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Chapter 3: The Substantive Content of Article 1105

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This chapter examines the content of the FET standard under Article 1105. Before specifically reviewing how NAFTA tribunals have defined the actual scope of the standard (at section §3.02), we will first make a few observations on the important role played by arbitral tribunals in that respect (section §3.01[A]). We will also briefly examine the manner in which different scholars have determined the various 'elements' that comprise the FET standard (section §3.01[B]).

§3.01 General Remarks

[A] The Critical Role Played by Tribunals in Determining the Content of the Fair and Equitable Treatment Standard

As mentioned above, (1) the obligation for NAFTA Parties to provide foreign investors with an FET does not simply mean that they must be treated 'fairly' and 'equitably'. The concept of FET has a distinct meaning *of its own*. At the same time, the standard is flexible and depends on the circumstances of each case. (2) Its inherent flexibility results from the fact that it is a '*standard*'. (3) The concept of a 'standard' in international
P 128 investment law has recently been examined by scholars. (4) As stated by the *Waste Management* tribunal, the FET standard 'is to some extent a flexible one which must be adapted to the circumstances of each case'. (5) The *Mondev* tribunal also came to the conclusion that '[a] judgment of what is fair and equitable cannot be reached in the abstract; it must depend on the facts of the particular case. It is part of the essential business of courts and tribunals to make judgments such as these'. (6)

Although the inherent flexibility of the FET standard leaves tribunals with a certain margin of discretion, it is not an *unlimited* one. (7) This important nuance has been recognized by NAFTA tribunals. The *Mondev* tribunal, for instance, referred to the position of the United States in its pleadings to the effect that 'Article 1105(1) did not give a NAFTA tribunal an unfettered discretion to decide for itself, on a subjective basis, what was "fair" or "equitable" in the circumstances of each particular case'. (8) For the United States, 'while possessing a power of appreciation', it remains that a NAFTA tribunal was 'bound by the minimum standard as established in State practice and in the jurisprudence of arbitral tribunals' and therefore 'could not simply adopt its own idiosyncratic standard of what is "fair" or "equitable", without reference to established sources of law'. (9) The *Mondev* tribunal fully endorsed the following proposition: '[t]he Tribunal has no difficulty in accepting that an arbitral tribunal may not apply its own idiosyncratic standard in lieu of the standard laid down in Article 1105 (1)'. (10) In other words, NAFTA tribunals' discretion is limited by the requirement to apply the minimum standard of treatment existing under custom.

It may be argued that some NAFTA tribunals have in fact applied their very own idiosyncratic version of the FET standard, detached from the requirements found in the text of the provision and the FTC Note. This is certainly the case with both the *Merrill & Ring* and *Pope & Talbot* tribunals.

Tribunals play a critical role in determining the substantive content of the FET standard
P 129 precisely because of the flexible nature of the standard. (11) Some scholars have argued that when an arbitral tribunal has to interpret a broad provision, to fill gaps, and to clarify ambiguities in a provision such as the FET standard, its role is not limited to the *interpretation* and *application* of the law created by others (the States). (12) In fact, in these circumstances, tribunals have a *creative* role in determining the very content of international law. (13) For Schill, FET clauses are an example of a 'fundamental shift in power from States to arbitral tribunals' whereby 'substantial rule making power' has, in effect, been transferred to tribunals whose 'function is not restricted to applying pre-existing rules and principles to the facts of a case, but extends to developing the existing principles into more precise rules and standards of conduct'. (14) Brower speaks of the FET clause as an 'intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules necessary to achieve the treaty's object and purpose in particular disputes'. (15) This important function has also been recognized by tribunals themselves. In this light, the *Saluka* tribunal has explained that the standard was 'susceptible of specification through judicial practice' by other tribunals. (16) The *Enron* tribunal also stated that the evolution of the FET standard that had taken place in recent years 'is for the most part the outcome of a case by case determination by courts and tribunals'. (17) Yet, as mentioned above, NAFTA tribunals have a much narrower margin of discretion on these matters as a result of the contextual elements examined in the previous chapter.

But how have tribunals actually used their 'creative' role in the context of the FET clause?

above, the *Waste Management* tribunal also referred to the same three basic points ('breach of representations made by the host State which were reasonably relied on by the claimant'). (246) As subsequently pointed out by the *Mobil* tribunal, (247) these different statements suggest that a legitimate expectations claim requires the following *four elements*:

- Conduct or representations have been made by the host State.
- The claimant has relied on such conduct or representations to make its investment.
- Such reliance by the claimant on these representations was 'reasonable'.

