reasoning**, that relies on previous decisions and builds upon relevant precedents to identify typical situations in which the FET standard applies.

(3) the third, the **case-by-case** (or fact-specific) reasoning

# DEDUCTIVE REASONING

(a) **Good faith** (Grierson-Weiler, Laird, Tecmed § 154-5): that FET encompasses, inter alia, the general principle of good faith, has been upheld by several Tribunals. It is however very difficult to generalise and conclude that the principle of good faith can articulate, in an all-encompassing manner, all facets of FET and explain/justify all aspects of jurisprudence. For example, in *Occidental v. Ecuador*, the Tribunal held that FET is an 'objective standard that does not depend on whether the respondent has proceeded in good faith or not.'

(b) **Rule of law** (Schill, Vanderveelde, Diehl): in the case of *ELSI (US v. Italy)*, the ICJ held that the principle of non-arbitrariness is understood as the respect for the rule of law. Nonetheless, this overarching definition is insufficient: rule of law, means above all, respect for the legal safeguards afforded within a legal order. If we were to accept that FET is defined as the embodiment of the rule of law, that could not explain arbitral awards, holding that a change in government policy may still breach the FET standard, even if it did not violate the rule of law' (*LG&E Energy v. Argentina*).

(c) **Justice** (Klager): the concept of justice is an ambitious attempt to provide an overarching rationalization of the jurisprudential fluctuations. However, there are serious problems to it. Its main proponent, Klager, provides for six objectives implicated in FET decisions (fair procedure, non-discrimination, transparency, legitimate expectations, sovereignty and sustainable development). However, this theory is not supported by arbitral practice at all: no Tribunal has attempted to define a broad definition of justice under the FET standard; rather, they refer to 'manifest' or 'gross' breaches of justice.

# DEDUCTIVE REASONING

- i. The concept of the **rule of law** (ELSI- US v. Italy).
- ii. Willful neglect of duty (Neer v. Mexico, ELSI – US v. Italy).
- iii. **Good faith** (Neer v. Mexico, Genin v. Estonia, TECMED v. Mexico, MTD v. Chile).
- iv. Respect towards the **legitimate expectations** reasonably relied on by the investor, based on representations made by the State (TECMED, Waste Management v. Mexico).
- v. Consistency in State practice and the use of the legal instruments applicable to the investor in the normal function assigned to them (TECMED, Saluka v. Czech Republic).
- vi. Transparency of the State 's laws and regulations applicable to the investor (TECMED, Saluka, Waste Management).
- vii. Due process of law that does not offend judicial propriety (ELSI, MTD, Waste Management).
- viii. **Non-discrimination** (MTD, Saluka) or racial prejudice (Waste Management).
- ix. Conduct that is not grossly unfair (Neer), arbitrary or unjust (Waste Management).
- x. Reasonableness (Saluka) or proportionality (MTD).



## INDUCTIVE REASONING

Identify typical factual situations where this principle has been (and will be) applied:

(aa) Awards dealing with the protection of **legitimate expectations**

(bb) Awards reviewing governmental conduct on **substantive grounds**

(cc) Awards reviewing governmental conduct on **procedural grounds**

## LEGITIMATE EXPECTATIONS

Expropriation?

***Thunderbird v. Mexico, T. Walde*** made a Separate Opinion, pointing that legitimate expectations, as a self-standing sub-category and independent basis for a claim under FET ‘...provides a more supple way of providing a remedy appropriate to the particular situation as compared to the more drastic determination and remedy inherent in concept of regulatory expropriation. It is probably for these reasons that “legitimate expectation” has become for Tribunals a **preferred way of providing protection to claimants in situations where the tests for a ‘regulatory taking’ appear too difficult, complex and too easily assailable for reliance on a measure of subjective judgment.’**

## LEGITIMATE EXPECTATIONS

Identifying the basis for State liability under the legitimate expectations doctrine, there are three consecutive questions that need to be answered.

- **Expectations:** On what basis must an expectation rest, to qualify for protection under the FET standard?
- **Legitimate:** Of expectations that rest on an accepted basis, which of these expectations may be deemed as 'legitimate' under the FET protection?
- **Reliance:** To what extent must a claimant rely on a legitimate expectation, to recover for its breach?

# LEGITIMATE EXPECTATIONS

Scope of legitimate expectations?

