New York City Bar Association
Committee on International Trade

BILATERAL INVESTMENT TREATIES-EVOLUTION OR REGRESSION?

This paper proposes an improvement to the language of the next U.S. model Bilateral Investment Treaty (BIT) clause regarding fair and equitable treatment. It is the Committee's position that the current 2004 U.S. model BIT language is inadequate to both parties and, therefore, discourages instead of encourages foreign direct investment. The fair and equitable treatment clause is vital because many claims at the International Centre for Settlement of Investment Disputes (ICSID) include claims for expropriation; a standard used to determine the existence of expropriation (including what is known as indirect or 'creeping' expropriation) is the fair and equitable treatment clause. We propose new language for a new, more progressive model BIT.

I. Background

The first U.S. treaties that addressed the issue of protection of U.S. investors abroad started with the birth of the country and were called treaties of Friendship, Commerce and Navigation. Although they did not cover investment specifically, they were the closest instrument to an investment treaty the U.S. had. These were in use until the end of the 1960's. At the end of World War II, the General Agreement on Tariffs and Trade (GATT) was signed. However, GATT covers trade, not foreign direct investment specifically, and it was realized that another kind of treaty was needed to address the concerns of direct investors.

The first BIT was signed in 1959 between West Germany and Pakistan. The U.S. BIT program, however, did not start until 1981 when the first US model BIT was created. Based on the Letters of Submittal of U.S. BITs, U.S. BITs have been negotiated jointly by the Department of State and the U.S. Trade Representative, with the assistance of various U.S. agencies such as the Departments of Commerce, Treasury, and Energy. Since the beginning of the U.S. program, 41 BITs have been signed and ratified. Currently, six BITs have been signed but not yet ratified. Today, BITs are the most important legal tool regulating U.S. foreign investment. They address five issues: who is covered, admission, treatment, expropriation, and settlement of disputes.

The 1981 model BIT was the shortest and vaguest of all the models thus far created; it did not address the issue of fair and equitable treatment beyond stating that investments should be accorded protection "in accordance with … international law." The 1994 model raised the standard of fair and equitable treatment. *See, e.g.*, the U.S.-Bahrain BIT, signed September 29, 1999. Article 2, section 3 (a) of the 1994 model reads: "each Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by international law." This paper delineates how the subsequent 2004 model lowered the fair and equitable standard. As of May 1, 2007, according to a BIT coordinator at the U.S. Department of State, only one BIT has been signed using the 2004 model: the BIT with Uruguay.

There are four BITs that have been negotiated between the U.S. and its trading partners and are in the pipeline waiting ratification by Congress; however, it is uncertain whether they will come to fruition. These include BITs with Peru, Panama, South Korea, and Colombia. Negotiations on agreements with Malaysia and Thailand have begun but have not been completed. President Bush's fast-track authority, which allows the President to negotiate non-amendable agreements, expired on July 1, 2007. Trading partners may not be as eager to negotiate with the U.S., since any agreement is now subject to amendment by the U.S. Congress. Congress and the Bush administration recently made headlines due to their compromise to incorporate more stringent labor and environmental provisions in US Free Trade Agreements (FTAs). Because current FTAs contain a chapter on investment protection, similar to the Bilateral Investment Treaty, it is feasible that the next model BIT could include similar provisions.

II. The New Model BIT

In November 2004, the United States Trade Representative (USTR) updated the U.S. model bilateral investment treaty[1]. This new BIT was a collaboration between the USTR and the State Department, as they share responsibility for BIT policy. But when the new BIT was unveiled, many observers were surprised to see that the new model actually provided less protection for investors than had been the case previously. In

[1] Article 24(3) of the 2004 Model BIT provides that a claimant may submit a claim under one of four potential rule regimes. If both claimant and respondent are parties to the ICSID Convention, the ICSID Rules of Procedure for Arbitration may be chosen, or, in the case of only one side being party, the ICSID Additional Facility Rules may be chosen. UNCITRAL Arbitration Rules is the third option, or, if claimant and respondent agree, any other arbitration institution and its corresponding rules may be chosen.

