

Kluwer Arbitration Blog

The Emergence of a Consistent Case Law: How NAFTA Tribunals have Interpreted the Fair and Equitable Treatment Standard

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Last week the hearing on jurisdiction and liability in an arbitration between [Bilcon of Delaware et al. and the Government of Canada](#) was streamed live on the website of the [Permanent Court of Arbitration](#) ('PCA'). One of the most disputed issues between the parties in this case is the meaning and the scope of the obligation for NAFTA Parties to provide foreign investors with a fair and equitable ('FET') treatment. This post summarizes the most fundamental findings of NAFTA tribunals regarding Article 1105 in the last 20 years (see, [Patrick Dumberry, *The Fair and Equitable Treatment Standard: A Guide to NAFTA Case Law on Article 1105*](#), Wolters Kluwer 2013).

At the outset, it should be highlighted that the FET standard clause under Article 1105 must be analyzed under specific parameters that do not exist under most other investment treaties. The specificity of Article 1105 is first and foremost the result of the language contained in the provision whereby the NAFTA Parties must accord an FET *under 'international law'* to investors. This feature contrasts with the vast majority of BITs which contain FET clauses that do not make any reference to 'international law'.

In the different context of *unqualified* FET clauses (not referring to international law), there are good reasons to interpret the term FET as an *independent* treaty standard that has a distinct and separate meaning from the minimum standard of treatment ('MST'). Yet, this approach is not convincing in cases where the treaty *explicitly* links the FET standard to 'international law'. Moreover, this approach is simply not sustainable in situations where the parties to a treaty have expressly stated their intention that the FET standard be considered as a reference to the MST under custom. This is clearly the case under NAFTA Article 1105. Thus, under the aegis of the Free Trade Commission ('FTC'), NAFTA Parties responded to three controversial awards that had been rendered in 2000 ([Metalclad](#), [S.D. Myers](#) and [Pope & Talbot](#)) and issued in 2001 its '[Notes of Interpretation of Certain Chapter 11 Provisions](#)' ('Notes'), which clarified that the FET to be accorded under 'international law' constitutes a reference to the MST under custom. The conclusion reached under this subsequent agreement between the Parties regarding the meaning of Article 1105 is also supported by other 'contextual' elements of treaty interpretation, including submissions made by non-disputing Parties (under NAFTA Article 1128), unilateral official statements made by the Parties when NAFTA was being implemented and Model BITs subsequently adopted by the United States and Canada.

How have these particular parameters influenced NAFTA tribunals' interpretation of Article 1105? Three observations will be made.

First, several tribunals have surprisingly challenged the FTC Notes. Thus, faced with a binding interpretation that *restricts* the extent of investors' rights (by linking 'international law' to the MST), several tribunals (including [Pope & Talbot](#), [Mondev](#) and [ADF](#)) have simply 'moved the goal post'. They have thus interpreted custom broadly by emphasizing its evolutionary character, which result in offering investors (at least theoretically) a level of protection *superior* to the treatment under the traditional interpretation of the MST. Yet, it should be noted that the adoption of this 'evolutionary' approach has had no practical impact on the outcome of these cases in terms of liability.

The [Merrill & Ring](#) tribunal later took this 'evolutionary' approach to the extreme by adopting the so-called theory of 'convergence'. Under this controversial theory, the level of treatment to be accorded to foreign investors under the MST has apparently evolved so rapidly in recent years that it is now said to be the same as that existing under BITs containing an unqualified FET clause. As further explained in my [book](#), the tribunal's reasoning on this point is flawed for many reasons; it also represents a direct challenge to the FTC Note. It is true that other tribunals ([Glamis](#), [Cargill](#)) have, on the contrary, concluded that no evidence had been presented to establish that current customary international law had moved beyond the MST. Yet, the [Glamis](#) tribunal also added that what is considered today as 'egregious' and 'shocking' has changed since the 1920s. As a result, the practical difference between the reasoning adopted by the *Glamis* tribunal and that of others may be more apparent than real.