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- The host State subsequently repudiated these representations therefore causing damages to the investor. (248)

Sixth, subsequent NAFTA tribunals have all followed these four requirements. They have also continued to further *qualify* and *narrowly* define these requirements. The most significant development came three years later in 2009 when the *Glamis* tribunal rendered its award. This award is important for having greatly clarified the scope of an investor's legitimate expectations as protected under Article 1105. In its ruling, the tribunal reiterated *Thunderbird*'s proposition that an investor's expectations must be 'reasonable and justifiable'. The requirement is also recognized by other non-NAFTA awards. (249) What is 'reasonable' of course will depend on the circumstances of the case. (250)

The *Glamis* award also clarified three fundamental aspects of the concept of legitimate expectations. First, the expectations must be *objective*. Other tribunals have come to the same conclusion. (251) As pointed out by one writer, the investor's expectations 'must be objective and reasonable, rather than subjective or held by one party alone'. (252) This means that an investor 'takes the law of the host State as it finds it and cannot subsequently complain about the application of that law to its investment'. (253) The reasonableness of an investor's expectations is therefore a function of its actual knowledge of the general regulatory framework and political and economical environment of the country in which it plans to invest. (254) The *Duke* tribunal speaks of a requirement to take into account 'all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic cultural and historical
P 166 conditions prevailing in the host State'. (255) In other words, an investor must assess ● and bear the risk associated to the business it intends to conduct. (256) Case law requires a high degree of due diligence from investors. (257)

The second clarification made by the *Glamis* award is that expectations must be based on *specific* 'definitive, unambiguous and repeated' *assurances* or *commitments* made by the host State to the investor. Non-NAFTA tribunals have also highlighted the requirement of specific representations. (258) As pointed out by Fietta, 'the more specific the assurances that are given, the more likely they are to give rise to some basis for a legitimate expectations-based claim'. (259) The additional qualification mentioned by the *Glamis* tribunal that representations be not only specific, but also 'definitive, unambiguous and repeated' suggests the adoption of an even narrower interpretation of the concept of legitimate expectations. A third qualification made by the *Glamis* award is the fact that any assurances given by the host State to the investor must have been made 'purposely and specifically' to have 'induced' its investment. This qualification has the effect of further narrowing down the scope of application of the concept of legitimate expectations under Article 1105.

Seventh, under Article 1105, legitimate expectations *cannot* be based simply on the host State's existing domestic legislation on foreign investments at the time when the investor makes its investment. This is clear from the *Glamis* award's emphasis on a *threshold* requirement of a *quasi-contractual* relationship between the investor and the host State. Other NAFTA tribunals have also adopted the same position.

Thus, the *Grand River* tribunal held that *general legislation* could not be the source of legitimate expectations, which requires *specific* assurances by the government. (260) The tribunal noted that the 'conduct' of the United States said to be giving rise to some expectations were in fact an international treaty (the Jay Treaty) and its own domestic legislation (U.S. federal Indian law). (261) The tribunal was reluctant to admit that these instruments could 'serve as sources of reasonable or legitimate expectations for the
P 167 purposes of a NAFTA claim'. (262) Thus, it explained that '[o]rdinarily, reasonable ● or legitimate expectations of the kind protected by NAFTA are those that arise through *targeted representations or assurances* made explicitly or implicitly by a state party'. (263) The tribunal concluded that these instruments could not 'serve as sources of reasonable or legitimate expectations for the purposes of a NAFTA claim'. (264) This is because the investor could not have reasonably relied on the unsettled legal framework of the U.S. federal Indian law to create any expectations. (265) Similarly, the reasoning of the *ADF* tribunal suggests that an investor's legitimate expectations cannot be generated by its sole reliance on domestic *case law* when it decides to make its investment. (266) Thus, the tribunal emphasized upon the requirement of *misleading* representations made by *authorized officials* about such case law. In other words, 'mere silence or evasive statements do not suffice and will not generate legitimate expectations with regard to the status of the law'. (267)

outcome which offends judicial propriety'. (368) In other words, the *Waste Management* tribunal considered that lack of transparency is relevant in order to determine whether a State has breached its due process obligation.