particular, Article 5, “Minimum Standard of Treatment” sets out what each party to the BIT agrees to accord to covered investments:

> Article 5: Minimum Standard of Treatment
> 1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
> 2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
> (a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
> (b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.
> Article 5 [Minimum Standard of Treatment] shall be interpreted in accordance with Annex A.
> 3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.
> 4. Notwithstanding Article 14 [Non-Conforming Measures](5)(b) [subsidies and grants], each Party shall accord to investors of the other Party, and to covered investments, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.
> 5. Notwithstanding paragraph 4, if an investor of a Party, in the situations referred to in paragraph 4, suffers a loss in the territory of the other Party resulting from:
> (a) requisitioning of its covered investment or part thereof by the latter's forces or authorities; or
> (b) destruction of its covered investment or part thereof by the latter's forces or authorities, which was not required by the necessity of the situation,
> the latter Party shall provide the investor restitution, compensation, or both, as appropriate, for such loss. Any compensation shall be prompt, adequate, and effective in accordance with Article 6

> [Expropriation and Compensation] (2) through (4), *mutatis mutandis.*
> 6. Paragraph 4 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 3 [National Treatment] but for Article 14 [Non-Conforming Measures](5)(b) [subsidies and grants].

Whereas the 1994 model BIT directed each party to accord to covered investments "treatment in accordance with customary international law, including fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by international law," the new BIT directs only that fair and equitable treatment in accordance with customary international law must be given, making what was formerly a minimum standard now essentially a maximum. Effectively the parties to the BIT, and the arbitrators hearing any cases under it, are constrained in their interpretation of fair and equitable treatment to what they can determine customary international law is at the moment.

That would not be such a misfortune if in fact, there were any consensus at all as to what customary international law is regarding bilateral investment treaties, and in particular fair and equitable treatment. But quite the contrary, there are many commentators who believe that customary international law does not exist at all with relation to BITs, because customary international law only arises when there is a sense of legal obligation. The classic definition of customary international law is when a State consistently acts in a certain way, and does so based on a belief that such adherence is legally required[2]. Those who argue that BITs cannot be customary international law have

[2] Restatement (Third) of the Foreign Relations Law of the United States § 102(2) (1987).

argued that because BITs are signed for economic advantage in the competition for foreign investment, the motivation is purely economic rather than flowing from a sense of obligation and therefore customary international law does not arise[3].

Other learned commentators have suggested to the contrary, that while the BIT does not fit the classic customary international law model, such a model must change with the times to include the undertaking of legal obligations by a large group of states, even from a mixture of motives[4]. Those that support this view draw attention to a recent ICSID arbitration brought under a BIT, in which the Tribunal wrote that "[a]lthough it is true . . . that this is mostly the result of *lex specialis*[5] and specific treaty arrangements that have so allowed, the fact is that *lex specialis* in this respect is so prevalent that it can now be considered the general rule, certainly in respect of foreign investments and increasingly in respect of other matters."[6]

Regardless of who is correct in this debate over customary international law, it is evident that using customary international law as the sole standard of fair and equitable treatment is a potent cause of great confusion and discontinuity. Having now subjected "fair and equitable treatment" to the potentially confusing and less protective standard of customary international law, the new model BIT goes on to say in paragraph 2 that what

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[3] Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties,* 38 Va.J. Int'l L. 639 (1998).
[4] Andreas F. Lowenfeld, *Investment Agreements and International Law,* 42 Columbia Journal of Transnational Law 123 (2003).
[5] *Lex specialis* comes from the Latin maxim *Lex specialis derogat legi generali* and stands for the concept that a specific norm of conventional international law may prevail over a more general norm. *See, e.g.,* discussion in *Indonesia-Certain Measures Affecting the Automobile Industry—Report of the Panel,* WT/DS54/R; WT/DS55/R; WT/DS59/R; WT/DS64/R; (98-2505), 1998 WTO DS LEXIS 17 (July 2, 1998).
[6] *CMS Gas Transmission Co. v. Argentina,* ICSID Case No. ARB/01/8 para. 48 (July 17, 2003).

is meant by paragraph 1 is the "minimum standard of treatment of aliens," and that fair and equitable treatment and full protection and security do not require any better treatment than that, and do not create any additional substantive rights. The paragraph recites the "minimum standard of treatment of aliens" as if it were some standard fully articulated in some source of law, when in fact this is a new turn of phrase whose meaning has never been articulated. The new model BIT has, in effect, set a standard for treatment of covered investment that has yet to come into existence. Given that the goal of having BITs is to create an atmosphere of certainty and consistency, this is a glaring deficiency and represents a regression in U.S. BIT policy.

