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Editore
Centro di documentazione europea dell' Università degli Studi di Verona
Dipartimento Studi giuridici
Via Carlo Montanari, 9
37121 – Verona (Vr)
Tel. +39.045.8028847
Fax. +39.045.8028846
cde@ateneo.univr.it
http://fermi.univr.it/europa/

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The EFT clause in the EU_Singapore Free Trade Agreement.

A first Analysis

Solange Baruffi

Abstract

The paper analyses the content of the fair and equitable treatment (FET) clause included in the EU-Singapore Free Trade Agreement, which, departing from the past practice, sets out an exhaustive list of conducts entailing a breach of the FET standard. Further to a preliminary description of the content of the most typical FET clauses included in previous investment agreements and free trade agreements, the paper focuses on the innovative capacity of the FET clause under analysis, with the aim of evaluating whether (i) such clause provides for an adequate balance between the interests of the host State and the investor; and (ii) it is preferable to include in investment treaties and free trade agreements detailed and circumscribed FET clauses or rather to draft the standard in more generic terms, leaving it open to different interpretations on a case-by-case basis.

The FET clause in the EU-Singapore Free Trade Agreement. A first analysis

by Solange Baruffi*

CONTENTS: 1. Introduction – 2. Origins of the clause and recent drafting developments – 3. The FET Standard in the FTA – 4. Conclusions

1. Introduction

The obligation for a host State to provide foreign investors with fair and equitable treatment (FET) has been included in the vast majority of investment treaties as from 1960s; however it is only in the last 15 years that investors have pursued FET claims, complaining an alleged violation of the relevant treaty clause by the State. In many of such cases, the arbitral tribunals concluded that the host State breached its obligation under the FET standard, qualifying it as an independent source of liability for the State.

One of the reasons for the recent wide recourse by investors to the FET standard is its ambiguity: the ambit and threshold of the standard remain largely indeterminate, implying that it can be used as a flexible tool susceptible to be adapted to the circumstances of each case. As several tribunals put it, "the judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the fact of the particular case" and the "standard is to some extent a flexible one which must be adapted to the circumstances of each case".[1] This is mainly due to the fact that many investment treaties refer to the FET standard in generic terms and do not specify in what such treatment exactly consists, thus implicitly allowing the arbitrators to substitute their personal views of what is fair and equitable for objective legal standards. One of the consequences of this situation is that, in a system where precedent cases are not binding, case-law has applied the standard in contrasting manners contributing to create a debate on its exact content, which cannot be considered as concluded yet and of which investors have benefited in many cases. The other side of the coin is that, being the standard so vague, its content is somehow unpredictable and this generates uncertainties that make investment arbitration hard to be acceptable, in particular for the State, and which can also result in frustrating the investor's expectations.

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* PhD candidate in European and International Law at University of Verona

1 See, among others, *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability of 27 December 2010, para. 109, citing *Mondev International Ltd. V. United States of America*, ICSID Case No. ARB(AF)/99/2, Award of 11 October 2002, para. 118; and *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Final Award of 30 April 2004, para. 99.

In order to circumvent this issue, in more recent times, investment treaties have tried to be more specific with respect to the content of the FET standard, for instance combining it with other absolute standards of treatment and treatment in accordance with international law or spelling out some specific obligations on the State parties.

In this context, a considerable step forward has been made in the recent EU-Singapore Free Trade Agreement (FTA).[2] On 17 October 2014 the European Union and Singapore have concluded the negotiations of the investment part of the FTA (the other parts have been initialled in September 2013 and they are now under the scrutiny of the European Commission and the Council of Ministers, before being ratified by the European Parliament). The FTA provides for a very detailed FET clause, which significantly departs from the past practice, since it sets out an exhaustive list of conducts entailing a breach of the FET standard among which it is expressly included the frustration of investors' "legitimate expectations".

The aim of this note is to analyze the content of the FET clause included in the FTA in order to evaluate whether (i) it provides for an adequate balance between the interests of the host State and the investor; and (ii) it is preferable to include in investment treaties and free trade agreements detailed and circumscribed FET clauses or rather to draft the standard in more generic terms and leaving it open to different interpretations on a case-by-case basis.