P 180 The position adopted by all post-*Metalclad* tribunals is fitting with that of all of the NAFTA Parties which have repeatedly rejected the view that the FET standard ● under Article 1105 includes any obligation of transparency. (369) Mexico, (370) Canada, (371) and the United States all made such a submission when acting as respondents in proceedings. (372) It is noteworthy in this context that BITs recently entered into by Canada include a transparency obligation in a distinct provision (i.e., separate from the FET clause). (373) The 2004 US Model BIT also includes two transparency-related provisions. (374) However, these instruments expressly exclude any recourse to investor-State arbitration for matters arising from a breach of such transparency obligations. (375)

The conclusion reached by NAFTA tribunals that Article 1105 does not include any obligation of transparency is in sharp contrast with that prevailing under BITs outside of the NAFTA context where tribunals have recognized that transparency is an element of the FET standard. (376) As mentioned above, a number of non-NAFTA tribunals have also found that the stability and predictability of the legal framework is an essential element of the FET standard. (377) Some of these tribunals have mentioned that this stability requirement also includes an obligation of transparency. (378) On the contrary, in the

P 181 context of NAFTA, the *Mobil* tribunal concluded that it had 'not been ● provided with any material to support the conclusion that the rules of customary international law require a legal and business environment to be maintained or set in concrete'. (379)

[D] Arbitrary Conduct

[1] Defining Arbitrariness

The objective of the present section is not to examine the origin and development of the concept of arbitrariness under international law in exhaustive detail. This exercise has already been undertaken by a number of scholars. (380) Arbitrariness is a multifaceted term that has different meanings depending on the context surrounding it. In legal terms, *Black's Law Dictionary* defines 'arbitrary' as a conduct 'founded on prejudice or preference rather than on reason or fact'. (381) This definition has been adopted by several investor-State arbitration tribunals. (382) In its 2012 study, (383) UNCTAD put forward the following definition in the context of international investment law:

> In its ordinary meaning, 'arbitrary' means 'derived from mere opinion', 'capricious', unrestrained', 'despotic'. Arbitral conduct has been described as 'founded on prejudice or preference rather than on reason or fact'. Arbitrariness in decision-making has to do with the motivations and objectives behind the conduct concerned. A measure that inflicts damage on the investor without serving any legitimate purpose and without a rational explanation, but that instead rests on prejudice or bias, would be considered arbitrary. (384)

The classic definition of arbitrary conduct in international law was enunciated by the ICJ in its 1989 *ELSI* case. (385) It involved allegations of mistreatment in the context of a requisition by an Italian mayor of a factory owned in part by American investors, which was contrary to the 1948 U.S.-Italy Treaty of Friendship, Commerce and Navigation specifically prohibiting arbitrary measures. In deciding the issue in favor of Italy, the

P 182 Court addressed the notion of arbitrariness in two oft-cited passages: ●

> by itself, and without more, unlawfulness cannot be said to amount to arbitrariness...To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. Nor does it follow from a finding by a municipal court that an act was unjustified, or unreasonable, or arbitrary, that that act is necessarily to be classed as arbitrary in international law, though the qualification given to the impugned act by a municipal authority may be a valuable indication (...). (386)
>
> Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the Asylum case, when it spoke of 'arbitrary action' being 'substituted for the rule of law' (Asylum, Judgment, I.C.J. Reports 1950, p. 284). It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety. (387)

The Court therefore applied a high threshold of liability for finding a breach of arbitrary conduct (i.e., 'wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety'). The decision has been criticized by some writers not only for the vagueness of the standard it enunciates, (388) but also for its lack of relevance as a precedent in the context of the FET standard. (389) Yet, it remains that this definition has been endorsed by numerous investor-State tribunals. (390)

Case law suggests that there is 'substantive' (391) arbitrariness when no rational relationship exists between a measure adopted by the government and the alleged

equitable treatment standard of Article 1105 that they do not treat investors of another State in a *manifestly* arbitrary manner'. (547) As mentioned above, it is true that a number
P 201 of other tribunals have referred to the concept of arbitrariness in the context of their analysis of denial of justice (*Azinian*, (548) *Mondev* (549)). Still, these few tribunals ● have not rejected the proposition that the prohibition of arbitrariness is a stand-alone obligation under Article 1105.