Annex A of the model BIT contains another section of essentially unhelpful language, reciting that the parties confirm that customary international law as referenced in paragraph 5 results from a general and consistent practice of States that they follow from a sense of legal obligation, and that minimum standard of treatment of aliens refers to customary international law protecting the economic rights and interests of aliens. These again leave the parties to rely on terms of uncertain definition, as was explained above.

The arbitrators dealing with these cases have been more direct. In the ICSID case of *CMS Gas Transmission Co. v. Argentina*, Case No. ARB/01/8 (May 12, 2005), the Tribunal noted that:

> 274. The Treaty Preamble makes it clear, however, that one principal objective of the protection envisaged is that fair and equitable treatment is desirable "to maintain a stable framework for

> investments and maximum effective use of economic resources." There can be no doubt, therefore, that a stable legal and business environment is an essential element of fair and equitable treatment.
> 275. The measures that are complained of did in fact entirely transform and alter the legal and business environment under which the investment was decided and made. The discussion above, about the tariff regime and its relationship with a dollar standard and adjustment mechanisms unequivocally shows that these elements are no longer present in the regime governing the business operations of the Claimant. It has also been established that the guarantees given in this connection under the legal framework and its various components were crucial for the investment decision.
> 276. In addition to the specific terms of the Treaty, the significant number of Treaties, both bilateral and multilateral, that have dealt with this standard also unequivocally shows that fair and equitable treatment is inseparable from stability and predictability. Many arbitral decisions and scholarly writings point in the same direction. (139)
> 277. It is not always a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects.
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> 280. The Tribunal believes that this is an objective requirement unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard.

These comments are fascinating in several respects. First, the Tribunal clearly has a broader interpretation of customary international law, one that includes jurisprudence under the various BITs. Second, the emphasis on a stable legal and business environment is key to the modern idea of fair and equitable treatment. Third, the Tribunal makes it clear that the party's intention is essentially irrelevant to whether fair and equitable treatment was accorded. The 2004 model BIT neither acknowledges nor clarifies any of

these points. While from the point of view of the State Department and USTR, having some ambiguity in the obligations set forth in the BIT might prompt more states to sign them, it also undermines the certainty and predictability that is the stated goal of having BITs in the first place. Allowing some lesser standard to become too established might have the effect of ultimately wounding the very nations that most need foreign investment and are willing to sign BITs to get it.

One might wonder why the United States decided to take such a seemingly regressive approach with its 2004 model BIT. The answer may lie in the NAFTA arbitration that has been going on for several years, in particular when NAFTA parties found themselves facing expropriation claims in situations that were very different from the classic idea of expropriation. In the *Pope & Talbot* case[7], in order to implement its obligations under the 1996 United States-Canada Softwood Lumber Agreement (SLA), Canada promulgated regulations requiring applications for export permits, requiring the payment of fees when the permits were issued, and incorporating a discretionary mechanism for exempting certain exporters from the full fees, with such exemptions to be based on the SLA's annual quota levels. As noted by the Tribunal, and as the essential background for understanding Canada's export restrictions and the disputes arising out of them, regulations issued under the SLA defined an "established base" (EB), for which