2. Origins of the clause and recent drafting developments

One of the first references to the FET standard can be traced in the Havana Charter of 1948 for the creation of an International Trade Organization. Although the Charter never came into force, because of the lack of ratifications by many States, its reference to the FET standard[3] served as a precedent in subsequent instruments concerning international investments.

At the regional level, in the same year, a clause providing for the FET was included in the Economic Agreement of Bogota,[4] adopted by the Ninth International Conference of American States, which however never came into force, owing to lack of support by the capital importing states which perceived it as being too foreign investor-oriented.

At the bilateral level, the United States and various other States provided for an obligation on the State parties to accord "equitable treatment" or "fair and equitable treatment" to investors in a series of Friendship, Commerce and Navigation (FCN) treaties in the 1950s.

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2 The full text of the FTA is available at: <http://trade.ec.europa.eu/doclib/press/index.cfm?id=961>.

3 Article 11(2) of the Havana Charter provided that the Organization could make recommendations to promote "bilateral or multilateral agreements or measures designed: (i) to assure *just and equitable treatment* for the enterprise, skills, capital, arts and technology brought from one Member country to another (…)" [emphasis added].

4 Article 22 of the Economic Agreement of Bogota provided that "Foreign capital shall receive *equitable treatment*. The States therefore *agree not to take unjustified, unreasonable or discriminatory measures* that would impair the legally acquired rights or interests of nationals of other countries in the enterprises, capital, skills arts or technology they have supplied." [emphasis added].

A boost to the inclusion of the FET clause in investment treaties was then given by the provision thereof in the Draft Convention on Investments Abroad, proposed in 1959 by a number of European business persons and lawyers under the leadership of Hermann Abs and Lord Shawcross and in the most influential of the early postwar drafts on investment, namely, the Draft Convention on the Protection of Foreign Property produced by the Organization for the Economic Cooperation and Development (OECD). The Convention, first published in 1963 and revised in 1967, was approved by the Council of the OECD, but it was never opened for signature. Given the economic and political influence represented by the OECD acting as a group, the draft agreement reflected the dominant trends and perspectives among capital-exporting countries in investment matters and was highly influential in subsequent BIT practice. In this respect, it has been written that the origin of the phrase "fair and equitable treatment" is usually "*traced in the OECD Convention of 1967*".[5]

Since then, the FET clause has been included in the vast majority of multilateral, regional and bilateral investment treaties currently in force.[6]

However, the text of fair and equitable provisions in investment treaties and free trade agreements varies considerably, contributing to the lack of certainty surrounding the FET standard. More precisely, investment treaties employ the following main formulations and approaches to the FET standard[7]:

- unqualified obligation to provide fair and equitable treatment;[8]

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5 M. Sornrajah, *The International Law on Foreign Investment*, 2nd edn., 2004, at p. 333.

6 It is worth noting that, also in recent times, investment treaties may not contain any reference to the FET standard (e.g., the Australia-Singapore FTA of 2003). Treaty practice suggest that States that have not included a FET obligation or a reference to it in their treaty have done so on purpose, probably because they were unwilling to subject their regulatory measures to review under the said standard. However, it is to highlight that the international minimum standard of treatment of aliens, being a customary law rule, shall in any event apply, securing that foreign investments are granted with a minimum level of protection. The international minimum standard of treatment in customary international law has been characterised as an "obligation on States to ensure that aliens are treated in accordance with the ordinary standard of civilisation irrespective of the they accord to their nationals" (H. Haeri, *A Tale of Two Standards: 'Fair and Equitable Treatment and the Minimum Standard in International Law'*, Arbitration International, 27(1), 2011, pp. 27 – 45, esp. p. 28). For a more detailed analysis of the international minimum standard of treatment and its interplay with the FET standard, see, *inter alia*, M. Valenti, *The Protection of general interest of host States in the application of the fair and equitable treatment standard*, in *General Interests of Host States in International Investment Law*, edited by G. Sacerdoti with P. Acconci, M. Valenti and A. De Luca and K. Milles, Cambridge University Press, Cambridge, 2014, pp. 26 – 56, at pp. 29-32; C. Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, Journal of World Investment & Trade, 6(3), 2005, pp. 357 – 386; M. Kinnear, *The Continuing Development of the Fair and Equitable Treatment Standard*, Investment Treaty Law, Current Issues III (A. K. Bjorklund et al. eds. 2008), pp. 209-239, at p. 217 and followings. In the cases where no FET clause is included in the treaty, the point is whether prejudiced investors would be entitled to enforce a violation of the minimum standard of treatment through the investor-State dispute settlement (ISDS) mechanism set out in the relevant treaty, which will depend on the breadth of the treaty's ISDS clause.