Fourth, the main reason why NAFTA tribunals have been so keen on stating that arbitrary conduct is a stand-alone element of the FET standard is because Article 1105 does not contain any specific reference to the prohibition of arbitrary (or discriminatory) treatment. (550) Non-NAFTA tribunals that have interpreted similarly-drafted FET clauses (containing no express reference to arbitrariness) have also concluded that the prohibition of arbitrariness is one of the elements of the FET standard. (551) This is also the dominant opinion of authors. (552) It should be noted, however, that others have treated arbitrariness as a component of the denial of justice/due process category. (553)

This specific feature of NAFTA contrasts with that of a great number of BITs that include an FET clause containing additional substantive content, such as specific prohibition of arbitrary, unreasonable and discriminatory measures. (554) The present author's own survey of 365 BITs has shown that this is the case for 197 of them. (555) Parties include such language to be 'more precise about the content of the FET obligation and more predictable in its implementation and subsequent interpretation'. (556) The inclusion of the word 'arbitrary' in such a clause is largely perceived as redundant since the FET standard includes a prohibition of arbitrariness. (557) This is why some tribunals have applied these two standards together interchangeably. (558)

In addition to containing an FET clause, a number of BITs are comprised of *another distinct* stand-alone non-impairment clause explicitly prohibiting 'arbitrary', 'unjustified'
P 202 'unreasonable' or 'discriminatory' measures (sometimes in conjunction ● with one or the other ('and') and other times disjunctively ('or') (559)). (560) Tribunals have interpreted clauses of this nature inconsistently. (561) While a number of tribunals have examined the FET standard clause and the arbitrary measure clause separately, (562) others have applied these two standards in close conjunction. (563) The real impact of a specific prohibition of arbitrary measures in a provision distinct from the FET clause is also controversial amongst scholars. Several opine that there is essentially no substantive difference between the two clauses insofar as a measure violating a stand-alone arbitrary clause would necessarily also violate the arbitrary element of an FET clause. (564) Others consider that the fact that a BIT contains two distinct provisions is evidence of the existence of different types of violations. (565) As such, while a violation of the non-impairment standard would amount to a violation of the FET standard, (566) 'the finding that the non-impairment obligation has not been breached does not necessarily mean that the FET standard has not been breached either'. (567) In any event, this debate is not relevant in the context of NAFTA which does not contain any distinct clause prohibiting arbitrary conduct.

Fifth, it is noteworthy that the position of NAFTA Parties has evolved over time with respect to the issue of whether or not arbitrary conduct is a stand-alone element of the FET standard under Article 1105. For instance, Canada's traditional position has been to the effect that arbitrariness is not an independent source of obligation under Article 1105; it is only relevant for the interpretation of other elements that are part of the customary
P 203 international minimum standard, such as denial of justice. (568) While ● Canada took the same stance (as a matter of principle) in *Merrill & Ring*, (569) it also put forward a fall-back position emphasizing the high threshold of liability for arbitrariness under the minimum standard of treatment. (570) The final stage of the evolution of Canada's view on this issue seems to have been completed in the recent cases of *Gallo* (571) and *Mobil*. (572) In these recent cases, Canada no longer denies that arbitrary conduct is an element of the FET standard under Article 1105, but instead emphasizes the requirement that such conduct be *manifestly* arbitrary.

The evolution of the United States' viewpoint on this issue is similar. In earlier cases, it systematically argued that there was no general obligation to refrain from 'arbitrary' conduct under Article 1105. (573) In recent cases, the United States has continued to maintain this basic argument, (574) but added that 'if there is an obligation for a State to not act arbitrarily', (575) a high threshold would nevertheless apply to consider arbitrariness as a violation of Article 1105. (576) In contrast, Mexico has consistently acknowledged that arbitrariness is one of the elements of the FET standard under Article 1105 (577) and that the threshold to establish arbitrariness is high. (578)

Sixth, the threshold applied by NAFTA tribunals in order to establish a finding of arbitrariness has been consistently high. This restrictive interpretation results from
P 204 tribunals adopting the standard set out by the ICJ in *ELSI* requiring, *inter alia*, that a ● finding of arbitrariness 'shocks, or at least surprises, a sense of juridical propriety'. (579) Similar wording has been used by earlier NAFTA tribunals, including *S.D. Myers* (referring to treatment that 'rises to the level that is unacceptable from the international perspective' (580)), *Waste Management* (speaking of '*wholly* arbitrary' conduct (581)) and *Thunderbird* (requiring proof of 'manifest arbitrariness falling below international standards' (582)). The *Thunderbird* award was the first one to set the threshold level at 'manifest arbitrariness' (although its reasoning was made in the different context of

an assertion that, as part of the duty prescribed by Article 1105 to not act arbitrarily, there is a duty to not unfairly target a particular investor, whether based upon nationality or some other characteristic'. (720) The tribunal therefore examined this discrimination-related allegation in the context of arbitrariness. (721) Yet, it is significant that throughout the award, the tribunal nevertheless referred some eleven times to the terms 'evident discrimination' alongside other elements of the FET standard such as denial of justice, arbitrariness and due process. (722) The consistent repetition of this expression strongly suggests that the *Glamis* tribunal was of the view that some types of 'discrimination' (other than nationality-based) are covered by Article 1105. The present author believes that this is indeed the case.