1. Expectations can rest on **specific rights** acquired by the investor under domestic law ('legal rights')
2. In addition to (1), expectations can rest on **specific representations** made by the host State to the investor by governmental officials ('representation approach').
3. In addition to (2), expectations can rest on the **regulatory framework in force** in the host State when the investment was made ('stability approach').
4. In addition to (3), expectations can rest on the **business plan** of the investor ('business plan approach').

## LEGITIMATE EXPECTATIONS: LEGAL RIGHTS APPROACH

- Strictest approach
- Only rights that have been acquired and are enforceable under domestic law
- Unilateral statements?
- Legal framework?
- Business plan?

## LEGITIMATE EXPECTATIONS: LEGAL RIGHTS APPROACH

**LG&E v. Argentina:** This case was about the measures taken by Argentina amidst the sheer economic recession. Originally, in the 1990s Argentina sought to create a friendly regulatory framework to attract investors in the **privatization of the gas distribution sector**. *Inter alia*, the framework provided that tariffs would be based on the US Price Index, calculated in dollars US and would be adjusted twice annually. These terms were specifically incorporated into the licenses of gas distribution and were part of the agreements with the private licensees. Therefore, the government could not modify the terms of the licenses without explicit consent of the licensees. LG&E was a foreign investor that became a shareholder in three privatized entities that were the holders of the licenses. Argentina subsequently faced serious social and economic crisis and was forced to issue an Emergency Law in 2002, that **unilaterally modified the indexation of tariffs and removed the licensees' right to calculate tariffs in US dollars**. The claimant sought protection before the Tribunal, invoking the protection of FET standard. In LG&E's view, the State had breach its 'basic expectations' under the licenses and thus, the FET standard. The Tribunal adopted the 'legal rights approach' by stating: *'the investor's fair expectations...are based on the conditions offered by the host State at the time of the investment and **may not be established unilaterally by one of the parties: they must exist and be enforceable by law**; in the event of infringement by the host state, a duty to compensate the investor for damages arises.'* Thus, Argentina had breached the FET standard as the repudiation of the terms of the licenses, that formed a set of rights granted and specifically guaranteed by the State, amounted to a breach of the investor's legit. expectations.

## LEGITIMATE EXPECTATIONS: LEGAL RIGHTS APPROACH

**LG&E v. Argentina** also held that the expectation resting a specific legal rights vested in the investor must be 'fair', in the sense that the investor 'cannot fail to consider parameters such as **business risk or industry's regular pattern.**' Therefore, of all the acquired legal rights qualifying as 'expectations', only those are 'legitimate', as long as they are **consistent with regular pattern of the industry and the reasonable business risk.** In § 130, the Tribunal added that *the investor 'must have relied on the expectation in making its initial investment.'*

**EDF v. Romania** also added that 'to validly claim a breach of the FET standard under the BIT, claimant should have proven **not only a breach of the Contract, but also that such other assurances had been given by the Government.**' Therefore, the Government's representations play a role in the *legitimacy* of the expectations.

## LEGITIMATE EXPECTATIONS: LEGAL RIGHTS APPROACH

**Is any breach of contractual obligations equated to a breach of legitimate expectations?**

Legitimate expectations are an essential element under the 'fair and equitable treatment standard', which is a clause different from an 'umbrella clause'

In *Parkerings v. Lithuania*, the most important case in this respect, held: 'it is evident that **not every hope amounts to an expectation under international law**. The expectation a party to an agreement may have of the regular fulfilment of the obligation by the other party is not necessarily an expectation protected by international law. In other words, **contracts involve intrinsic expectations from each party that do not amount to expectations as understood in international law**. Indeed, the party whose contractual expectations are frustrated, should, under specific conditions, seek redress before international law.'



## LEGITIMATE EXPECTATIONS: LEGAL RIGHTS APPROACH

- if the breach was 'substantial' (*Parkerings*, §316);
- if it amounted to 'outright and unjustified repudiation of the transaction' (*Waste Management*, §115);
- if it amounted to a denial of justice or was effected in a discriminatory manner (*Glamis Gold*, §620);
- a violation of a contract that could have been committed by any ordinary partner would not rise to the level of a breach of FET: what is needed is an exercise of sovereign power (*Consortium RFCC v. Morocco*) or a misuse of public power (*Impregilo v. Pakistan*).
- if it was a 'wilful refusal to comply with the contract, an abuse of authority to evade agreements with foreign investors and an action in bad faith in the course of contractual performance (*Schreuer, FET in Arbitral practice, Journal of World Investment and Trade* 357, 380, 2005).

# LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

What is the scope of this approach?

□ Accepts the rights approach but extends the scope of expectations to unilateral statements or representations made by the government to the investor

Two elements:

- (a) **Factual element** – that the domestic authority made specific representations, promises or reassurances to the investor (*Thunderbird*)
- (b) **Teleological element** – that the representations need to have been made with the purpose of inducing the investor to invest (*Sempra*)

## LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

***Thunderbird v Mexico***: the case of *Thunderbird v. Mexico* is the first case ever to use the exact term 'legitimate expectations'. The case was about an investor that wished to install gaming machines in Mexico, although such devices were prohibited under domestic law. Prior to making the investment, the (potential) investor required an official opinion concerning the legality of its gaming machines from SEGOB, the national regulatory authority. In its request, *Thunderbird* declared that its machines operated according to the users' skills and abilities, not luck, betting or gambling. SEGOB replied that, **if the investor's machines operated in the manner described**, the machines would be permissible under Mexican law (later on it was revealed that *Thunderbird's* description was inaccurate). One year later, and after *Thunderbird* had started installing gaming machines across Mexico, SEGOB on its own motion held an administrative hearing, to assess the legality of *Thunderbird's* games. On the basis of the new evidence adduced, SEGOB concluded that the games were illegal under Mexican law. *Thunderbird* contended that this conduct was a breach of FET, because, **relying on the response of SEGOB**, it had a legitimate expectation that its machines complied with domestic law.

## LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

### **Thunderbird v Mexico:**

Even though the investor had no 'acquired legal rights' under domestic law, the Tribunal interpreted the scope of 'legitimate expectations', saying that 'the concept of legitimate expectations relates...to a situation where **a Party's conduct creates reasonable and justifiable expectations on the part of an investor to act in reliance on said conduct, such that a failure to honour those expectations could cause the investor to suffer damages**'. As a result, *Thunderbird* extends the concept of expectations not only to legal entitlements, but also to unilateral actions upon which the other party relies. The Tribunal rejected the claim on the basis that **(a)** the official letter of SEGOB was explicitly conditional upon the accuracy of the information provided therein, **(b)** the information provided by *Thunderbird* had been inaccurate, **(c)** *Thunderbird* had already started installing those machines prior to the official response, thus did not really rely on this statement. As a result, its 'expectations' had not been breached because SEGOB had not made any 'clear and specific statement on which the investor could have relied upon'.

## LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

Where exactly should the line be drawn, in defining the level of specificity required for legitimate expectations to be born, under the FET standard?

Does the legal framework itself generate legitimate expectations?

### A. Specific commitments

rejects the argument that general legal framework can generate legitimate expectations under FET, unless there is a violation of specific commitment to the investor (***El Paso***)

What about representations by the Government to the investor that the regulatory framework will not change?

# LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

## *El Paso:*

### **(a) specificity as to the addressee**

There must be specific commitments directly made to the investor (contract, letter of intent, etc.)

### **(b) specificity as to the object**

a commitment can be considered specific if its precise object was to give a real guarantee of stability to the investor

**CMS** - liability arose from changes to the general regulatory framework governing the investment, in light of the specific commitments and representations that this framework would not be changed. Hence, the claimant was entitled to expect that the tariff regime would not change.

# LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

## **B. Political statements**

Politicians make general statements to attract investors.

For example, Nikol Pashinyan states in a meeting that no foreign investor will be treated less favorably than another foreign investor.

Does this create legitimate expectations?

## LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

### ***Continental Casualty***

the Claimant said it had “legitimate expectations” that the convertibility regime of Argentina would not be changed, whereas Argentina subverted the business environment (§251). The Claimant relied as a basis for its alleged legitimate expectations on a series of acts and pronouncements by Argentina’s authorities from different sources and having unequal legal value. Such as the Intangibility Law by which “Argentina assured investors that Argentina would not interfere with bank deposits, Argentina’s representations to keep its money in Argentina and certain public statements by Minister Cavallo undertaking not to abandon the convertibility regime (§252). The Tribunal in the case sought to strike a balance and establish a normative hierarchy between the various sources that may engender ‘legitimate expectations’.