7 This classification among the FET clauses - that is supported by in the UNCTAD Series on International Investment Agreements II, Fair and Equitable Treatment, 2012, available at: <http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf> - is not the only possible classification. For a different classification, see, *inter alios*, M. Kinnear, *supra*, note 6, at p. 213.

8 For instance, the Argentina-Spain Bilateral Investment Treaty of 1991, in its Article 4(1), provides that each Party shall accord in its territory fair and equitable treatment to investments made by investors of another Party.

- FET obligation linked to international law without reference to a minimum standard of treatment of aliens;[9]

- FET obligation linked to the notion of minimum standard of treatment of aliens in accordance with customary international law;[10]

- FET obligation with an additional substantive content (such as, prohibition of denial of justice, prohibition of unreasonable/discriminatory measures, irrelevance of breach of other treaty obligations) and without reference at all to international law.[11]

In the cases when the FET standard is not expressly linked textually to the minimum standard of treatment of aliens or to international law, the FET has been interpreted by many tribunals[12] as an autonomous or self-standing standard. Instead of deriving the content of the standard from its original source (i.e., the minimum standard of treatment of aliens), they focused on a literal interpretation of

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9 For instance, (i) the United States of America-Argentina Bilateral Investment Treaty of 1991, in its Article II(2)(a), provides that "Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law"; and (ii) the Croatia-Oman Bilateral Investment Treaty of 2004, in its Article 3(2), provides that: "Investments or returns of investors of either Contracting Party in the territory of the other Contracting Party shall be accorded fair and equitable treatment in accordance with international law and provisions of this Agreement".

10 For instance, Article 1105 of the North America Free Trade Agreement (NAFTA), which is titled "Minimum Standard of Treatment", 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". In relation to this provision, further to decisions that declared the standard additive to the minimum standard of treatment (see especially, *Pope and Talbot Inc. v. The Government of Canada* (*Pope and Talbot*), UNCITRAL, Award on the Merits of Phase 2, 10 April 2001), the NAFTA Free Trade Commission, composed of representatives of the 3 NAFTA countries, issued in 2001 the binding Notes of Interpretation of Certain Chapter 11 Provisions, which rejected any notion that NAFTA Article 1105 contained any elements that were "additive" to the international minimum standard (the note is available at: <http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp>). The language of the note has influenced the drafting of many subsequent investment treaties by NAFTA and non-NAFTA countries (see, *inter alia*, the Japan-Philippines FTA (2006), the U.S. Model Bilateral Agreement (2007) and the Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area (2009)).

11 With respect to the link between the FET standard and the prohibition to deny justice, see, *inter alia*, the ASEAN Comprehensive Investment Agreement of 2009 which, in its Article 11(2), specifies that "For greater certainty: (a) *fair and equitable treatment requires each Member State not to deny justice* in any legal or administrative proceedings in accordance with the principle of due process; (…)" [emphasis added]. The prohibition of unjustified or discriminatory treatment is mentioned in Article 2(2) of the Netherlands-Oman Bilateral Investment Treaty of 2009 according to which: "Each Contracting Party shall ensure fair and equitable treatment to the investments or nationals or persons of the other Contracting Party and *shall not impair, by unjustified or discriminatory measures,* the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals or persons.". Finally, with respect to the irrelevance of breach of other treaty norms, see, *inter alia*, Article 4(3) the Mexico-Singapore Bilateral Investment Treaty of 2009, which states that: "A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.".