[F] Good Faith

Good faith has been described by the ICJ as 'one of the basic principles governing the creation and performance of legal obligations' in international law. (723) It is also a central principle in the context of international investment law. (724) It has been argued
P 223 by ● scholars (725) and tribunals (726) that the FET standard is in fact an expression of the principle of good faith. The principle of good faith is also considered by many as a 'guiding principle' to determine whether or not a breach of the FET standard has been committed by the host State. (727) What is clear is that good faith is not an autonomous stand-alone obligation under the FET standard (like arbitrariness or denial of justice). (728) The ICJ has also come to the conclusion that the principle of good faith is 'not in itself a source of obligation where none would otherwise exist'. (729)

In the context of NAFTA arbitration, some investors seem to argue that the principle of good faith should be considered as a stand-alone obligation under the FET standard. (730) NAFTA Parties have consistently opined that Article 1105 does not impose any free-standing, substantive obligation of good faith. (731) NAFTA tribunals have all concluded that the principle of good faith is not a stand-alone obligation under the FET standard, but rather a guiding principle relevant to determine whether a breach of Article 1105 has been committed. An illustration of this position can be found in the separate opinion of Wälde in the *Thunderbird* case where he speaks of good faith as a 'guiding principle' 'for applying' the FET standard under Article 1105. (732)

In *ADF*, the claimant maintained that the United States had 'violated its Article 1105(1) obligation by failing to perform its NAFTA obligations in good faith' (733) and that 'the principle of good faith performance has clearly attained the status of customary
P 224 international law and is subsumed in the Article 1105(1) obligations undertaken by the ● U.S. in respect of investors and their investments'. (734) The tribunal was unconvinced and stated that '[a]n assertion of breach of a customary law duty of good faith adds only negligible assistance in the task of determining or giving content to a standard of fair and equitable treatment'. (735)

In *Waste Management*, the tribunal dealt with allegations of arbitrary conduct and denial of justice. The tribunal framed the denial of justice allegation as follows: 'Acaverde was subjected to a denial of justice at the hands of the City, Guerrero and Banobras, which conspired to obstruct its access to judicial and arbitral forums to resolve claims under the concession (...).' (736) The tribunal made the following comment regarding the allegation of conspiracy:

> The Tribunal has no doubt that a deliberate conspiracy—that is to say, a conscious combination of various agencies of government without justification to defeat the purposes of an investment agreement—would constitute a breach of Article 1105(1). A basic obligation of the State under Article 1105(1) is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means. (737)

The tribunal clearly does not refer to good faith as a stand-alone obligation under Article 1105. The award has nevertheless been interpreted by some as supporting the proposition that the 'obligation to act in good faith [is] a basic obligation under the FET standard as contained in Article 1105 of the NAFTA' and that 'in particular, a deliberate conspiracy by government authorities to defeat the investment would violate this principle'. (738)

The *Merrill & Ring* tribunal has seemingly taken a different approach. The tribunal was quite reluctant to accept Canada's argument that good faith was not a stand-alone element of the FET standard under Article 1105. In any event, it concluded that good faith was a 'general principle of law' and that 'no tribunal today could be asked to ignore th[is] basic obligation [...] of international law'. (739) The *S.D. Myers* tribunal also referred to good faith in a rather ambiguous way. (740)

Numerous tribunals (741) and scholars (742) have also generally recognized, on the one
P 225 hand, that an investor does not have to show that the host State has acted in bad faith ● in order to prove the commission of a violation of the FET standard. Thus, a breach of the FET standard may occur even if the host State has acted in good faith. The same conclusion was reached by all NAFTA tribunals. (743) On the other hand, tribunals (744) and scholars (745) have recognized that the fact that the host State acted in bad faith is indicative of the existence of a breach of the FET standard. The *Glamis* tribunal also came

