Principles of International Investment Law

Second Edition

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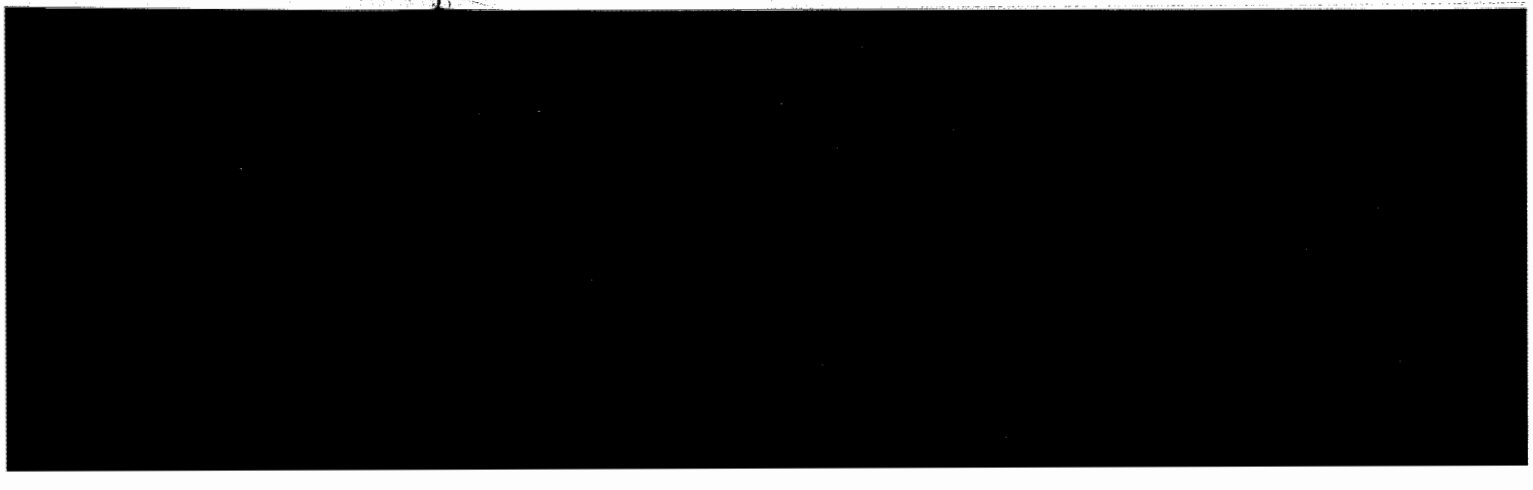
UNIVERSITY PRESS



project, will typically be addressed during these initial negotiations. Unless these risks are appropriately addressed in an applicable investment treaty, the investor may ask for protection on a number of points, such as the applicable law, the tax regime, provisions dealing with inflation, a duty of the host state to buy a certain volume of the product (especially in the field of energy production), the future pricing of the investor's product, or customs regulation for materials needed for the product, and, especially, an agreement on future dispute settlement. Such rights may be included in an investment contract between the investor and the host state.

Once these negotiations are concluded and the investor's resources are sunk into the project, the dynamics of influence and power tend to shift in favour of the host state. The central political risk which henceforth arises for the foreign investor lies in a change of position of the host government that would alter the balance of burdens, risks, and benefits which the two sides laid down when they negotiated the deal and which formed the basis of the investor's business plan and the legitimate expectations embodied in this plan. Such a change of position on the part of the host country becomes more likely with every subsequent change of government in the host state during the period of the investment.

(d) The host state's perspective: attracting foreign investment

It is reasonable to assume that the object and purpose of investment treaties is closely tied to the desirability of foreign investments, to the benefits for the host state and for the investor, to the conditions necessary for the promotion of foreign investment, and to the removal of obstacles which may stand in the way of allowing and channelling more foreign investment into the host states. Thus, the purpose of investment treaties is to address the typical risks of a long-term investment project, and thereby to provide stability and predictability in the sense of an investment-friendly climate.

Under the rules of customary international law, no state is under an obligation to admit foreign investment in its territory, generally or in any particular segment of its economy. While the right to exclude and to regulate foreign investment is an expression of state sovereignty, the power to conclude treaties with other states will also be seen as flowing from the same concept.

Once it has admitted a foreign investment, a host state is subject to a minimum standard of customary international law.[82] Modern treaties on foreign investment go beyond this minimum standard in the scope of obligations a host state owes towards a foreign investor. Whether such treaties in general, or any particular version of them, are beneficial to the host state, remains a matter for each state to decide. In particular, each state will weigh, or at least has the power to weigh, the economic and financial benefits of a treaty-based promotion of foreign investments against the consequences of being bound to the standards of protection laid down in the treaty. None of these benefits and consequences is open to a qualitatively or

[82] See E Root, 'The Basis of Protection to Citizens Residing Abroad' (1910) 4 *AJIL* 517, 528—see pp 134–8.