12 Among others: *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award of 17 May 2006, para. 309 (*Saluka*); *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award of 24 July 2008, para. 591. This approach is also supported by scholars. According to C. Schreuer, *supra*, note 9, at p. 365 "In the absence of indications to the contrary, the better view is to give to it an autonomous meaning". See also, F. M. Téllez, *Conditions and Criteria For The Protection of Legitimate Expectations Under International Investment Law*, ICSID Review, 27(2), 2012, pp. 432-442, esp. p. 432; M. Kinnear, *supra*, note 6, at pp. 223 and 224; and H. Haeri, *supra*, note 6. For a dissenting opinion, see: G. Mayeda, *Playing Fair: the Meaning of Fair and Equitable Treatment in Bilateral Investment Treaties*, Journal of World Trade, 41(2), 2007, p. 273 – 291, according to which the FET standard should be always interpreted in line with the minimum standard set out in international law.

the clause of the relevant treaty. In this way, tribunals have enlarged the scope of the standard, and its content has been determined on a case-by-case basis, becoming a topic in continuous development, as well as the field for uncertainty and unpredictability.

On the contrary, when the FET standard is linked to the minimum standard of treatment of aliens – whose goal is to preclude conducts against foreigners that fall below a certain threshold which is considered unacceptable in international law[13] – the scope of the standard is somehow limited[14]. The alignment of the FET standard with the minimum standard of treatment is clearly aimed at preventing over-expansive interpretations of the FET standard, with an attempt to control the discretion of the tribunals when assessing its content. The issue with this approach is however that there is no general consensus as to what constitutes the minimum standard of treatment of aliens under customary international law. Indeed, the minimum standard itself does not have a clearly defined content and requires interpretation, thus opening the door, once again, to the discretion of the arbitrators. In this respect, according to the UNCTAD[15], three different approaches of the tribunals can be identified: *(i)* the standard has been set out as requiring "a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process or a manifest lack of reason";[16] *(ii)* liability threshold is lower than in *(i)*, and can a violation of the standard occurs in case of a conduct which is "arbitrary, grossly unfair, unjust, idiosyncratic" or that is "discriminatory and exposes claimant to sectional or racial prejudice" or which involves a "complete lack of transparency and candour in an administrative process";[17] and *(iii)* the liability threshold is low, since there is no difference between minimum standard of treatment and fair and equitable treatment.[18] As it is clear, from *(iii)* also when FET standard is linked to the minimum standard of treatment of aliens, tribunals have been able to widen the scope of the protection granted by the standard, substantially overruling the presumable will of the parties at the time of the signing of the treaty.

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13 *Glamis Gold, Ltd v. United States of America*, UNCITRAL, Award of 8 June 2009, paras. 615 and 616.

14 In this respect, it is worth referring to the definition of the minimum standard given in the concurring opinion by American Commissioner, in the context of the influential case *L. F. H. Neer and Pauline Neer v. United Mexican States*, 1926), IV RIIA 60, at p. 65, whereby the General Claims Commission stated that "the treatment of an alien, in order to constitute an international delinquency, should amount to an *outrage, to 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 readily recognize its insufficiency*." [emphasis added]. Despite almost 90 years old this passage is largely still deemed to reflect the high threshold for violating the international minimum standard.

15 See UNCTAD, *supra*, note 7.

16 *Glamis Gold, Ltd v. United States of America*, UNCITRAL Rules (NAFTA), Award, 8 June 2009, para. 616. As highlighted by UNCTAD, "even this – apparently the most conservative approach to the interpretation of the minimum standard of treatment of aliens – goes beyond the orthodox view of the standard as limited to the obligations to accord police protection and security and not to deny justice" (*supra*, note 7, at p. 93).

17 *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Final Award of 30 April 2004, para. 98.

18 *Merrill & Ring Forestry L. P. v. The Government of Canada*, UNCITRAL Rules (NAFTA), Award of 31 March 2010. Note that this approach seems to contradict the 2001 NAFTA's Notes of Interpretation of Certain Chapter 11 Provisions (see, *supra*, note 10), whose aim was to draw a clear distinction between the minimum standard of treatment of aliens under customary law and an unqualified obligation to grant fair and equitable treatment. Also due to the lack of clear arguments for taking such approach, this award contributed to create confusion as to the exact level of protection of investor under NAFTA's FET clause.

Finally, it is worth noting that also when the FET standard provision includes additional substantive content, its scope and purpose remains somehow vague, despite such elements may help to interpret the will of the States parties at the time of the negotiation.

