

Variability of fair and equitable treatment standard according to the level of development, governance capacity and resources of host countries

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Abstract. The article provides a thorough examination of the fair and equitable treatment standard by considering what constitutes an act to be regarded as fair and equitable treatment of an investor and his investment, what are the criteria in establishing that there have been a breach of the fair and equitable standard in line with the interpretation in treaties, Bilateral Investment Treaties (BITs), decision of Tribunals etc. And finally should the criteria used vary based on the level of development, governance capacity and resources in the host State.

1. Introduction

The fair and equitable treatment standard is still a mystifying legal term. Although it has been thoroughly examined, particularly in the last few years, it has not yet been entirely clarified. What is certain is that it is an ‘absolute’, ‘non-contingent’ standard of treatment, i.e. a standard that states the treatment to be accorded in terms which have their own normative content, though their exact meaning has to be determined by reference to specific circumstances of application, as opposed to the ‘relative’ standards embodied in ‘national treatment’ and ‘most-favoured-nation’ principles which define the required treatment by reference to the treatment accorded to other investment in similar circumstances.¹ It is regarded as an absolute standard in the sense that it has its own meaning, and is not necessarily satisfied by treating the investor as well as the host State treats its own nationals or other foreigners.²

The standard of fair and equitable treatment is said to be flexible because its application could be stretched in order for it to accommodate new definition. Based on this feature of elasticity of the fair and equitable treatment standard, it is believed to have been the most invoked treaty standard in Investor-State arbitration which is present in almost every single claim brought by foreign investors against host States.³

In this article, the writer would be considering the fair and equitable treatment, what constitutes an act to be regarded as fair and equitable treatment of an investor and his investment, what are the criteria in establishing that there have been a breach of the fair and equitable standard in line with the interpretation in treaties, Bilateral Investment Treaties (BITs), decision of Tribunals etc. And finally should the criteria used vary based on the level of development, governance capacity and resources in the host State.

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¹ A. Fatouros, *Government Guarantees to Foreign Investors* (CUP, New York 1962) 135-141, 214-215; UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* <http://www.unctad.org/en/docs/iteiia20065_en.pdf>

² Katia Yannaca-Small, ‘Fair and Equitable Treatment Standard: Recent Developments’ *Standards of Investment Protection* ((ed) August Reinisch OUP 2008)

³ Fatouros (n 2)

2. Fair and Equitable Treatment

The notion of fair and equitable treatment is regarded as the most important criterion in the field foreign investment law with origin traceable to the customary international law. A breach of which is still the most reported claim by foreign investors against their host State.

Furthermore, fair and equitable treatment provides a basic level of protection to the foreign investor based on fairness and equity. The problem with this notion of fair and equitable treatment is that there has not been a precise definition for the phrase ‘fair and equitable treatment’. This is due to the fact that there has been no consensus between writers, arbitrators and judges on what would constitute a fair and equitable treatment. It is worthy to note that a great deal of time and resources have been spent on considering the issue whether the concept of ‘fair and equitable treatment’ only reflects the international minimum standard as contained in the general principles of law and treaties i.e. customary international law or does it goes beyond such minimum standard including other sources of investment protection obligations found in treaties or whether the standard is an autonomous self-contained concept in treaties which do not explicitly link it to international law.

More so, the obligation to provide “fair and equitable treatment” is often stated, together with other standards, as part of the protection due to foreign direct investment by host countries. It is an “absolute”, “non-contingent” standard of treatment, i.e. a standard that states the treatment to be accorded in terms whose exact meaning has to be determined, by reference to specific circumstances of application, as opposed to the “relative” standards embodied in “national treatment” and “most favoured nation” principles which define the required treatment by reference to the treatment accorded to other investment.⁴

A review of the provisions of treaties and decisions of tribunal highlights the fact the definitions given to fair and equitable treatment is not uniform. The variation of which is attributed to the linkage of the standard of customary international law.

Since the fair and equitable treatment is regarded as a standard for the protection of the investment of a foreign investor, it is normal for it to vary depending on the facts of each case. The mere fact that there has been no precise definition for what constitutes fair and equitable treatment should not be seen as a weak point but should be seen as an advantage. The vagueness of the phrase is seen as intentional as it appears to give the arbitrator the possibility of accommodating wider meanings.

2.1 Evolution of Fair and Equitable Treatment

Article II (2) of the 1948 Havana Charter for an International Trade Organisation contained the first reference to the “equitable” treatment to be accorded to the investment of a foreign investor. It provides that the International Trade Organisation (ITO) could:

1. make recommendations for and promote bilateral or multilateral agreements on measures designed...
2. to assure *just and equitable treatment* for the enterprise, skills, capital, arts and technology brought from one member country to another.(Emphasis added)

Despite the fact that the above provision was considered as precedent, it failed to provide for the standard of treatment that an investor was to expect or get from the host State which was one of the reasons why the major developed countries failed to ratify it.⁵ As a result of the early attempts in giving a concrete definition to the phrase “fair and equitable treatment”, there began in-depth deliberation at the helm of the Organisation for

⁴ Fatouros (n 2) 135-141, 214-215

⁵ See also the *1948 Economic Agreement of Bogotá* like its counterpart, it was also not a successful one.