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[83] See eg E Neumayer and L S
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[84] In 2006, the OECD adopte
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Preamble p 7).

[85] See C Schreuer, 'Investm
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origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.

2. TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions... include those which... restrict: (a) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports; (b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or (c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

Issues of competing jurisdiction and of consistency would arise if such measures were to be challenged both before the WTO dispute settlement system and before a tribunal with its jurisdictional basis in a BIT.[14] Furthermore, the admissibility of performance requirements applying only to foreign investors remains to be clarified under the standard of national treatment.

With regard to the hiring and presence of non-local personnel to manage a foreign investment in the host country, a few treaties contain language to the effect that applications by such persons will receive 'sympathetic consideration'[15] or that quotas or numerical restrictions will not be allowed in that context.[16] As regards appointment of top personnel by the investor, some treaties recognize this freedom, subject, however, to the laws of the host state.[17]

4. Non-compliance by investor with host state law and international public policy

Many investment treaties provide that they cover investments made 'in accordance with the laws' of the host state. For example, Article 1(1) of the German-Philippines BIT reads: 'the term "investment" shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State...'

Sometimes, the requirement of compliance of the investment with domestic laws is part of the definition of 'investment'; sometimes it is found in other parts of the treaty.[18] In *Plama v Bulgaria*, the Tribunal pointed to an obligation of the investor

[14] An investor would presumably have a right to invoke the TRIMs Agreement before an investment tribunal if both states parties concerned are members of the WTO. This would be beyond doubt if a BIT refers to other existing international obligations that could be invoked by the investor.

[15] See Protocol to the Treaty between Germany and Bosnia & Herzegovina concluded on 18 October 2001, para 3(c). See also on this point UNCTAD, *Bilateral Investment Treaties 1995–2005: Trends in Investment Rulemaking*, Draft (2006) 129 et seq.

[16] See Art VII(1)(b) of the Treaty between the United States and Nicaragua concerning the Encouragement and Reciprocal Protection of Investments, signed on 1 July 1995.

[17] See Treaty between Australia and Egypt on the Promotion and Protection of Investments of 3 May 2001, Art 5.

[18] See U Kriebaum, 'Illegal Investments' (2010) *Austrian Yearbook on Int'l Arbitration* 307; C Knahr, 'Investments "in accordance with host state law"' (2007) 5 *Transnational Dispute Management*.

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[21] *Plama v Bulgaria*, Award
[22] At para 133.
[23] At para 146.
[24] *Alasdair Ross Anderson v*
[25] At para 58.
[26] *Hamester v Ghana*, Awa
[27] At paras 123, 124.
[28] At para 127. The Tribu

2. The three branches of the law

Beyond the right of the host state to expropriate, international law on expropriation has developed three branches, which regulate the scope and conditions of the exercise of this power. The first one defines the interests that will be protected. This facet has not traditionally been in the forefront of academic and practical discussions but has received some prominence more recently. Most contemporary treaties, in their provisions dealing with expropriation, refer to 'investments'. Similarly, the jurisdiction of arbitral tribunals is typically restricted to disputes arising from 'investments'. Therefore, it is 'investments' as defined in these treaties that are protected.[3]

The second branch concerns the definition of an expropriation. While this matter raises no questions in cases of a formal expropriation, the issue may acquire a high degree of complexity when the host state interferes with the rights of the foreign owner without a formal taking of title. Indeed, in the practice of the past three decades, most cases relating to expropriation have turned on the controversy of whether or not a 'taking' had actually occurred. Matters of public health, the environment, or general changes in the regulatory system may prompt a state to regulate foreign investments. This has led to claims against the state on the basis that a regulatory taking or indirect expropriation has occurred. The elements of indirect expropriation are discussed below.[4]

The third branch of the law on expropriation relates to the conditions under which a state may expropriate alien property. The classical requirements for lawful expropriation are a public purpose, non-discrimination, as well as prompt, adequate, and effective compensation. In practice, the requirement of compensation has turned out to be the most controversial aspect. This issue is discussed in the next section.

3. The legality of the expropriation

It is today generally accepted that the legality of a measure of expropriation is conditioned on three (or four) requirements. These requirements are contained in most treaties. They are also seen to be part of customary international law. These requirements must be fulfilled cumulatively:

- The measure must serve a public purpose. Given the broad meaning of 'public purpose', it is not surprising that this requirement has rarely been questioned by the foreign investor. However, tribunals did address the significance of the term and its limits in some cases.[5]

[3] For the concept of an investment, see pp 60 et seq. See further p 248.
[4] See pp 101 et seq.
[5] See eg *ADC v Hungary*, Award, 2 October 2006, paras 429–33.