In light of the above, it is clear that any of the typical formulations of FET clauses contained in investment treaties and free trade agreements are not able to clarify the exact content of the standard, allowing the arbitrators to give their personal interpretation of what is fair and equitable. In this context the FET clause included in the FTA may be regarded positively, since it identifies in a precise manner the content of the FET clause, limiting the discretion of the arbitrators in determining whether the State has violated its obligations under an investment treaty.

3. The FET Standard in the FTA

3.1 Preliminary Considerations

Article 9.4 (*Standard of Treatment*) of the FTA provides that:

"1. Each Party shall accord in its territory to investments of the other Party fair and equitable treatment and full protection and security.[19]

2. To comply with the obligation to provide fair and equitable treatment set out in paragraph 1, neither Party shall adopt measures that constitute:

(a) Denial of justice in criminal, civil and administrative proceedings;

(b) A fundamental breach of due process;

(c) Manifestly arbitrary conduct;

(d) Harassment, coercion, abuse of power or similar bad faith conduct; or

(e) A breach of the legitimate expectations of an investor arising from specific or unambiguous representations from a Party so as to induce the investment and which are reasonably relied upon by the investor."

This clause is divided in two parts. The first one sets out the general principle; while the second one, which deserves a more detailed analysis, specifies the conducts that the relevant State shall keep in order for it to comply with the FET standard.

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[19] The FTA includes the obligation to provide full protection and security to investments in the same sentence expressing the obligation to accord fair and equitable treatment. As regards, it may be worth clarifying that the two standards cover distinctive areas. FET deals with the process of administrative and judicial decision-making, while the full protection standard is meant as the obligation for the host State to adopt all reasonable measures to physically protect assets and property from threats or attacks by public officials or third parties. Please however note that an analysis of the obligation of States to provide investors with full protection and security is outside the scope of this note.

3.2 Lack of reference to the minimum standard of protection of aliens or international law

It shall first be noted that the clause, setting out the FET principle, does not refer to customary international law, nor to the minimum standard of treatment. In addition, it is titled "Standard of Treatment" rather than "Minimum Standard of Treatment".[20] This should be read as an index of the fact that, in the context of the FTA, the FET standard and the international minimum standard are distinct and autonomous and Parties did not intend to align the scope of the FET standard with the level of treatment required by international law or by the international minimum standard of treatment of aliens. This approach is evidently more favorable to the investor in line with the most recent jurisprudence and the majority of scholars that, in case no specific reference is made in the treaty to either the customary international law, nor to the minimum standard of treatment, has recognized FET as a norm with a self-contained existence.[21]

3.3 List of conducts to comply with the FET obligation under the FTA

Paragraph 2 of the clause does not set out a mere list of non-exhaustive behaviors that exemplify, in a generic manner, what a State should not do; on the contrary, it indicates in a precise manner what a State must do to comply with the obligation to provide fair and equitable treatment. In this way, the FET standard ceases to be a vague provision of the treaty, flexible to different interpretation based on the personal beliefs of the relevant arbitrator and, for this, in principle this drafting technicality should be regarded positively. However, since the arbitrator is now forced to limit himself to the provision of the FTA, the list of misbehaviors included in paragraph 2 shall be analyzed in order to assess whether it is sufficiently comprehensive[22] and whether it can be considered more in favor of the State or to the investor and if and to what extent it has adhered to the attainments of case-law.

(a) Denial of justice and breach of due process

Procedural fairness is considered as "vital element"[23] of the FET standard. Express reference to the obligation not to deny justice as part of the FET standard is also often included in investment treaties[24] and is consistently recognized by tribunal practice[25]. Denial of justice is traditionally defined as any gross misadministration of justice by domestic courts resulting from the ill-functioning of the State's judicial systems. The obligation not to deny justice may

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20 The articles of, *inter alia*, the NAFTA and the U.S. Model Bilateral Investment Treaty (2007) which set out the FET standard are entitled "Minimum Standard of Treatment". See, *supra*, note 10.

21 See, *supra*, note 12.

22 According to C. Schreuer (*supra*, note 6, at p. 365) "it is impossible to anticipate in the abstract the range of possible types of infringement, upon the investor's legal position".

