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# The *Fair and Equitable Treatment Standard* in the International Law of Foreign Investment

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# *General Editor's Preface*

There are few legal concepts that have had such a dramatic impact upon the world of legal practice as the 'Fair and Equitable Treatment' standard in the field of international investment law. Offering the possibility of redress in circumstances where no remedy is available, and even where no wrong is committed, under any national legal system, the standard has become an enormously potent tool in the legal workshop.

This monograph is a systematic analysis of the standard as it appears in investment treaties and as it is employed in international tribunals. It brings together an already large body of material in this fast-developing field and provides a clear view of the present state of the law. Dr Tudor's appraisal of the concept is careful and subtle. At a time when there is much discussion of the question whether investment treaties favour investors excessively, the conclusion that the Fair and Equitable Treatment provision may contribute to the re-balancing of the investor-State relationship is one that will attract many readers, both academic and practising lawyers, to this important study.

AVL

*All Souls College, Oxford*
*October 2007*

# *Foreword*

The book written by Ioana Tudor is the first monograph which is dedicated to an in depth study of the fair and equitable treatment standard, a topic of interest both for academics and practitioners in the field of investment arbitration. It represents a major contribution to the analysis of the nature, meaning and effects of one of the key rules of public international law applied to international investment law. This field of international law cannot be reduced to a mere branch of public international law. Still today, there is a significant number of cases in which either a national law or the law of the host State (including its rules on the conflict of laws), as it may be agreed by the parties, must be applied. Nevertheless, since the *AAPL* award, investors have been entitled to file a claim directly against a State before an ICSID tribunal. An identical possibility was later extended in the framework of other regional or multilateral instruments like the Energy Charter. These procedural novelties led to an overwhelming proportion of treaty-based claims in comparison with contract claims. In this way, private investors became ardent defenders of public international legal rules and principles, originally designed for normalizing the relations between sovereign States.

In the framework of a *treaty claim*, the treaty involved in a majority of cases is the one signed between the home State of the investor and the host State, welcoming the investment; nevertheless, this does not exclude the existence of instruments which are regional or universal in scope. One of the most striking conclusions drawn by Ioana Tudor in this book is that, although being called a 'principle', the fair and equitable treatment is first and foremost of conventional nature, i.e. it belongs to the *lex specialis* constituted by the relevant treaty. But this does not mean that it does not, concurrently, belong to customary international law. This book follows on the interaction between treaty law and international custom while analysing the way in which the FET is applied to concrete cases.

On the treaty front, after a comparative analysis and a classification of almost 400 bilateral investment treaties and nearly all existent regional and multilateral agreements, the author identifies the exact scope and meaning of the fair and equitable treatment principle and emphasizes the necessity of looking carefully at the wording of the treaty provision containing a reference to FET. One must agree with this conclusion. Despite the seven categories of drafting formulations identified in this book, they all share a common substantial vagueness. Ioana Tudor convincingly demonstrates that the minimalist drafting category of FET is also rooted in customary international law. In addition, the very concepts of 'fairness' and 'equity', which are at the basis of the FET, are, as such, almost meta-juridical concepts. They articulate law and ethics at the international level; however not all States share the same definition of these

notions since they are as philosophical in nature as they are sociological; they refer to what a determined society considers as being reasonable and rational at a certain moment in time.

As far as the FET is concerned, it would be a mistake to look at the relationship between treaty law and customary law in terms of a sterile confrontation. On the contrary, one feeds and contributes to the development and application of the other. Either implicitly or explicitly, the treaty provisions incorporating the FET refer, one way or the other, to general (i.e. customary) international law. As indicated above, a FET clause requires a careful analysis of its wording; but it requests at the same time a careful consideration of the context, both legal and material, of the relevant treaty. At the contentious level, when asked to consider an investor's claim for alleged breach of FET by the host State, arbitrators will refer to FET not only as a norm but also as a 'standard'. Now, what is a standard? I agree with the extensive analysis of this concept made by the author in this book and I believe that it is a legal technique which allows the arbitrator to establish, in a concrete case, what is a 'fair and equitable' treatment provided by the State to the foreign investor. In the actual evaluation of the conduct of the State, arbitrators use this legal technique as a tool for reconciling the legal, philosophical and sociological dimensions of the FET standard. The standard is, at the same time, a benchmark for identifying a rule and the rule itself as it is established by taking into account every pertinent element of fact and law to be selected out of the complex relationship existing at a certain time between the investor and the host State. The author describes in a very clear manner the implications that derive from the standard nature of FET on its content and on its function. In this enlarged context, and contrary to what has been argued by some scholars, it seems difficult to consider the FET as a 'self-contained' principle, the notion of 'self containment' being in any case equivocal and understood differently, depending of the legal tradition concerned.