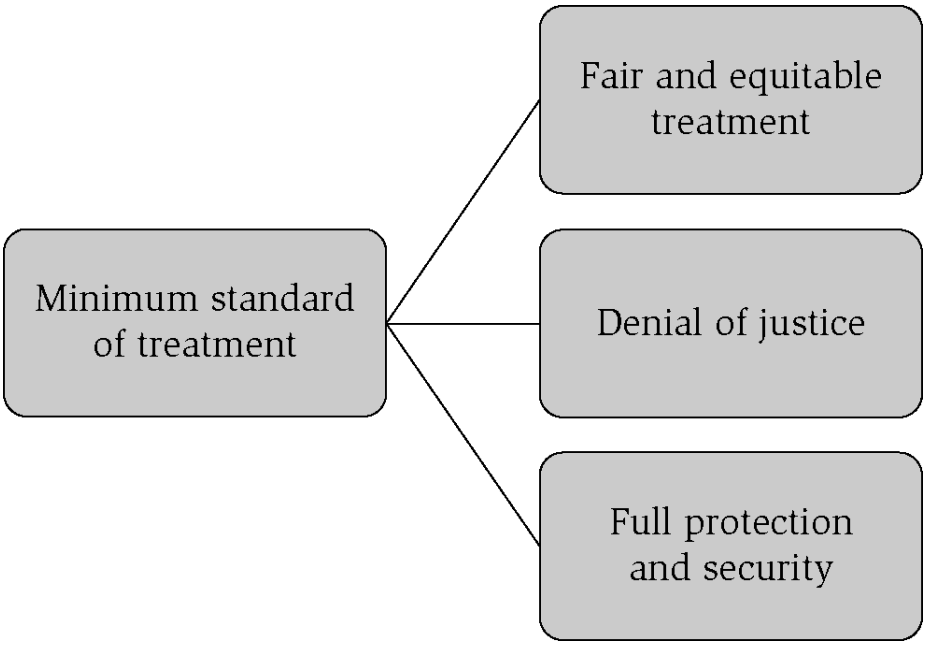
to the same conclusion. (746)

[G] Denial of Justice and Due Process

[1] Interaction between Denial of Justice, the Fair and Equitable Treatment and the Minimum Standard of Treatment

As mentioned above, (747) under NAFTA Article 1105 the FET standard must be considered as one of the elements included in the umbrella concept of the minimum standard of treatment. This is clear from the fact that the text of the provision requires States to provide foreign investors with a treatment consistent with 'international law' (a reference to the minimum standard of treatment as reaffirmed by the FTC Note (748)), *including* FET. This is also the approach adopted by NAFTA tribunals, including *Waste Management*
P 226 (749) and *Cargill*. (750) Where does the concept of 'denial of justice' fit in this ● picture? In the *specific context* of NAFTA Article 1105, the issue can be examined through two different perspectives.

First, the obligation not to deny justice can be considered as one of the many principles existing under the minimum standard of treatment under customary international law. The prohibition of denial of justice is indeed widely recognized by scholars, (751) the OECD, (752) and UNCTAD (753) as being part of custom. Under this scenario, the obligation not to deny justice would exist for States under the minimum standard of treatment alongside other principles such as the obligation to provide foreign investors with a FET as well as full protection and security. The first scenario can be illustrated by the following simple graph:



Second, the obligation not to deny justice can also be envisaged as one of the many elements comprising the obligation for States to provide foreign investors with the FET standard. There is a consensus amongst scholars to that effect that the obligation not to
P 227 deny justice is certainly one of the elements of the FET standard. (754) ● Several NAFTA tribunals have concluded as such, including *Mobil*, (755) and *Waste Management*. (756) The inclusion of denial of justice as one of the elements of the FET standard is also clear from the 2004 US Model BIT, (757) as well as a number of recent of FTAs entered into by the United States. (758) Under this scenario, this obligation would exist under the FET standard alongside other elements (such as the prohibition of arbitrary conduct). This hypothesis can be illustrated as follows:

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means and the end of this requirement' other than to persuade the US government to change its trade policy. (1041) In other words, it is precisely because the measures were undoubtedly egregious that they were not considered to have been adopted by Mexico for any legitimate purpose. As a consequence, the *Cargill* tribunal did not have to carry out the three-step analysis of the proportionality test.