23 C. Schreuer, *supra*, note 6, at p. 381.

24 See, *supra*, note 11.

25 Among others, *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 (*Metalclad*), Award of 30 August 2000, para. 91; *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award of 12 April 2002, para. 143; *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2 (*Tecmed*), Award of 29 May 2003, para. 162.

be violated not only by courts but also by means of executive actions. Errors, misinterpretations and misapplication of domestic law cannot be considered as such, unless they result from "the clear and malicious misapplication of the law".[26] Breach of fundamental due process guarantees (such as failure to give notice of the proceedings and to provide an opportunity to be heard) is usually considered as a denial of justice as well.[27]

(b) Manifest arbitrariness

Several tribunals have highlighted that prohibition of arbitrariness is part of the FET standard. A conduct may be considered as arbitrary if "it is founded on prejudice and preference rather than on facts".[28] Therefore, a measure that inflicts a damage on the investor without having any underlying purpose or a rational explanation would be considered as arbitrary. In order to establish whether a conduct is to be deemed as arbitrary, the factual situation of the State must be taken into consideration. For instance, in the cases Enron v. Argentina[29] and LG&A v. Argentina,[30] the fact that the State was facing a financial crisis was taken into account in order to exclude that Argentina acted in an arbitrary or discriminatory manner. In this respect, it should be noted, that in the two mentioned cases Argentina has been found guilty for breach of the FET, even if its conduct was not arbitrary. This shows that, in line with the provision of Article 9.4, arbitrariness shall be deemed only a part of the FET standard.

(c) Abusive treatment

According to the FTA, harassment, coercion, abuse of power or similar bad faith conducts are included among the State's conducts that violate the FET standard. As per the denial of justice, breach of due process and manifest arbitrariness, also abuse treatments are comprised among the conducts that according to predominant case-law constitute breaches of the FET standard.[31] In the FTA, the Parties rather than listing all the conducts that may constitute an abusive treatment, limited themselves to expressly indicate those that more frequently occur and most evidently entail a breach of the FET standard (harassment, coercion and abuse of power), leaving to the arbitrators the exact identification of what falls within the scope of the

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26 *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States*, ICSID Case No. ARB (AF)/97/2, Award of 1 November 1999, para. 103.

27 See N. Gallus, *The 'fair and equitable treatment' standard and the circumstances of the host State*, in *Evolution in Investment Treaty Law and Arbitration*, edited by C. Brown and K. Milles, Cambridge University Press, New York, 2011, pp. 223 – 245; and R. H. Kreindler, *Perspectives on State Party Arbitration: The Future of BITs – The Pratictioner's Perspective*, Arbitration International, 22(1), 2007, pp. 43 – 62, esp. pp. 53 – 55, on how the circumstances of the host State may influence decisions on denial of justice.

28 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Award of 3 September 2001, para. 221; *Plasma Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, para. 184.

29 *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award of 22 May 2007, para. 254.

30 *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Award on Liability of 3 October 2006, paras. 161 and following.

31 Among others, *Pope and Talbot*, *supra*, note 10, paras. 156 – 181; Tecmed, *supra*, note 25, para. 163.

"similar bad faith conducts". This drafting technicality shall be positively regarded, as (i) an exhaustive closed-end clause listing all possible abusive treatments would have been impossible to draft; (ii) the fact that the bad faith conducts in order to amount to a FET violation must be similar to harassment, coercion, abuse of power limit the freedom of the arbitrators, setting a high liability threshold (i.e., not any bad faith conduct can amount to a FET violation, but only those conducts that entail a high level of misconduct). Based, on precedent decision, it may be argued that this provision includes conducts such as persecutions, threats, intimidations, use of force.[32] The fact that bad faith conducts are expressly mentioned only in one letter of Clause 9.4(2) of the FTA implies that in order to violate the FET standard in the case under issue, the conduct of the State must be carried out without any lawful grounds and the harm consequent thereto must be inflicted for improper reasons. In addition it also means that in order for the other conducts listed in Article 9.4(2) to be relevant, no investigation on the bad faith of the State is necessary.[33] Therefore, for instance, a denial of justice is to be condemned, disregarding any evaluation on the good or bad faith of the State.[34]