As illustrated in this book, in applying the FET, the role of the arbitrator is not only central: it is also necessarily creative. The arbitrator must apply the law as it is objectively set out by the dynamic combination of treaty and custom, but also take into account the average values and behaviours of a society at a given moment in time. Thus, the arbitrator becomes the vehicle through which reality is incorporated within the legal norm. The social or economic fact acquires a normative character. Of course, benefiting from such a high degree of autonomy in the exercise of its judicial function, a 'transnational' tribunal is endowed with a heavy burden of responsibility.

Conducting a thorough analysis of the existent case law, this book very well illustrates the art of establishing the right balance between the elements of fact and law to be taken into account when deciding whether the FET has been breached or not. There are different aspects of this art. One concerns the unilateral character of the FET as it sets an obligation for the host State and the way in which it is often balanced by incorporating other considerations into the arbitral



analysis: for instance, the actual economic and even sociological situation of the State or the expectations of the investor as far as they are 'legitimate'.

The above observations are only a rapid survey of some of the legal considerations surrounding the FET, and which are developed at length in this book. The book has the advantage of identifying the relevant and practical issues connected to the FET while presenting an in depth analysis of each one of them. In this way, the author manages to offer a balanced and insightful study of a complex concept, by placing her academic skills at the service of her practitioner acumen.

Moreover, Ioana Tudor has conducted an outstanding study in her book of the various elements that transform the arbitrator into a third player of the game. Just have a look at the painting on the cover of this book: inspired by a series of predecessors, like Giorgione, Caravaggio, Van Gogh, or Cezanne, it shows three characters around a table. Two of them are seated. They most probably represent the parties to an arbitral proceeding. Only the third one, close to the same table, is playing the guitar. He is most probably the arbitrator.

*Pierre-Marie Dupuy*

*Chair in Public International Law, at the European University Institute, Florence and at the Université de Paris II (Panthéon-Assas). International arbitrator.*

# *Preface*

*The* Fair and Equitable Treatment *Standard in the International Law of Foreign Investment* is mainly the result of the research I carried out between September 2004 and May 2006 in the course of writing my doctorate, at the European University Institute (hereinafter 'EUI') in Florence. The idea behind this work was conceived in the aftermath of the WTO Ministerial Conference that took place in Cancùn in September 2003. At this time, I started an internship with the WTO Trade and Investment division in Geneva. I had been admitted to the EUI, in 2002, on the basis of a research proposal that focused on multilateralism: more precisely, on the way in which investment rules could be designed at the multilateral level. Yet, after the first year of research under the supervision of Professor Petersmann, I discovered that multilateralism in the area of foreign investment was a story of more failures than successes, and that even the existing successes took the form, most of the time, of non-binding effect agreements. The Cancùn ministerial conference produced a point-blank verdict concerning the negotiations on investment: 'The situation does not provide a basis for the commencement of negotiations in this area.'[1] The existing and ever growing number of bilateral investment treaties (hereinafter 'BITs') was there to confirm that multilateralism in the area of foreign direct investment was dead - at least for the next couple of years. What could have been the options available to a researcher who, opting for a topical subject, was clearly a victim of multilateralism in decline? Basically, there were two: either continuing on the same path, or taking a u-turn and start looking for a new topic.

My initial decision to write a thesis emanated from my aspiration to not only ask relevant questions but also to propose practical answers. Since I wanted to continue a professional career as a practitioner in the field of foreign investment, I thought that the best method to identify the topic that was in need of such answers was to ask practitioners. In early May 2004, I met a number of prominent lawyers in Paris and from those discussions stemmed the idea of concentrating on the treatment of foreign investment. In the end, it was Professor Dupuy, who, after a long series of discussions, persuaded me to undertake a study of the fair and equitable treatment standard (hereinafter 'FET'). Two years and a multitude of discussions later, I defended my thesis in front of an eminent panel of professors who despite their criticism and observations encouraged me to publish it.

Thus, the current book builds on my doctoral thesis which I revised through the lenses of my short but intense and ongoing experience as a lawyer and the

[1] World Trade Organisation, Draft Cancùn Ministerial Declaration (2003), available at <http://www.wto.org>, at point 13.

many comments I received from my doctoral thesis jury, my OUP reviewers and all those who took the time to read my work and send me their comments.

The FET standard became, in only ten years, an ***incontournable*** feature of the international law of foreign investment, mostly due to the Investor-State settlement of disputes system. Divided between the host States' discontent and the Investors' enthusiasm, FET creates mostly confusion. In this study this research puzzle is tackled by applying four conceptual frames: the legal basis of FET, its nature as a standard, its content and finally the implications of its breach (i.e. the calculation of compensation) and the enforcement of the award.