Economic Co-operation and Development (“OECD”) and this saw the emergence of the *Draft Convention on the Protection of Foreign Property*.⁶

Article 1(a) which was christened “*Treatment of Foreign Property*” provide thus:

“Each Party shall at all times ensure fair and equitable treatment to the property of the national of the other party. It shall accord within its territory the most constant protection and security to such property and shall not in any way impair the management, maintenance...by the unreasonable or discriminatory measures.” (Emphasis added)

The above draft went a step further than its predecessors in laying emphasis on the standard that was required of the host State in ensuring that the investor and his investment were accorded a fair and equitable standard. Sadly, this draft never saw the light of the day.

Even though the draft never got to the signing stage, its influence on later treaties could be seen as the inclusion of clauses on “fair and equitable treatment” was visibly in several bilateral investment treaties⁷ and was also considered by tribunals. For instance in the *American Manufacturing & Trading Inc v Democratic Republic of Congo*⁸ (also known as the AMT case) where the tribunal considered for the first time the violation by a State of its fair and equitable treatment.

2.2 Fair and Equitable Treatment and its standard

The classical debate that has been on since the evolution of the fair and equitable treatment is whether the phrase is part of the international minimum standard. To resolve this, there are two main approaches to the connection between fair and equitable treatment and customary international law: the first considers the phrase as part of the customary international minimum standard (the traditional view) and the second identifies the phrase as an independent standard which may have reached a customary character (the modern view).⁹ It is evident that the two approaches have received endorsement in the academic and judicial world. For instance in *Mondev*,¹⁰ a case before a North American Free Trade Agreement (NAFTA) tribunal where the difference between the standard of fair and equitable treatment under NAFTA and BITs was acknowledged.

It is observed that NAFTA treaties appear to favour the traditional view while the modern view seems to be preferred by the BITs. *Article 1105 (1) of NAFTA* provides that:

“Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security”.¹¹ (Emphasis added)

While *article 11-3-(a) of the 1994 US BIT Model* provides that:

⁶ <<http://www.oecd.org/dataoecd/35/4/39286571.pdf>>

⁷ Except for those signed by some Asian countries e.g. Pakistan, The Kingdom of Saudi Arabia etc. See UNCTAD (n 1)

⁸ AMT case, ICSID, ARB/93/1, Final Award rendered on 21 February 1997 (Sucharitkul.Golsong.Mbaye)

⁹ Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (1st edn OUP, Oxford 2008)

¹⁰ *Mondev International Ltd v United States of America*, ICSID, ARB(AF)/99/2, Final Award rendered on 11 October 2002(Ninian Crawford.Schwebel)

¹¹ The 31st of July interpretation by the NAFTA Free Trade Commission has been perceived to be one of obligatory nature in which the provision of article 1105 (1) was believed to establish the minimum standard of treatment expected by customary international law to be accorded to a foreign investor and his investment. The concepts of ‘fair and equitable’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment. The fact that there has been a breach of another provision of the NAFTA, or of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105 (1).

“Each Party shall at all times accord to covered investments, fair and equitable treatment and full protection and security, and shall in no case accord treatment less favourable than the one required by international law”. (Emphasis added)

To the 1994 US BIT had an explanatory note which states that a minimum standard of treatment as required of under the customary international has been included in the provision of the treaty. Argument arose about the level of treatment which is less favourable than the one required by international law and this was cured by the provision of article 5 of the 2005 US BIT which states the customary international law as the minimum standard of treatment to be accorded to a foreign investor and his investment.

The international minimum standard is regarded as a benchmark of customary international law which regulates the treatment of investors, by laying down the minimum standard that is expected of the host State irrespective of the domestic laws and regulation. What this means is that the host State would be expected not to go below the minimum standard that is accorded to the nationals of the host State.¹²

As a matter of textual interpretation, it is inherently implausible that a treaty would use an expression such as “fair and equitable treatment” to denote a well-known concept such as “minimum standard of treatment in customary international law”. If the parties to a treaty want to refer to customary international law, it must be presumed that they will refer to it as such rather than using a different expression.¹³

Dr Mann who is one of the proponents of the modern view on the standard of fair and equitable treatment wrote in his book:¹⁴

“The terms “fair and equitable treatment” envisage conduct which goes beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words. A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all circumstances the conduct in issue is fair and equitable or unfair and inequitable. No standard defined by other words is likely to be material. The terms are to be understood and applied independently and autonomously.”