[7] The principal *Pope & Talbot* awards are: *Pope & Talbot v. Canada*, Motion to Dismiss (Jan. 26, 2000) (scope and coverage) [hereinafter *Pope & Talbot I*]; *Pope & Talbot v. Canada*, Interim Award (June 26, 2000), 40 ILM 258 (2001) (expropriation issues, merits) [hereinafter *Pope & Talbot II*); *Pope & Talbot v. Canada*, Merits, Phase Two (Apr. 10, 2001) (national treatment and fair and equitable treatment, merits) [hereinafter *Pope & Talbot III*]; *Pope & Talbot v. Canada*, Damages (May 31, 2002), 41 ILM 1347 (2002), hereinafter *Pope & Talbot IV*; and *Pope & Talbot v. Canada*, Costs (Nov. 26, 2002) (procedural aspects of fair and equitable treatment, costs) [hereinafter *Pope & Talbot V*]. All are available on the Web site of the Canadian Department of Foreign Affairs and International Trade at <http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp>.

there was no export fee, a "lower fee base" (LFB), for which the export fee was U.S. $ 0.50 per thousand board feet, and an "upper fee base" (UFB), for which the export fee was U.S. $ 1.00 per thousand board feet. The specific amounts were to be allocated among primary lumber producers, remanufacturers, and new entrants, "based on their recent export shipments, and on special criteria for new entrants." The system was to be subject to annual review and adjustments, with the objective of a "flexible and responsive" allocation system. The American-owned firm Pope & Talbot charged that this allotment system discriminated against the firm's Canadian subsidiary, and that Canada's actions in implementing the allotment system violated NAFTA Chapter 11's provisions concerning national treatment, minimum standards of treatment, performance requirements, and expropriation. An arbitral panel convened under Chapter 11 of NAFTA determined that Canada had denied Pope & Talbot its right to fair and equitable treatment under NAFTA Article 1105. The third and fourth opinions in *Pope & Talbot* set forth a detailed discussion of fair and equitable treatment under Article 1105. Article 1105(1) provides: "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." Although Canada and the claimant initially agreed that the provision set out a minimum standard of treatment "that applies apart from the treatment a NAFTA party may accord to its own or to other countries' investors and investments," they had different views on the content of the minimum standard. Canada sought a narrow interpretation of the "fair and equitable treatment" standard, arguing on the basis of older cases that the "minimum standard of treatment" embodied in Article 1105 required "egregious" conduct before the necessary violation of international law could be

found, and that Article 1105 thus did not go beyond traditional customary international law principles of fairness. The claimant contended that the provision should be construed in light of all relevant sources of international law. There was no disagreement in principle that treaties are a primary source of international law, particularly the various bilateral investment treaties (BITs). As the Tribunal noted, "These treaties evolved over the years into their present form, which is embodied in the [U.S.] Model Bilateral Investment Treaty of 1987. Canada, the UK, Belgium, Luxembourg, France and Switzerland have followed the Model." The model BIT specified "Investment shall 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."

The Tribunal believed that the above language confirmed the adoption of the "additive character of the fairness elements" of Article 1105. That is, investors under NAFTA were entitled to the international law minimum, plus the fairness elements. The Tribunal's acceptance of the "additive" approach was based on its conclusion that the "bilateral commercial treaties negotiated by the United States and other industrialized countries"--upon which Article 1105 was based--represented an evolution of investor rights to include the fairness elements, "no matter what else their entitlement under international law [and] . . . free of any threshold that might be applicable to the evaluation of measures under the minimum standard of international law." The Tribunal rejected the contention that the "drafters of NAFTA Chapter 11 “excluded any possible conclusion that the parties were diverging from the customary international law concept of fair and equitable treatment'". The Tribunal ignored the linguistic differences between the model

BIT provision in question and NAFTA Article 1105, and rejected the idea that the NAFTA parties would have intended in NAFTA "to provide each other's investments more limited protections than those granted to other countries not involved jointly in a continent-wide endeavor aimed, among other things, at 'increasing substantially investment opportunities in the territories of the Parties.'"

The Tribunal also rejected Canada's argument that the customary international law to be applied here was frozen in the 1920's and that the standard to be applied was set forth in that era in *United States (L.F. Neer) v. United Mexican States*, which was quoted as stating that a breach of international law required treatment amounting "to an outrage, to bad faith, to willful 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." *Pope & Talbot IV*, para. 57 n.42.