3.4 Legitimate expectations

The most innovative provision of Clause 9.4 is the express inclusion among conducts capable of breaching the FET standard the violation of the investor's legitimate expectations. Indeed, notwithstanding the fact that protection of the investors' legitimate expectations has been "repeatedly identified by tribunals and scholars as one of the major components of the standard",[35] legitimate expectations have not been expressly mentioned in any actual FET provision before. The aim of the Parties was probably to provide with a stringent definition of what falls within the scope of the legitimate expectations to be protected under the FET clause of the FTA. This probably because, being an arbitral innovation and in lack of the system of binding precedents, the tribunals have interpreted in different manners the concept of

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32 According to the UNCTAD (*supra*, note 7, at pp. 82-83) "*Abusive conduct can potentially take many forms, such as arresting or jailing of executives or personnel; threats of or initiation of criminal proceedings; deliberate imposition of unfounded tax assessments, criminal or other fines; arresting or seizing of physical assets, bank accounts and equity; interfering with, obstructing or preventing daily business operations; and deportation from the host State or refusal to extend documents that allow a foreigner to live and working the host State*" [emphasis added], provided that the conduct of the State will be abusive where the actions cannot be considered as justified and proper.

33 This is in line with *Tecmed* (*supra*, note 25), where, at para. 153, it is stated that the fair and equitable treatment in the Spain-Mexico BIT: "is an expression and part of the bona fide principle recognized in international law, although bad faith from the State is not required for its violation (…)". Also in *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award of 26 June 2003 and *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award of 14 July 2006, the tribunals found that bad faith or malicious intention are not necessary elements in the failure to treat investments fairly and equitably.

34 See M. Kinnear, *supra*, note 6, at p. 225, according to which "Bad faith is not a *sine qua non* of a breach of FET. While bad faith often exists where a tribunal finds a breach of FET, it is entirely possible to have good faith breaches of the obligation".

35 UNCTAD, *supra*, note 7, at p. 9; F. M. Téllez, *supra*, note 12, at p. 432.

legitimate expectations and, therefore, what is to be considered as a legitimate expectation protected under the standard is not univocally determined yet.[36]

Expectations of the investor can qualify as legitimate if they are objectively and subjectively reasonable. This means that first of all, from an objective standpoint, it must be verified whether the expectation is one of a diligent and prudent investor, having taken into account all circumstances surrounding the investment, including the political, socio-economic, cultural and historical conditions prevailing in the host State.[37] Expectations can be considered subjectively legitimate if they do not conflict with the knowledge of that the investor had on the law and the representations made by the host State.

The concept of legitimate expectations is linked to the fact that investments by their very nature are long-term transactions and there comes the risk that conditions of the investment's operations will change negatively affecting the relevant investment during its term. As a general principle, it can be stated that expectations can be considered legitimate if they rely on the stability, predictability and consistency of the host State's legal and business framework existing at the time when the investment was made and at each later moment when a decisive step concerning the investment (such as expansions, developments and reorganizations thereof). However, this cannot imply that a State cannot legitimately change its legal and business framework: protection of legitimate expectations cannot be pushed as to entail a "freeze" of the host State's regulatory system as at the time when the investment (or major decision concerning the same) was made. In addition, it does not prevent the host State from acting in public interest even if such acts adversely affect the investment. The only limit is that changes may not be made in an abusive manner or in bad faith.

The FTA circumscribes the cases when a violation of legitimate expectations shall be deemed to occur thereunder, limiting it to the cases when a specific or unambiguous representation has been made by the host State inducing the investor to make the investment.

In this way, the FTA clarifies that no legitimate expectations may arise exclusively from existing background and regulation if no promises have been made by the host State, and so changes in the law or in the government conduct may not violate legitimate expectations in the absence of promises or assurances by the State. By taking this approach, the FTA aligns with the majority of case-law, whereby no FET violations have been found in lack of specific commitments or promised by the State.[19 April 2015] This approach is also supported by part of the commentators that argued that the doctrine of legitimate expectations can be engaged

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[36] Among others, *Metalclad*, *supra*, note 25; *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award of 12 May 2005; and *Eureko B.V. v. Republic of Poland*, Partial Award of 19 August 2005.