Although this standard is reiterated in treaties, it is merely couched in different forms. What is of importance is the required duty of customary international law which expects host State to accord to nationals of other state fair and equitable treatment and vice versa.

Dolzer and Stevens state that “the fact that parties to BITS have considered it necessary to stipulate this standard as an express obligation rather than rely on a reference to international law and thereby invoke a relatively vague concept such as the minimum standard is probably evidence of a self-contained standard. Further, some treaties refer to international law in addition to the fair and equitable treatment, thus appearing to reaffirm that international law standards are consistent with, but complementary to, the provision of the BIT”.¹⁵

3. View from the Arbitral Tribunal

Due to the paucity of finding a concrete definition of the content of the phrase, a lot of discussion has taken place in finding what would be the minimum standard of customary international law. The general view though is that the host state should accord to the foreign investor treatment that is “fair” and “equitable”. But the question that keeps popping up is ‘what treatment would be regarded as been fair and equitable.

Kudos should be given to the arbitral tribunals for their efforts in attempting to fill the lacunae, for they have gone the extra mile in bringing to light the essentials contained in the standard. They are the following under listed which would be discussed in details.

¹² Swiss Foreign Office supports the proposition that Fair and equitable treatment refers to the minimum standard

¹³ Christoph Scheuer, ‘*Fair and Equitable Treatment in Arbitral Practice*’. Offprints of the Journal of World Investment and Trade. June 2005 Vol. 6 No.3 p.360

¹⁴ F.A. Mann, ‘*British Treaties for the Promotion and Protection of Investments*’, B.Y.I.L Vol. 52, 1981, p.241 @ p.244

¹⁵ R. Dolzer and M. Stevens, ‘*Bilateral Investment Treaties*’. (Martinus Nijhoff Publishers 1995)

- Transparency and the protection of the investor's legitimate expectation
- Obligation of Vigilance and Protection
- Denial of Justice, Due Process
- Lack of Arbitrariness and Non-discrimination
- Good faith

3.1 Transparency and the Protection of the investor's legitimate expectation

There is a close relationship between transparency and the legitimate expectation of an investor from his investment. Transparency means that the legal framework for the investor's operations is readily apparent and that any decision that would affect the investor can be traced to that legal framework.¹⁶ The *Metalclad* Tribunal was noted as the first tribunal to comment on the canon of transparency with respect to administrative proceedings where this was considered as one of the facet of the concept of fair and equitable treatment.

In *Metalclad Corporation v Mexico*¹⁷, the Tribunal found that the absence of a clear rule concerning construction permits requirements in Mexico, had "failed to ensure a transparent and predictable framework for Metalclad's planning and investment".¹⁸ The tribunal decided that the failure on the part of the Mexican government as required by NAFTA under Article 1802 amounted to a breach of the provision contained in Article 1105. While in another case involving *Tecmed* and the United Mexican States,¹⁹ the tribunal gave credence to the interpretation by putting it in the context of more concrete procedural principles and rights and expanding it to include the investor's legitimate expectations.

3.2 Obligation of Vigilance

In a number of early decisions, the tribunals made reference to the obligation of vigilance, also phrased as an obligation to exercise due diligence in protecting foreign investment in order to define an act or omission of the State as being contrary to fair and equitable treatment and full protection and security.²⁰ The concept of "fair and equitable treatment" and "full protection and security" has been joined together and reviewed by arbitral tribunal in a number of cases. The full protection and security standard has often been included in treaties as a separate obligation and was applied essentially when the foreign investment has been affected by civil strife and physical violence.

Several cases have equated the criteria of fair and equitable treatment and that of full protection and security. Some of which are *Occidental v Ecuador*,²¹ *Asian Agricultural Products Ltd (AAPL) v Sri Lanka*,²² *Wena Hotels v Egypt*²³ and a host of others. In *Occidental v Ecuador*, the tribunal decided that 'a treatment that is not fair and equitable automatically entails an absence of full protection and security.

3.3 Denial of Justice, Due Process

Denial of justice has been the root of most arbitration. Procedural fairness is regarded as a rudimentary requirement of the rule of law and an essential element of fair and equitable treatment. This is seen as a contradistinction to the international delinquency of denial of justice.²⁴

The US Model BITs and a host of Free Trade Agreements (FTAs) are the only investment agreements which specifically set out the scope of application of the fair and equitable standard. A definition of denial of justice was offered by Brownlie where he describes the Harvard Research Draft on International Law as the "best guide" to the meaning of denial of justice. According to him, denial of justice exists where there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the

¹⁶ Scheuer (n 13) 374

¹⁷ *Metalclad Corporation v Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000.