## LEGITIMATE EXPECTATIONS: REPRESENTATIONS APPROACH

Noting that the sources of reliance adduced by the claimant had 'unequal legal value', it set out in §261 the ranking of 'sources of expectations' through these relevant factors:

i) the **specificity** of the undertaking allegedly relied upon which is mostly absent here, considering moreover that **political statements** have the least legal value, regrettably but notoriously so;

ii) **general legislative statements** engender **reduced expectations**, especially with competent major international investors in a context where the political risk is high. Their enactment is by nature subject to subsequent modification, and possibly to withdrawal and cancellation, within the limits of respect of fundamental human rights and *ius cogens*;

iii) **unilateral modification of contractual undertakings** by governments, notably when issued in conformity with a legislative framework and aimed at obtaining financial resources from investors **deserve clearly more scrutiny**, in the light of the context, reasons, effects, since they generate as a rule legal rights and therefore expectations of compliance;

## LEGITIMATE EXPECTATIONS: STABILITY APPROACH

Can the investor complain about the law as it was at the time of making the investment?

Can the investor complain about change of that law?

FET protects legitimate expectations that derive not only from **(a)** 'undertakings made by the host State including those in legislation, treaties, decrees, licenses and contracts' and **(b)** 'representations made explicitly or implicitly by the host state', but also **(c)** 'expectations based on the legal framework' of the Host State (***Frontier Petroleum v. Czech Republic***, §285).

## LEGITIMATE EXPECTATIONS: STABILITY APPROACH

In ***Occidental v. Ecuador***, the investor claimed that the refusal of the tax authorities to allow VAT refunds amounted, *inter alia*, to a breach of the FET standard. Notwithstanding the fact that the investor actually **did have a vested and acquired enforceable right** under the law of Ecuador to a refund of tax already paid, the Tribunal did not base its reasoning on that to conclude a breach of FET. Rather, the Tribunal stressed that **'the stability of legal and business framework is... an essential element of FET'**

In ***CMS Gas v. Argentina***, the Tribunal dealt with the same issue as in LG&E. The Tribunal held that, in accordance with the BIT's preamble, **'stable legal and business environment is an essential element of FET'**. By entirely transforming the legal business environment upon which the investment was grounded Argentina was found in breach of the FET standard

## LEGITIMATE EXPECTATIONS: STABILITY APPROACH

In *Saluka v. Czech Republic*, the Tribunal noted that **no investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged**. Further, to imply an unqualified requirement of stability within FET would place obligations on States that are **unrealistic** and **inappropriate**.

In *Continental Casualty*, the Tribunal said that '**it would be unconscionable for a country to promise not to change its legislation as time and needs change**, or even more to tie its hands by such a kind of stipulation in case a crisis of any type or origin arose. Such an implication as to stability in the BIT's Preamble would be contrary to an **effective interpretation** of the Treaty; reliance on such an implication by a foreign investor would be **misplaced** and indeed, **unreasonable**.'

## LEGITIMATE EXPECTATIONS: STABILITY APPROACH

1) If the BIT contains a **specific stabilization clause** on the basis of which the State agreed not to change its domestic laws applicable to the investor, then subsequent regulatory change violates not only the FET standard, but also a specific treaty obligation. This clause functions as an extraordinary circumstance where the State renounces unequivocally the exercise of its regulatory power. This has been confirmed in *Parkerings v. Lithuania*, *Total v. Argentina*, *EDF v. Romania* and *El Paso*).

2) If the State has made an **explicit or implicit unilateral representation** that it will not alter its domestic regulatory framework (see above and *Total*).

3) A third set of exceptions is trying to limit the omnipotence of the regulator by recognizing some **limitations**: hence, there are instances where the change in regulatory framework is so severe that a Tribunal may find a breach of the FET standard, notwithstanding the fact that there is no stabilization clause or unilateral declaration.

What are these circumstances?

Tribunals have advanced various criteria, such as cumulative effect, discriminatory intent, prejudicial intent, etc.