In the first two chapters I discuss the three classical sources of international law as possible sources for FET. I conclude that the main sources of FET lie in a rich conventional framework, mainly bilateral, although the increasingly important role of regional agreements must be noted. However, the high number of BITs does not appear to offer a uniform model of FET clauses, quite the opposite. I was able to classify the FET clauses found in 365 BITs in seven categories. Having concluded that the conventional framework is essential to FET, I turn to an examination of the possible customary character of FET and argue that the view that seeks to equate FET with the International Minimum Standard (hereinafter 'IMS') is not only erroneous but also limits the scope of FET. Alternatively, I suggest the FET itself to be a standard of customary nature. To complete the research into the legal basis, I look at the question whether FET constitutes a general principle of law. Having surveyed a number of legal systems that retain treatment according to fairness and equitableness as inherent to their systems, I conclude that FET is a general principle of law, which, in certain cases, is conditional upon an examination of the municipal laws concerned.

The study then looks at the nature of FET, that of being a standard, and retains three direct consequences for its meaning: its flexibility, the absence of a fixed content and its evolutionary character. With these three characteristics in mind, I proceed to the third conceptual framework, ie the content of FET. Although no fixed content may be given to it, I identify those situations in which the FET standard has already been applied. Moreover I propose a method for the arbitrators dealing with a FET claim as well as four pre-conditions for the validity of such a claim. Finally, the last conceptual framework aims at discussing the final act of a FET claim, i.e. the amount of compensation awarded in case of breach of FET. I argue that FET is a standard that balances the interests and behaviours of both the States and the Investors, at the stage of compensation. The legal obligation of the host State to treat foreign Investors fairly and equitably is a unilateral obligation and does not place the Investor in a reciprocal relationship in which he would assume a corresponding obligation. Despite its unilateral character, the FET obligation may contribute to the re-balancing of the Investor-State relationship, as opposed to its natural tendency to tilt in favour of the Investor. Directly connected to the calculation of compensation is the question of the enforcement of the award, which, if not annulled, opens the way for additional



negotiations between the parties as to the amount and methods of payment of the compensation.

The aim of this work is to use the legal characteristics of FET in order to propose new methods and ideas for its application. At the end of this study, it is appropriate to point to an element of ***non-dit*** that is inherent to the standard of FET and which constitutes both its paradox and its fortune. All my conclusions stem from a series of empirical research that are attached in the form of appendices at the end of the study.

# *Acknowledgements*

The acknowledgements section of a book is the time to realize that this is not an individual work. The people I met in the course of this adventure have all contributed to the final product and had a positive impact on both my professional and personal life.

Completing this work required the assistance of, first and foremost, two professors. The first was Ernst-Ulrich Petersmann who accompanied me during my first two years at the EUI, providing me with indispensable research tools and making available to me his learned experience and deep understanding of international law. I am most grateful to him for his unfaltering support and for his understanding at the moment in which I decided to radically change the direction of my research. The second was Pierre-Marie Dupuy, who was pivotal in pointing me into the direction this work took me. In periods of hesitation and anxiety, he was as generous in encouragement as he has since been in his assistance. His extensive knowledge and passion for law, his availability, trust, and sense of humour have influenced me considerably in writing this work. I can only hope that I made the best of our long and numerous discussions and that I have managed to illustrate in this work what he has always taught me: that a lawyer has to be curious and imaginative.

I would like to extend my sense of appreciation to Emmanuel Gaillard, Andrea Giardina, and Christoph Schreuer, who gave me informed and thought-provoking advice for numerous parts of this work. Also, the three reviewers of my book proposal were extremely generous in sharing their ideas and comments. I am also indebted to Yannick Radi, who took time to read individual chapters and made helpful suggestions.

In the preparation of this book, I also benefited from the expert guidance and the availability of John Louth and Rebecca Smith from Oxford University Press, who made each step of this publication a joyful experience.

In addition, there are those who supported me on a personal level. I would like to mention my close EUI friends whose presence inspired me at various stages of this work and who will forever remain part of my EUI experience. I am most indebted to my parents, Rodica and Nicolae, and to my sister Olivia for their love, faith and determination, as well as for the sacrifices made during the years. Finally, I would like to thank Bernhard Knoll, who has contributed to this work by his constructive criticism and contagious passion for legal reasoning, always seated at the other side of the desk, completing his own book, through the late hours of the Florentine, Viennese, and now Warsowian nights.

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# The *Fair and Equitable Treatment Standard* in the International Law of Foreign Investment

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Writing an acknowledgement section to a book represents the end of a long and winding road; without prejudice to the reader's judgement whether this book is a valuable contribution to the state of scholarship in the law of foreign investment, Henry Kissinger's words—evoking a degree of modesty as well as a sense for the challenges ahead—shall be recalled here: 'Each success only buys an admission ticket to a more difficult problem.'