¹⁸ *Metalclad* (n 17) para 99

¹⁹ *Técnicas Medioambientales Tecmed, S.A. v United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003.

²⁰ G. Moss, 'Full Protection and Security', *Standards of Investment Protection* (ed) August Reinisch OUP 2008)

²¹ *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA No. UN 3467, Award, 1 July 2004.

²² *Asian Agricultural Products Ltd (AAPL) v Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990

²³ *Wena Hotels Limited v Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, 8 December 2000.

²⁴ Scheuer (n 13); In *United States (L.F. Neer) v. United Mexican States, (1927) 4 R.I.A.A.* the notion of 'denial of justice' was dealt with is one of the early case on the issue of unfair treatment.

administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice or a manifestly unjust judgement. An error of a national court which does not produce manifest injustice is not a denial of justice.

The Loewen's case²⁵ concerns the propriety of domestic court proceedings. The Tribunal applied Article 1105 of NAFTA and found that for its violation "manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough". It was decided that the jury were influenced by the persistent appeal to local favouritism against the foreign claimant.

3.4 Lack of Arbitrariness and Non-discrimination

This is another element of the standard of fair and equitable treatment. In *CMS v Argentina*,²⁶ the tribunal linked the standard of protection against arbitrariness and discrimination to the fair and equitable treatment standard. While tribunals in *MTD v Chile*,²⁷ *PSEG v Turkey*,²⁸ and *Saluka v Czech Republic*,²⁹ declined to differentiate between the two standards.

The tribunal in *Saluka* agreed with that of *S.D. Myers Inc. v Canada*,³⁰ that 'an infringement of the fair and equitable standard requires treatment in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective'.

3.5 Good Faith

The connection between investor's expectation of the fair and equitable treatment and good faith was considered in line with the provision of the BITs and the tribunal was of the opinion that this must be paired with a legitimate objective.

Furthermore in the case of *Tecmed S.A. v The United Mexican States*, the Tribunal interpreted the "fair and equitable treatment standard" as resulting from the good faith principle. What the tribunal did not clarify in the above case was whether the good faith principle was a source of obligation or a principle which governs the creation of the obligation to accord fair and equitable treatment.

Bad faith is not a requirement for the violation on the part of the host State. In *Neer's Case*³¹ it was held that the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would recognize its insufficiency. But in *Mondev's case*,³² this notion of bad faith was rejected. The view of the tribunal was that to the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.

4. Conclusion

The fair and equitable treatment standard that a host State must accord to the foreign investor and his investment has been based on a minimum standard. From the above analysis, it is obvious that there are lots of debates going on about what should be the minimum standard. For instance, should the standard vary according to the level of development, governance capacity or resource available in the state? My answer would be No. To allow for differentiation in the interpretation of the fair and equitable treatment standard would jeopardize the provision of the standard.

²⁵ *Loewen Group, Inc and Raymond L. Loewen v United States of America (Loewen)*, Award, 26 June 2006, 7 ICSID Reports 442.

²⁶ *CMS Gas Transmission Company v The Argentina Republic*, ICSID Case No. ARB/01/8, Award, 12 May 2005

²⁷ *MTD Equity Sdn. Bhd. and MTD Chile S.A. v Republic of Chile*, ICSID Case No. ARB/01/7. Award, 25 May 2004.

²⁸ *PSEG Global et al. v Republic of Turkey*, ICSID Case No. ARB/02/5, Award, 19 January 2007.

²⁹ *Saluka Investments BV (The Netherlands) v The Czech Republic*, Partial Award, 17 March 2006.

³⁰ *S.D. Myers Inc. v Canada (UNCITRAL)*, First Partial Award, 13 November 2000.

³¹ *Neer (n 24)*

³² *Mondev International LTD v. United States of America*, ICSID Case No. ARB(AF)/99/2 (Award)

Variability of fair and equitable treatment standard according to the development

It is true that some states are willing to accept a treaty clause on fair and equitable treatment rather than offer the investor a treatment based on the international minimum standard because they believe the investor could be entitled to a more favourable treatment than a local investor. In reality, an investor from a developed country will not be willing to be subjected to the same standard as experienced by its counterpart from a developing state.

In the *S.D. Myers Inc. v. Canada* award, the Tribunal affirmed that the inclusion of a “minimum standard” provision is necessary to avoid what might otherwise be a gap.

“A government might treat an investor in a harsh, injurious and unjust manner, but do so in a way that is no different than the treatment inflicted on its own nationals.... the ‘minimum standard’ is a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner.”³³

Variability of fair and equitable treatment standard according to the level of development, governance capacity and resources of host countries

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³³ *S.D. Myers, Inc. v. Canada*, (November 13, 2000), Partial Award. International Legal Materials 408