## LEGITIMATE EXPECTATIONS: BUSINESS PLAN APPROACH

In ***MTD v. Chile***, the investor wished to make an investment in a land close to Santiago, where development was not allowed, in accordance with municipal laws. In order to import the necessary funds in Chile, the investor asked for permission from the Foreign Investment Commission, which required the investor to specify the location and nature of the project. The FIC approved the transfer of funds (not the project) with an explicit mention that the project must comply with all applicable national laws. Consequently, the municipal authority refused MTD's request for a land redevelopment in that zone. The claimant invoked the FET standard, claiming that the inconsistencies between the two arms of the same Government vis-à-vis the same investor (par. 163) had given rise to a breach of the FET standard.

The Tribunal upheld the claim: even though it could not identify any unilateral statement addressed to the investor that its investment would proceed, nor was that permissible under domestic law, the Tribunal found a breach of legitimate expectations relying on the investor's plans.

# PROCEDURAL PROPRIETY

What does this concept mean under FET?

Procedural propriety comprises two distinct concepts, depending on the authority responsible for the conduct: (1) **due process of law** (which involves serious procedural shortcomings) and (2) **denial of justice**.

In general, investment Tribunals agree that with respect to the conduct of judicial authorities, the FET standard does not go beyond what is required by the doctrine of denial of justice (*Mondev v. US*, §126). Denial of justice is a traditional concept of international law that refers to the treatment of an alien by the judicial system of the host state. Thus, unlike all other elements of IIL, is contingent upon the rule of **prior exhaustion of domestic remedies**.

**Azinian v. Mexico** - *'a denial of justice could be pleaded if the relevant courts refuse to entertain a suit, if they subject it to undue delay or if they administer justice in a seriously inadequate way...there is a fourth type of denial of justice, namely the clear and malicious misapplication of the law.'*

# PROCEDURAL PROPRIETY

Due process in administrative proceedings?

The principle of due process means that a State 's conduct may be found to contravene FET standards, even if, in its **substance**, it is a perfectly legitimate decision. As a general rule, we could say that 'procedural propriety' (due process of law) under FET means that any procedure affecting the investor

- must meet certain standards of fairness,
- it must be consistent with national law (*lawfulness*),
- it must be effected in a legally proper manner (*no procedural shortcomings*) and
- must provide the investor with the opportunity to be heard, the opportunity to present its observations and a certain degree of *transparency* of the legal framework applicable to the investor



# PROCEDURAL PROPRIETY

Does every violation of domestic procedural law mean a violation of FET standard?

1. The **narrow approach** projects that not every violation of domestic procedural legal framework could lead to a violation of FET. What is needed is not 'mere illegality', but a serious, manifest, clear abuse of power that gives rise to a breach of international law (*Glamis Gold v. US*, *Genin v. Estonia*). The threshold thus for finding a breach is particularly **high** for it needs to be aggravated either by being international, or by having led to an outcome that cannot be justifiable on **substantive grounds**.

2. The **middle ground approach** suggests that a breach of the procedural aspect of FET would arise in case of 'procedurally improper behaviour that **is serious in itself** and **material** to the outcome'. This approach recognises a lower threshold and a more lenient intensity of review (*Chemtura*). Furthermore, the procedural element of FET includes **a transparency requirement** that imposes the obligation on the State to make readily capable of being known all the laws applicable to the investor (*LG&E v. Argentina*, *Metalclad*) and an obligation to provide reasons for administrative decisions (*Lemire v. Ukraine II*).

3. The **exacting approach** argues that any procedural unfairness will breach the FET standard, without the need of additional finding that the unfairness exceeds a particular threshold of seriousness (*Tecmed*). Furthermore, this approach goes further, saying that the FET standard not only imposes an obligation of transparency of the laws (that they are being readily available), but also that the laws be free from ambiguity and 'totally transparent': that means that simply making the laws readily available does not suffice; the State must take measures to make the normative framework sufficiently clear (*Metalclad*).

## SUBSTANTIVE REVIEW

Does an investment tribunal have the right to examine the conduct of the state on substantive grounds?

The question revolves around the question whether the conduct has been proportionate, reasonable and non-arbitrary and may have serious implications for the State 's interests.

**'yes' answer** - would result in a particularly intrusive regime, in which Tribunals (that lack democratic legitimisation whatsoever) would have the power to subject general laws (passed by democratically elected parliaments in the public interest) to an extreme scrutiny.