Warsaw, August 2007

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# *List of Abbreviations*

| | |
|---|---|
| ACP | Africa Caribbean Pacific |
| AJIL | American Journal of International Law |
| ASEAN | Association of SouthEast Asian Nations |
| BBC | British Broadcasting Corporation |
| BIT, BITs | Bilateral Investment Treaty, Bilateral Investment Treaties |
| BYIL or BYBIL | British Yearbook of International Law |
| CARICOM | Carribean Community |
| COMESA | Common Market for Eastern and Southern Africa |
| CU | Custom Union |
| CUP | Cambridge University Press |
| EC | European Community |
| ECT | Energy Charter Treaty |
| EEC | European Economic Community |
| EUI | European University Institute |
| FCN | Friendship Commerce and Navigation Treaties |
| FDI | Foreign Direct Investment |
| FET | Fair and Equitable Treatment |
| FIPA | Foreign Investment Protection and Promotion Agreement |
| FTA | Free Trade Area |
| FTC | Free Trade Commission |
| GPL | General Principles of Law |
| IBRD | International Bank for Reconstruction and Development |
| ICC | International Chamber of Commerce |
| ICJ | International Court of Justice |
| ICLQ | International and Comparative Law Quarterly |
| ICSID | International Court for the Settlement of Investment Disputes |
| IIAs | International Investment Agreements |
| ILC | International Law Commission |
| ILM | International Legal Meterials |
| ILR | Transnational Disputes Management |
| ILSA | International Law Students Association |
| IMS | International Minimum Standard |
| ISO | International Standardization Organization |
| ITO | International Trade Organisation |
| LCIA | London Court of International Arbitration |
| LE | Legitimate Expectations |
| MAI | Multilateral Agreement for Investment |
| MERCOSUR | Mercado Común del Sur |
| MFN | Most Favoured Nation |
| MIGA | Multilateral Investment Guarantee Agency |
| NAFTA | North American Free Trade Agreement |

| | |
|---|---|
| NT | National Treatment |
| OECD | Organisation for Economic Co-operation and Development |
| OUP | Oxford University Press |
| PCA | Permanent Court of Arbitration |
| PCIJ | Permanent Court of International Justice |
| RCADI | Recueil des cours de l'Académie de droit international de La Haye |
| RGDIP | Revue Générale de Droit International Public |
| RIAA | Reports of International Arbitral Awards |
| SCC | Stockholm Chamber of Commerce |
| SFDI | Société Française de Droit International |
| SPS | Sanitary and Phytosanitary Measures |
| TBT | Technical Barriers to Trade |
| UNCITRAL | United Nations Commission on International Trade Law |
| UNCTAD | United Nations Conference on Trade And Development |
| UNCTC | United Nations Code of Conduct on Transnational Corporations |
| UNGA | United Nations General Assembly |
| US | United States |
| WB | World Bank |
| WIR | World Investment Report |
| WTO | World Trade Organisation |
| YILC | Yearbook of the International Law Commission |

# Introduction

> When it is necessary for (a prince) to proceed against the life of someone, he must do it on proper justification and for manifest cause, but above all things he must keep his hands off the property of others, because men more quickly forget the death of their father than the loss of their patrimony.[1]

The following historical preface introduces the reader to the existence of the FET in the international law of foreign investment.

## *i. Historical Background of the Standard: A Long But Accelerated Story*

Historically, most cases brought before an international tribunal involved the protection of foreign investments; the recurrent situation was that of a direct expropriation by means of nationalization accompanied by a refusal of the host State to compensate the foreign Investor. This situation occurred in the context of the post-war decolonization process, where the attitude of the newly independent States towards foreign investment was rather ambivalent. The desire to safeguard recently gained independence conflicted with the generally recognized economic benefits of foreign investment. This resulted in inconsistent national policies. Naturally, the Investors' main concern was to secure their assets from possible acts of the host State that may have had a negative impact on their property. In the event of damage, Investors could rely exclusively on the diplomatic protection of their home State in order to solve the dispute. Of course, this mechanism offered an indirect protection since the Investors depended on the State's will to engage in such procedures against another State.[2] Therefore, the private Investor was deprived of a direct mechanism for enforcing his rights against the host State.

Early multilateral initiatives translated this growing problem in draft articles including the fair and equitable treatment clause. The first of this kind was the 1948 Havana Charter, prepared as the basis for the establishment of the International Trade Organization. The objective of the Charter was not only international trade but also more generally the encouragement of economic development, especially in developing countries. Article II (2) of the Charter gave as a mandate to the future organization 'to assure just and equitable treatment' to the Investors of the Member States. This first multilateral initiative was not ratified,

[1] N Machiavelli, *The Prince* (1515).

[2] Engaging in a diplomatic protection procedure could sometimes conflict with the home State's strategic plans in connection with the host State. In this case, the decision not to open a case, for reasons of political choice, was taken against the interests of the Investor.