However, having forcefully set out this broad standard for Article 1105, the Tribunal proceeded on its situation-by-situation analysis and, with one relatively minor exception, rejected all of the claimant's allegations that various Canadian actions in administering the SLA violated Article 1105. The violation the Tribunal did not reject related to the so-called verification review episode, in which Canada's Softwood Lumber Division (SLD) made especially aggressive requests for Pope & Talbot corporate data shortly after that firm filed its notice of arbitration. The Tribunal rejected not only all other Article 1105 claims, but also claims of discrimination/denial of national treatment under Article 1102, imposition of performance requirements in violation of Article 1106,

and expropriation under Article 1110.5. Pope & Talbot had valued these claims, in the aggregate, at approximately U.S. $ 509,000,000, but the amount of damages ultimately awarded was approximately $462,000, including interest through May 1, 2002, or 0.1 percent of the amount originally requested.

There were other cases alarming to national governments. S.D. Myers, Inc. (SDMI) entered the PCB-remediation industry in the 1980s, ultimately becoming one of the most prominent operators in the United States. To extend the useful life of its U.S. facilities, SDMI entered Canada's remediation market in the 1990s. Using a Canadian affiliate (Myers Canada) as its marketing arm, SDMI solicited orders for the destruction of Canadian-owned PCBs at its U.S. facilities. Because U.S. legislation prohibited the importation of PCBs, SDMI successfully lobbied the Environmental Protection Agency for an "enforcement discretion" relating to the importation of PCBs, which became effective in October 1995. Although several Canadian officials hailed the open border as an "environmentally sound" way to encourage the "destruction of . . . Canada's PCBs" at lower costs than in Canada, the Minister of the Environment took regulatory action in November 1995, banning the export of PCBs on the basis of a purportedly "significant danger to the environment and to human life and health." Contemporaneously, the Minister articulated a policy that remediation of Canadian PCBs should be performed "in Canada by Canadians." The Canadian government reversed that policy and lifted the export restrictions in February 1997. In arbitration proceedings conducted under the NAFTA's investment chapter, SDMI challenged Canada's sixteen-month export ban as an

expropriation, an unlawful performance requirement, a denial of national treatment, and a denial of fair and equitable treatment.

The Tribunal[8] said it ascertained "no legitimate environmental reason for introducing the ban", and that " the documentary record "clearly" indicated that the Minister had "intended primarily to protect the Canadian PCB disposal industry from U.S. competition." The Tribunal first addressed the national treatment claim and found there was a breach. It then considered whether Canada had breached Article 1105(1), which requires "treatment in accordance with international law, including fair and equitable treatment." In this regard, the Tribunal acknowledged that Article 1105(1) does not create an "open-ended mandate to second-guess government decision-making." SDMI would have to establish treatment so "unjust or arbitrary" as to be "unacceptable from the international perspective," bearing in mind "the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders." According to a majority, however, the breach of a rule of international law specifically designed to protect investors would "weigh heavily" in favor of finding a violation of Article 1105(1). Therefore, a majority concluded that Canada's denial of national treatment "essentially established" a breach of Article 1105(1). Myers's award ultimately totaled almost $7 million Canadian, and a judicial challenge in Canadian courts to the legitimacy of the award failed.

[8] *S.D. Myers, Inc. v. Canada* (Oct. 21, 2002), available at http://ita.law.uvic.ca/documents/SDMyersFinalAward.pdf .

An arbitral tribunal in *Metalclad*[9] found that the lack of transparency in Mexico's regulatory requirements constituted a denial of fair and equitable treatment in violation of NAFTA Article 1105, and that Mexico's actions to prevent Metalclad from operating a landfill constituted an expropriation under Article 1110. In interpreting the phrase "fair and equitable treatment," the Tribunal followed Article 102(2)'s instruction to look to NAFTA's stated objectives. "These objectives specifically include transparency and the substantial increase in investment opportunities in the territories of the Parties." The Tribunal interpreted transparency as imposing two related obligations. First, all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Second, "[o]nce the authorities of the central government of any Party . . . become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated . . . ". The Tribunal noted that Metalclad had been assured by federal officials, prior to purchasing Coterin, that it had all the permits necessary. The Tribunal further interpreted Mexico's General Ecology Law of 1988 as giving the federal government exclusive authority over hazardous-waste landfills and as limiting the municipal government's authority to "construction considerations." The Tribunal faulted the municipality of Guadalcazar for its delay in asserting the need for a municipal permit, for denying Metalclad the opportunity to appear at the meeting where the permit application was considered, and for denying that permit on environmental grounds. The absence of a clear rule as to the requirement for a municipal construction permit, as well