**'no' answer** - could result in an abuse of power, as states would use their regulatory omnipotence to run counter the object and purpose of investment accords.

## **SUBSTANTIVE REVIEW**

Before this dilemma, Tribunals have again, taken different approaches, that may be classified in three broad approaches:

1. The 'no substantive review approach' under FET (SD Myers).
2. The 'substantive review of reasonableness' with due margin of appreciation (AES v. Hungary).
3. The 'proportionality approach'.

# SUBSTANTIVE REVIEW

## 1. The 'no substantive review approach' under FET (SD Myers).

concerned a temporary ban on the import of products containing PCB toxic substance from the USA. The Tribunal, in examining briefly the FET standard, noted that: '*..when interpreting and applying the minimum standard, a Chapter 11 Tribunal does not have an open-ended mandate to second guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions ultimately ineffective or counterproductive.*'

***Mobil and Murphy Oil v. Canada*** the Tribunal further stressed that fair and equitable treatment, as a standard, was **never intended to amount to a guarantee against regulatory change or to expect that an investor is entitled to expect no material changes to the regulatory framework within which an investment is made.** Governments change, policies change and rules change. **These are facts of life with which investors and all legal and natural persons have to live with!** (§153).

## SUBSTANTIVE REVIEW

### 2. The 'substantive review of reasonableness' with due margin of appreciation (AES v. Hungary).

AES v. Hungary is the leading case in this approach. The case concerned the measures enacted by the Hungarian Government, in order to address the extremely high levels of electricity pricing. In particular, Hungary had entered into investment contracts in the electricity sector. The contracts did not fix the price at which the State was required by purchase electricity but only the volume of electricity that generators were entitled to sell to the State. Following serious political and public confrontation (that became a 'lightning rod in the face of upcoming elections') and upon need to comply with EU law, the Government introduced a regime of re-regulated pricing, in order to readjust the generators' profits on the fixed-volume electricity sale contracts that 'exceeded reasonable rates of return for public utility'. The Tribunal articulate its formula for substantive review of governmental decisions:

*There are two elements that require to be analysed to determine whether a State 's act was unreasonable:*

- (1) the existence of a rational policy
- (2) the reasonableness of the act of the State in relation to the policy.

## SUBSTANTIVE REVIEW

**2. The 'substantive review of reasonableness' with due margin of appreciation (AES v. Hungary).**

**(1)** *A rational policy is taken by a State following a logical (**good sense**) **explanation** and with the aim of addressing a **public interest matter**. Nevertheless, a rational policy is not enough to justify all the measures taken by a State in its name.*

**(2)** *A challenged measure must also be **reasonable**. That is, there needs to be an **appropriate correlation** between the State 's public policy objective and the measure adopted to achieve it. This has to do with the **nature** of the measure and the **way** it is implemented.*

# SUBSTANTIVE REVIEW

## 2. The 'substantive review of reasonableness' with due margin of appreciation (AES v. Hungary).

the Tribunal exercised a thorough degree of control over the legitimacy of the measures:

The **first aim** was to 'overcome electricity generators' refusal to reduce the capacity that they produced and sold to the State under the existing contracts. The Tribunal rejected this saying that the aim of forcing a private party to surrender contractual rights (as opposed to the situation where the pursuit of a public policy *affects adversely* the contractual rights of the investor), is not, **as such**, a rational public policy.

The **second aim** was to comply with EU law. This was also rejected, because EU law concerns had not crystallized at that time.

The **third aim**, was to readjust the profitability of electric sector, that was completely unregulated due to the absence of competition in the market or state-control. The Tribunal accepted this justification, saying that it was '*a perfectly valid and rational policy objective for a government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational.*' Consequently, the Tribunal considered the measures of price reregulation to be a reasonable way to achieve the public aim of regulating the excessive profits of the generators.

## SUBSTANTIVE REVIEW

### 3. The 'proportionality approach'.

The third approach agrees with the second that government conduct has to bear a reasonable relationship to some rational policy (*Biwater v. Tanzania*), but is less deferential to the host state's choice of policy objectives and applies a stricter test of proportionality: in addition to a legitimate objective, the interference must be proportionate to the objective pursued and whether there are other means of achieving the public interest objective is relevant but not conclusive



# FULL PROTECTION AND SECURITY

Scope?