[37] See N. Gallus, *supra*, note 27, at pp. 234 – 235 on how the circumstances of the host State may influence decisions on breach of the investor's legitimate expectations.

exclusively in case the State made a specific representation[38]. It shall be however mentioned that in a recent case the tribunal ruled that legitimate expectations "*need not to be based on an explicit assurance from the Chzech Government', given that the investor could reasonably expect that the Government would act in a consistent and even-handed way*" (the *Saluka* case)[39]. The FTA distances itself from the approach of the *Saluka* case. Referring only to the representations or undertakings of the host State, the FTA is less investor oriented and takes more into account the host State's legitimate regulatory interests.

It is also to exclude that legitimate expectations protected under the FTA include those arising from contracts and licenses. In particular, the State's mere non-performance of an agreement entered into with the investor may not constitute a violation of the FET: indeed, this would mean elevate contractual breach to a treaty breach. In any event the wording of letter (e) of Clause 9.4(2) of the FTA prevents such an interpretation. The case when an act of the regulatory or legislative authority interferes with the investor's rights arising from contract or licences is to be treated differently. Indeed, since the Clause expressly refers to the fact that the representations giving rise to a legitimate expectation must be specific and unambiguous, a breach of the provision of letter (e) there will only be if and to the extent the relevant licence contains a representation of the State not to alter the legal framework so that to deprive, in whole or in part, the investor from its investment. In lack of any such representation, the investor may claim a violation of other components of the FET (e.g., bad faith or discriminatory measure, lack of transparency in the decision making process). Finally, it is not clear from letter (e) of Clause 9.4(2) of the FTA whether the representations giving rise to legitimate expectations are also those not addressed to a particular investor, but made in general manner as to attract investments for a determined sector or industry. Indeed, the Clause only specifies that the representations must come "from a Party" *and shall be able to "induce the investment" and be reasonably relied upon by the investor*. A specific statement made by a representative of the State inducing to invest may be specific and unambiguous although not directly addressed to the specific investor that reasonably relied upon by the investor.[40]

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38 See, among others, S. Fietta, *Expropriation and the "Fair and Equitable" Standard. The Developing Role of Investors' "Expectations" in International Investment Arbitration*, Journal of International Arbitration, 25(3), 2006, pp. 375 – 399, esp. at p. 397. On the contrary, M Kinnear, *supra*, note 6, at p. 228 states that "The weight of authority suggests that an undertaking or promise need not be directed specifically to the investor and that reliance on publicly announced representations or well known market conditions is a sufficient foundation for investor's expectations"; and F. M. Téllez, *supra*, note 12, at p. 441 that believes that a State can violate the investor's legitimate expectations also "altering the legal order upon which the investor relied and/or repudiating or interfering with investor's licence or contract right".

39 See, *supra*, note 12, para. 329.

40 To the contrary, see *PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Electrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5, Award of 19 January 2007, paras. 241-243, whereby it is stated that "Legitimate expectations by definition require a promise of the administration on which the Claimants rely to assert a right that needs to be observed*" and that a general request made by a*

4. Conclusions

Clause 9.4 of the FTA can be considered as a model of FET standard clause in the context of investment treaties or free trade agreements.

Indeed, on the one side, such clause limits to the maximum extent the of the arbitral tribunal, clearly setting out which conducts entails a violation of the standard; other conducts will not be relevant. On the other side, the drafting technicality used in the FTA leaves the door open to interpretation in all cases where necessary, as when for example an exhaustive list of all possible relevant bad faith conducts of a State could not be reasonably listed.

As to the conducts described in the Clause, in addition to those that are nowadays well defined and included in certain investment treaties as examples of breaches of the FET standard, the FTA expressly includes a reference to the protection of legitimate expectations. This is the major innovation of this treaty, since prior to it there were no BITs or free trade agreements referring expressly to investors' legitimate expectations, despite it is considered in the most recent awards as a core indicator as to whether there has been a failure to accord FET. The FTA defines in a precise and quite circumscribed manner when a violation of legitimate expectations protected under the FET standards occurs, requiring a specific or unambiguous representation (i) capable to induce the investment, and (ii) on which the investor reasonably relied upon. Despite its content is very well defined, this provisions may allow different interpretations, for example with respect to where the representation is to be included, or whether it must be made directly to a specific investor or also broadly to all third parties in order to induce investments in the relevant State.

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government to attract new investments should not be understood as a promise by that government to any specific investor.

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