[9] *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1, at paras. 74-101 (Aug. 20, 2000).

as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounted to a failure on the part of Mexico to ensure the transparency required by NAFTA.

The Tribunal further held that Guadalcazar's conduct constituted an expropriation in violation of Article 1110.17. It observed that expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State. The Tribunal held that by permitting Guadalcazar's unfair and inequitable treatment, Mexico had "taken a measure tantamount to expropriation" and that Guadalcazar's conduct, when considered "together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount[s] to an indirect expropriation."

Mexico then sought to have the award set aside. Because the site of the arbitration had been Vancouver, British Columbia, Mexico filed its application with the Supreme Court of that province[10]. Justice David Tysoe held that his review of the award was governed by British Columbia's International Commercial Arbitration Act (ICAA), which is based on the UNCITRAL [UN Commission on International Trade Law] Model Law

[10] *United Mexican States v. Metalclad* Corp., 119 I.L.R. 646, 665, at para. 70 (S. Ct. of B.C. 2001) (Can.).

on International Commercial Arbitration. He reasoned that "the primary relationship between Metalclad and Mexico was one of investing" and that the ICAA applied to relationships of investing. He rejected Mexico and Canada's argument that the standard of review under the ICAA be determined by a "pragmatic and functional approach." He held that the court's review of the award was limited to the grounds set forth in ICAA Section 34(2) and, more specifically, to whether "the Tribunal made decisions on matters beyond the scope of the submission to arbitration by deciding upon matters outside Chapter 11."

Justice Tysoe then held that the Tribunal's finding of unfair and inequitable treatment based on a lack of transparency went "beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11." Agreeing with the Chapter 11 tribunal's award in *S.D. Myers, Inc. v. Canada*, and disagreeing with a the tribunal's award in *Pope & Talbot, Inc. v. Canada*, he reasoned that Article 1105 prohibited only such unfair or inequitable treatment as violated international law. He further reasoned that "in using the words 'international law', Article 1105 is referring to customary international law" rather than to treaty law. He faulted the Tribunal for citing "no authority . . . to establish that transparency has become part of customary international law." In his view, the Tribunal improperly imported into Chapter 11 a transparency obligation from Chapter 18.

In *Ethyl Corp. v. Gov't of Canada*[11], Ethyl, a U.S. corporation, filed a NAFTA claim against Canada for enacting legislation that affected Ethyl's investment in Canada.

[11] *Ethyl Corp. v. Canada* (Jurisdiction), 38 I.L.M. 708 (1999) (UNCITRAL, June 24, 1998).

The Canadian Parliament had enacted the 1997 Manganese-based Fuel Additives Act. This Act banned the importation and inter-state transportation of methylcyclopentadienyl manganese tricarbonyl ("MMT"), a fuel additive designed to boost octane levels in gasoline. Ethyl had been unsuccessful in selling MMT in the United States because the Environmental Protection Agency had delayed approval for MMT until 1995 due to concerns that MMT caused emission control devices to fail and led to neurological disorders and respiratory problems. Ethyl had instead been exporting MMT to Canada. The Canadian ban thus had a potentially huge impact on Ethyl's revenues.

After the NAFTA tribunal found that it had jurisdiction over some of Ethyl's claims, Canada was pressured into settling Ethyl's claims within six months. Under this settlement, Canada agreed to allow Ethyl to resume selling MMT in Canada, paid Ethyl $13 million in compensation, issued a public apology and conceded that MMT was not harmful.