The second observation is that while under the specific parameters of Article 1105 the FET standard must be considered as *one of the elements* included in the umbrella concept of the MST, the concept of the FET standard is not an 'empty box' and is *itself* comprised of different elements. NAFTA case law suggests that only the prohibition of arbitrary conduct, denial of justice and the obligation of due process are unambiguously stand-alone elements of the FET obligation under Article 1105. These findings illustrate the extent to which Article 1105 is significantly different from unqualified FET clauses found in most BITs. Thus, non-NAFTA tribunals have been increasingly willing to recognize new requirements as components of the ever-enlarged concept of FET. Prime examples of such new 'requirements' recognized by these non-NAFTA tribunals are the obligation to provide a stable and predictable business environment and transparency as well as the obligation to protect an investor's legitimate expectations.

NAFTA tribunals have adopted a much more narrow interpretation of the FET standard. For instance, for all NAFTA tribunals (except for [Glamis](#)), the host State's failure to respect an investor's legitimate expectations does *not* constitute a breach of the FET standard under Article 1105, but is rather a 'factor' to be taken into account when assessing whether or not *other well-established* elements of the standard have been breached (see, [Mobil](#)). Another notable unique feature of NAFTA case law is the fact that tribunals have repeatedly narrowly qualified the concept of legitimate expectations. They have thus required that an investor's expectations be *objective* and be based on 'definitive, unambiguous and repeated' specific 'commitments' (or 'assurances') made by the host State to have 'purposely and specifically induced the investment' by the investor ([Glamis](#), paras. 766-767, 801-802). NAFTA tribunals have also concluded that legitimate expectations *cannot* simply be based on the host State's existing domestic legislation on foreign investments at the time when the investor makes its investment. The [Glamis](#) award thus emphasized the *threshold* requirement of a *quasi-contractual* relationship between the investor and

the host State. Lastly, no NAFTA tribunal has ever read into the FET standard an obligation for the host State to maintain a stable legal and business environment.

Similarly, no NAFTA tribunal (except for the [Metalclad](#) award which was, however, set aside in judicial review before a [B.C. Court](#) precisely with regards to this point) has concluded that the concept of transparency is a stand-alone obligation under Article 1105. Finally, while a number of NAFTA tribunals ([Methanex](#), [Grand River](#)) have come to the conclusion that nationality-based discrimination is not covered by Article 1105, the reasoning of other tribunals ([Waste Management](#), [Glamis](#), and to a lesser extent that of [Methanex](#)) can be interpreted as suggesting that Article 1105 covers some types of specific ‘discrimination’ (other than nationality-based), such as ‘sectional or racial prejudice’. Case law remains unsettled on this point.

Our third observation is that NAFTA tribunals ([Glamis](#), [Cargill](#), [Waste Management](#), [ADF](#), [Thunderbird](#)) have emphasized the high threshold of severity and gravity that is required in order to conclude that the host State has breached any of the elements contained within the FET standard under Article 1105. The existence of such a high threshold is clear given NAFTA tribunals’ consistent use of qualifiers such as ‘manifest’, ‘gross’, ‘evident’, ‘blatant’, ‘wholly’ and ‘complete’. The [Merrill & Ring](#) tribunal is the only one to have adopted a much lower threshold whereby the FET standard ‘protects against all such acts or behavior that might infringe on a sense of fairness, equity and reasonableness’ (para. 201, 213). The concrete consequence of the consistent application of this high threshold of liability by NAFTA tribunals (except for one) is that very few of them have come to the conclusion that the host State has violated Article 1105. In fact, only one case ([Cargill](#)) involved a substantial amount of compensation awarded to an investor (USD 77 million, also covering for breaches of Articles 1102 and 1106).

In sum, the specific parameters under which the FET standard must be interpreted under Article 1105 have resulted in tribunals finding that (1) only a limited number of elements are part of the FET obligation under this provision and (2) a high threshold of severity and gravity is required in order to conclude that the host State has breached any one of these elements. The specific features of Article 1105 and the manner in which NAFTA tribunals have narrowly interpreted the FET standard mean, in turn, that many of the findings contained in my [book](#) are not easily transferable and applicable to tribunals interpreting *unqualified* FET clauses. Yet, the conclusions drawn from NAFTA case law do apply to FET clauses containing language similar to that of Article 1105.

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