Full protection and security (FPS) is a clause embodied in various investment treaties and affords, in general terms 'protection and security' to the assets and the individuals connected to the investment protected under the treaty.

The traditional scope of FPS is that it imposes a duty on the police forces, the administrative authorities and the judicial system of the host state, to provide full **physical protection and security** to the individuals and the assets connected to the investment and protect them (through prevention, prosecution and deterrence) from potential or actual threats against them

# FULL PROTECTION AND SECURITY

Treaty concept or customary international law concept?

**Three broad approaches can be formulated:**

## **1. International law as a ceiling**

Customary international law is understood as the maximum of protection to be afforded under FPS only in the context of NAFTA. Following the authoritative interpretation given by the FTC on Article 1105(1) of NAFTA, NAFTA Tribunals are bound by this interpretation and understand FPS as limited to the content of IMS (which does not mean however that through interpretation Tribunals cannot raise the level of the IMS as reflected in evolving practice).

# FULL PROTECTION AND SECURITY

## 2. International law as a floor

International law is understood as providing the minimum of protection in a number of BIT provisions that require FPS as treatment 'no less favourable' than that required by international law. This has been affirmed in *Azurix v. Argentina*, where the Tribunal held that the standard of IL is to be understood as a floor for the treaty based protection (§361). However, the same Tribunal noticed that it is not important whether IL is a floor or a ceiling, since the IMS is an evolving concept and its content and obligations are substantially similar both under the ordinary meaning of the term in the treaty and according to the standard under IL.

## 3. International law as equivalent

In *Noble Ventures v. Romania* the Tribunal noted that the treaty obligation under FPS is not larger than the general duty to provide full protection and security under customary international law. In *AAPL v. Sri Lanka*, the Tribunal applied a BIT that did not specify the relationship between FPS and IMS and noted that the treaty-based protection is the same protection afforded under international law, and would be applicable even in the absence of a specific clause in the treaty. And in *Eurotunnel*, the Tribunal confirmed that the application of FPS standard under international law would not add much to the protection accorded by the applicable treaty.

# FULL PROTECTION AND SECURITY

## 1. Traditional scope of FPS

the traditional scope of FPS contains an obligation to provide protection and security to the individuals and the assets connected to the investment (*PSEG v. Turkey*) and preserve public order and ordinary security by use of police and public powers (*Eurotunnel*)

## 2. Extended scope of FPS

(a) In a line of cases, arbitral Tribunals were emphatic in stressing that the breach of contractual rights, normative changes, arbitrary modifications of the regulatory framework, inconsistency in administrative practice and the breach of legitimate expectations **is not a breach of FPS but a breach of FET standard** (*Tecmed, Eureko v. Poland, PSEG v. Turkey*).

(b) In a different line of cases, Tribunals deem the standard of FPS as extending beyond the mere physical safety of the investment, with varying degrees as to its scope:

# UMBRELLA CLAUSE

What is an umbrella clause?

## 1. Full effect approach

In *Noble Ventures v. Romania*, the tribunal held that ***‘two states may include in a BIT a provision to the effect that in the interest of achieving the objects and goals of the treaty, the host state may incur international responsibility by reason of a breach of its contractual obligations towards the private investor of the other Party, the breach of contract being thus ‘internationalized’, i.e. assimilated to a breach of the treaty.’***

# UMBRELLA CLAUSE

## 2. Restrictive approach

- In CMS v. Argentina, the tribunal endorsed the restrictive approach saying that what is significant is the **nature** of the obligation (commercial or sovereign) and the **significance** of the interference:

*'The tribunal believes that the respondent is correct in arguing that **not all contract breaches result in breaches of the treaty** ... the standard of protection will be engaged only when **there is a specific breach of treaty rights protected under the treaty**. Purely commercial aspects of a contract might not be protected by the treaty in some situations but the protection is likely to be available when there is significant interference by governments or public agencies with the rights of the investor.'*

## 3. Integrationist approach

There is no *a priori* restriction in international law, as to what can constitute the *content* or the scope of a treaty. Nor is there any *a priori* definition of what is 'national' and what is 'international'. States, as sovereign entities, are free to enter into *binding treaties* that define the way in which sovereignty may be exercised.

**THANK YOU**