Methanex Corporation, a Canadian marketer and distributor of methanol, submitted a claim to arbitration[12] for alleged injuries resulting from a California ban on the use or sale in California of the gasoline additive MTBE.[13] Methanol is an ingredient used to manufacture MTBE. Methanex contended that a California Executive Order and the regulations banning MTBE expropriated parts of its investments in the United States in violation of Article 1110, denied it fair and equitable treatment in accordance with international law in violation of Article 1105, and denied it national treatment in violation

[12] Under the UNCITRAL rules.
[13] *Methanex Corp. v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 44 I.L.M. 1345, 1345-47 (Aug. 3, 2005).

of Article 1102. Methanex claimed damages of $970 million. A hearing on jurisdiction and admissibility was held in July 2001. On August 7, 2002, the Tribunal issued a First Partial Award on issues of jurisdiction and admissibility. A hearing on the merits was held in June 2004. On August 9, 2005, the Tribunal released the Final Award, dismissing all of the claims unanimously on jurisdictional grounds and determining further that, even if it had jurisdiction, the claim also failed on the merits. It held that Methanex did not face any nationality-based discrimination, was not treated in a manner that could be said to violate international law standards and did not suffer an expropriation of any property interest. Moreover, the Tribunal held that the California measures were not intended to harm Methanex or other foreign methanol producers and did not otherwise relate to Methanex; thus the claim was not covered by the investor-State arbitration provisions of the NAFTA.

In *Loewen Group Inc. and Ray Loewen v. United States*[14], Loewen Group ("LGI") was a Vancouver-based "death care" business that became one of the largest funeral home operators in North America. LGI bought a funeral home in Jackson, Mississippi that entered into funeral insurance contracts with O'Keefe, a local competitor. O'Keefe sued LGI in the Mississippi state court. During the jury trial O'Keefe's lawyers used (in the words of the ICSID tribunal) xenophobic and racist invective against Loewen and LGI, which the judge did nothing to prevent. The jury awarded damages against LGI in the amount of $500 million. The Mississippi appeals procedures required LGI to post a bond of 125% of the verdict appealed against as a condition of a stay, pending the appeal. LGI was unable to raise this amount. As O'Keefe threatened immediate seizure of their

[14] *Loewen v. United States* (June 26, 2003) 42 I.L.M. 811 (2003).

assets, LGI paid O'Keefe $170 million to settle the claim. LGI and Loewen filed an investment arbitration claim against the U.S. under Chapter XI of NAFTA under the ICSID Additional Facility Rules.

The tribunal held that a court judgment could be considered a governmental "measure" giving rise to liability for discrimination, failure to grant "fair and equitable treatment" and expropriation without adequate compensation. The arbitrators held that the combination of anti-Canadian rhetoric, arbitrary court procedures, the excessiveness of the jury verdict and the effective lack of a right of appeal combined to constitute a "denial of justice" and a breach of the NAFTA obligation to provide qualifying investors with fair and equitable treatment. The Tribunal held that fair and equitable treatment meant treatment in accordance with customary international law. Nevertheless, to the surprise of some commentators, the tribunal dismissed the case on two grounds. Firstly, LGI had not sufficiently exhausted available local remedies, as required under NAFTA:

> Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious) will damage both the integrity of the domestic judicial system and the viability of NAFTA itself . . .

Secondly, due to a bankruptcy reorganization, LGI had lost the requisite Canadian nationality and the tribunal held that it no longer had jurisdiction to decide the case under NAFTA. There is some question whether there is such a "continuing nationality" requirement under public international law, requiring the claimant to have the requisite nationality up to the time of the award. It is generally considered sufficient to have the

requisite nationality at the time the claim arose and at the time the claim was brought. In addition, LGI had also failed to establish discrimination because it been unable to identify an American investor in "like circumstances". In October 2005 the U.S. District Court rejected an application by Mr. Loewen to vacate the award, on the basis that the application was time-barred, and that the award had dispensed with the NAFTA Chapter 11 claims of both the Loewen Group and Loewen himself[15].