Third, at first glance, the reading of the above-mentioned passages extracted from the four awards (*Waste Management, Glamis, Cargill* and *Mobil*) suggests that a great number of elements have been recognized constituents of the definition of the FET standard under Article 1105. A closer examination of NAFTA case law in fact shows that NAFTA tribunals have been much more restrained. Out of the large number of elements that are typically enumerated by writers as components of the FET standard, NAFTA tribunals have found that only a few of them are actually covered by Article 1105. (1042) In this respect, NAFTA case law sharply contrasts with the position adopted by non-NAFTA tribunals. Thus, non-NAFTA tribunals have been increasingly willing to recognize new requirements as components of the ever-enlarged concept of the FET. (1043) Prime examples of such new 'requirements' recognized by these 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.

The next paragraphs will summarize this chapter's findings regarding the six principles which were specifically examined.

Legitimate expectations. Thus far, no NAFTA tribunal has found that a host State stood in
P 265 violation of an investor's legitimate expectations under Article 1105. The ● *Glamis* award (1044) (and to some extent the *Thunderbird* award (1045)) are the only ones that support the view that the concept of legitimate expectations constitutes a stand-alone element of the FET standard under Article 1105. Yet, these tribunals have not actually demonstrated the customary nature of the concept of legitimate expectations.

In the present author's view, the *Mobil* tribunal (as well as the *Waste Management* (1046) and *Cargill* (1047) tribunals) adopted a more convincing approach. They have held that the host State's failure to respect an investor's legitimate expectations does not constitute a breach of the FET standard, 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. (1048) These tribunals have thus endorsed the NAFTA Parties' position to the effect that the so-called 'obligation' to protect an investor's legitimate expectations is not a component of the customary international law minimum standard of treatment. In the present author's view, there is indeed little evidence to support the assertion that there exists under custom an obligation for host States to protect investors' legitimate expectations. Scholars have also interpreted the concept of legitimate expectations as a general principle of law based on its recognition in many domestic legal systems. This argument is of limited relevance in the specific context of Article 1105. This is because the binding FTC Note is clear to the effect that NAFTA tribunals should look *solely* to custom as a source of international law in their interpretation of Article 1105, and not at general principles of law. The position adopted by the majority of NAFTA tribunals contrasts with that of many tribunals outside NAFTA that have recognized that the FET standard encompasses an obligation to protect an investor's legitimate expectations.

Moreover, NAFTA tribunals have repeatedly narrowly qualified the concept of legitimate expectations in order to significantly reduce its scope of protection.

For instance, unlike non-NAFTA tribunals, NAFTA tribunals (with the possible exception of *Merrill & Ring* (1049)) have not pinpointed an obligation to maintain a stable legal and business framework under Article 1105. All NAFTA tribunals that have examined the concept have endorsed the four-elements definition of legitimate expectations adopted by the *Thunderbird* tribunal: (1) conduct or representations have been made by the host State; (2) the claimant has relied on such conduct or representations to make its
P 266 investment; (3) such reliance by the claimant on these representations was ● 'reasonable'; and (4) the host State subsequently repudiated these representations therefore causing damage to the investor. Another manifestation of a much narrower approach favored by NAFTA tribunals is the fact that they have continued to further restrictively *qualify* these four requirements in subsequent awards. Thus, the *Glamis* award (subsequently endorsed by other tribunals: *Cargill,* (1050) *Mobil,* (1051) and *Grand River* (1052)) required that an investor's expectations be *objective* and be based on 'definitive, unambiguous and repeated' (1053) specific 'commitments' (1054) (or 'assurances' (1055)) made by the host State to have 'purposely and specifically induced the investment' (1056) by the investor.

Similarly, no NAFTA tribunal has held that legitimate expectations can be protected without any *specific* representations made by the host State. 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. For instance, the *Glamis* award emphasized the threshold requirement of a *quasi-contractual* relationship between the investor and the host State. This situation contrasts with that of non-NAFTA tribunals that have held that legitimate expectations can be protected *without any specific* representations made by the host State. The *Mobil* tribunal clearly stated that no violation of Article 1105 occurs as a result of the host State

changing its regulation (even drastically) upon which the investor may have based its expectations when it made its investment. The *Glamis* award also confirmed that an investor's expectation is not violated by the mere fact that the host State has breached a contract.