Despite these mixed and somewhat contradictory results, the consternation that the Chapter 11 claims caused national governments was considerable and there were rumblings in all three NAFTA governments that NAFTA needed to be amended to clarify the scope of expropriation. In the U.S., Senator John Kerry pointed out "(w)hen we debated Nafta,…not a single word was uttered in discussing Chapter 11. Why? Because we didn't know how this provision would play out. No one really knew just how high the stakes would get."[16] Senator Kerry proposed an amendment that would have prevented future U.S. trade agreements from a wide interpretation by restricting investment protection actions to those cases where government action causes a physical invasion of property or denies all economic or productive use of that property. The Kerry Amendment failed in 2002.

One could speculate, that, to avoid being surprised by the broad interpretations being given by arbitrators beyond what was ever originally contemplated, the model BIT

[15] *Loewen v. United States*, Civ. No. 04-2151, slip. op. (D.D.C. Oct. 31, 2005), at <http://www.state.gov/s/1/c14802.htm>.
[16] "Review of U.S. Rulings by Nafta Tribunals Stirs Worries", The New York Times, http://query.nytimes.com/gst/fullpage.html?res=9506E7DA103BF93BA25757C0A9629C8B63&sec=&spon=, (last visited Jan. 26, 2008).

drafters decided to hamstring the BIT arbitrators so that they could not decide to set a new, much higher standard for fair and equitable treatment. But in the context of the developing countries that are eager to sign BITs, allowing such a lesser standard would hardly work to their ultimate benefit, if foreign investors were scared off. Given this reality, the Committee proposes a new model BIT that goes back to the minimum standard in the 1994 model while adding some definitions and clarification that further increases investor protection:

> Article 5: Minimum Standard of Treatment
> 1. Each Party shall at all times accord to covered investments treatment including fair and equitable treatment and full protection and security.
> 2. At no time shall each party accord to covered investments treatment less favorable than would have been accorded by international law, which includes both customary and treaty law. The concepts of "fair and equitable treatment" and "full protection and security" require treatment in accordance with that which is required by that standard. The obligation in paragraph 1 to provide:
> (a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world, and to provide a stable legal and business environment with appropriate transparency. It includes the obligation not to impair by unreasonable, arbitrary or discriminatory measures the management, conduct, operation and sale or other disposition of covered investments.
> (b) "full protection and security" requires each Party to provide the level of police protection required under international law.
> The intention of the party shall not be relevant to whether a breach of the standard of fair and equitable treatment or full protection and security has taken place.
> 3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article, but it may be offered as evidence thereof.
> 4. Notwithstanding Article 14 [Non-Conforming Measures](5)(b) [subsidies and grants], each Party shall accord to investors of the other Party, and to covered investments, non-discriminatory

> treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.
> 5. Notwithstanding paragraph 4, if an investor of a Party, in the situations referred to in paragraph 4, suffers a loss in the territory of the other Party resulting from:
> (a) requisitioning of its covered investment or part thereof by the latter's forces or authorities; or
> (b) destruction of its covered investment or part thereof by the latter's forces or authorities, which was not required by the necessity of the situation,the latter Party shall provide the investor restitution, compensation, or both, as appropriate, for such loss. Any compensation shall be prompt, adequate, and effective in accordance with Article 6 [Expropriation and Compensation] (2) through (4), *mutatis mutandis.*
> 6. Paragraph 4 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 3 [National Treatment] but for Article 14 [Non-Conforming Measures](5)(b) [subsidies and grants].
> 7. However, if a measure is undertaken for the genuine and reasonable necessity to protect human, animal or plant life or health, it shall not be considered to be a breach of this article.

III. Conclusion

The United States needs to return to a standard of fair and equitable treatment that guarantees investors stability and predictability. While the government has been fearful of expropriation having evolved far beyond the classic definition to include zealous environmental regulation or challenges to the judicial system, there is nothing preventing the BIT drafters from carving out an exception for items such as justifiable environmental regulations, as is the case with the GATT (which contains in Article XX(b) an exception for measures "necessary to protect human, animal or plant life or health"). Rather than paying lip service to the idea of fair and equitable treatment, a new model BIT would

serve to truly protect the interests of international investors, which can only benefit all BIT parties in the long run.

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