Transparency. All NAFTA tribunals that have examined the concept of transparency (*Glamis*, (1057) *Merrill & Ring*, (1058) and *Cargill* (1059)) have come to the conclusion that it is *not* a stand-alone element of the FET standard and that it does not impose any obligation on host States under Article 1105. The only exception is the *Metalclad* award (1060) which was, however, set aside in judicial review before a B.C. Court precisely with regards to this point. (1061) The concept of transparency is relevant to aid tribunals in assessing whether or not *other established* elements of the FET standard (such as due process (1062)) have been breached by a State. On the contrary, a number of non-NAFTA
P 267 tribunals have found that the stability and predictability of the legal ● framework, including an obligation of transparency, is an essential element of the FET standard.

Arbitrary conduct. Several tribunals (*Thunderbird*, (1063) *Waste Management*, (1064) *Mobil*, (1065) *Merrill & Ring* (1066)) have come to the conclusion that there exists an obligation for host States prohibiting arbitrary conduct under the minimum standard of treatment under custom. Yet, none of these tribunals have undertaken an examination of State practice and opinio juris on the matter. All NAFTA tribunals have listed the prohibition of arbitrary conduct as a stand-alone element of the FET standard under Article 1105. (1067) It is noteworthy that the NAFTA Parties' position has evolved over time. They no longer deny that arbitrary conduct is an element of the FET standard under Article 1105, but instead emphasize the requirement that such conduct be *manifestly* arbitrary.

The threshold of severity applied by NAFTA tribunals has been consistently high. Tribunals have thus referred to treatment that 'rises to the level that is unacceptable from the international perspective', (1068) to '*wholly* arbitrary' conduct, (1069) and to 'manifest arbitrariness falling below international standards'. (1070) For instance, the *Glamis* tribunal stated that Article 1105 'requires something greater than mere arbitrariness, something that is surprising, shocking, or exhibits a manifest lack of reasoning' (1071) and sets the threshold of liability at 'manifest arbitrariness'. (1072) The application of such a high threshold of liability by most NAFTA tribunals (1073) largely explains why they (except for *Cargill*) have not found arbitrary conduct to amount to a breach of Article 1105. Non-NAFTA tribunals have, on the contrary, often found violations of arbitrariness based on a lower threshold of liability.

In light of case law, a number of conclusions can be reached concerning the contours of this prohibition of arbitrary conduct. A government's failure to implement or to abide by its own laws and regulations does not amount to an arbitrary act unless it can be shown that the government committed a maladministration that amounts to an 'outright and
P 268 unjustified repudiation' of such laws and regulations. (1074) Similarly, a ● mere contractual breach does not amount to an arbitrary act, unless it can be shown that the government committed an 'outright and unjustified repudiation of the transaction' or that the breach was 'motivated by sectoral or local prejudice'. (1075) A government's 'inconsistent' or 'questionable' application of its own policy or procedure (or the fact that it made a mistake in its application) does not amount to an arbitrary act. (1076) The fact that a governmental measure is illegal under domestic law does not necessarily make it arbitrary in violation of the FET standard under Article 1105. A violation of this provision occurs when there is a 'manifest lack of reasons for the legislation' such as when the legislation bears no rational relationship with its stated purpose, when it is not 'reasonably drafted to address its objectives,' (1077) or when a governmental measure is adopted with the express intention to injure and cause damage to an investor's investment.

Discriminatory conduct. With the exception of *Merrill & Ring*, (1078) other NAFTA tribunals (*Methanex*, (1079) *Grand River*, (1080) *Glamis* (1081)) have come to the conclusion that nationality-based discrimination is not covered by Article 1105 and that customary international law contains no general prohibition of discrimination against foreign investors. Moreover, the *Grand River* tribunal added that the minimum standard of treatment applies to *all investors* (by definition) and therefore denied the existence of any custom rule prohibiting discrimination specifically against indigenous peoples. The reasoning of some NAFTA tribunals (*Waste Management,* (1082) *Glamis,* (1083) 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'. (1084) Case law is unsettled on this point.

Good faith. NAFTA tribunals have all concluded that the principle of good faith is not a stand-alone obligation under the FET standard, but rather a guiding principle that is relevant to the determination of whether or not a breach of Article 1105 has occurred.
P 269 (1085) They have also concluded that an investor does not have to show that the ● host State has acted in bad faith to prove a violation of the FET standard. (1086) Yet, proof of bad faith would be conducive to a finding of a breach of the FET standard. (1087)

Denial of justice and due process. All NAFTA tribunals have held that there exists an obligation not to deny justice and to respect due process under Article 1105. (1088) In light of case law, a number of conclusions can be reached with respect to the parameters