- The measure must not be arbitrary and discriminatory within the generally accepted meaning of the terms.
- Some treaties explicitly require that the procedure of expropriation must follow principles of due process.[6] Due process is an expression of the minimum standard under customary international law and of the requirement of fair and equitable treatment. Therefore, it is not clear whether such a clause, in the context of the rule on expropriation, adds an independent requirement for the legality of the expropriation.
- The expropriatory measure must be accompanied by prompt, adequate, and effective compensation. Adequate compensation is generally understood today to be equivalent to the market value of the expropriated investment.

Of these requirements for the legality of an expropriation, the measure of compensation has been by far the most controversial. In the period between roughly 1960 and 1990, the rules of customary law on compensation were at the centre of the debate on expropriation. They were discussed in the broader context of economic decolonization, the notion of 'Permanent Sovereignty over Natural Resources', and of the call for a new international economic order. Today, these fierce debates are over and nearly all expropriation cases before tribunals follow the treaty-based standard of compensation in accordance with the fair market value. In the terminology of the earlier decades this means 'full' or 'adequate' compensation. However, this does not mean that the amount of compensation is easy to determine. Especially in cases of foreign enterprises operating on the basis of complex contractual agreements, the task of valuation requires close cooperation of valuation experts and the legal profession.

Various methods may be employed to determine market value. The discounted cash flow method will often be a relevant yardstick, rather than book value or replacement value, in the case of a going concern that has already produced income. Before the point of reaching profitability, the liquidation value will be the more appropriate measure.[7]

A traditional issue that has never been entirely resolved concerns the consequences of an illegal expropriation. In the case of an indirect expropriation, illegality will be the rule, since there will be no compensation.

According to one school of thought, the measure of damages for an illegal expropriation is no different from compensation for a lawful taking. The better view is that an illegal expropriation will fall under the general rules of state responsibility, while this is not so in the case of a lawful expropriation accompanied by compensation. In the case of an illegal act the damages should, as far as possible, restore the situation that would have existed had the illegal act not been committed. By contrast, compensation for a lawful expropriation should represent the market value at the time of the taking. The result of these two methods can be markedly

[6] See eg the 2004 and 2012 US Model BITs, Art 6(1)(d).
[7] See pp 296–7.

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[10] R Dolzer and M Stevens, *Bilateral Inv*
[11] Dolzer and Stevens, n 11.
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[14] See pp 117 et seq.

different.[8] The difference will mainly concern the amount of lost profits. The issue of compensation and damages is discussed in more detail in Chapter X on the settlement of investment disputes.[9]

The requirement of 'prompt' compensation means 'without undue delay'.[10] The requirement of 'effective' compensation means that payment is to be made in a convertible currency.[11]

4. Direct and indirect expropriation

The difference between a direct or formal expropriation and an indirect expropriation turns on whether the legal title of the owner is affected by the measure in question. Today direct expropriations have become rare.[12] States are reluctant to jeopardize their investment climate by taking the drastic and conspicuous step of an open taking of foreign property. An official act that takes the title of the foreign investor's property will attract negative publicity and is likely to do lasting damage to the state's reputation as a venue for foreign investments.

As a consequence, indirect expropriations have gained in importance. An indirect expropriation leaves the investor's title untouched but deprives him of the possibility of utilizing the investment in a meaningful way. A typical feature of an indirect expropriation is that the state will deny the existence of an expropriation and will not contemplate the payment of compensation.

(a) Broad formulae: their substance and evolution

The contours of the definition of an indirect expropriation are not precisely drawn. An increasing number of arbitral cases and a growing body of literature on the subject have shed some light on the issue but the debate goes on.[13] In some recent decisions by the International Centre for Settlement of Investment Disputes (ICSID), tribunals have interpreted the concept of indirect expropriation narrowly and have preferred to find a violation of the standard of fair and equitable treatment.[14]

The concept of indirect expropriation as such was clearly recognized in the early case law of arbitral tribunals and of the Permanent Court of International Justice

[8] See eg D W Bowett, 'State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach' (1988) 59 *BYIL* 47; *Case Concerning the Factory at Chorzów*, 1928, PCIJ, Series A, No 17, 47. For a full discussion, see I Marboe, 'Compensation and Damages in International Law, The Limits of "Fair Market Value"' (2006) 7 *J World Investment & Trade* 723.

[9] See pp 294–7.

[10] R Dolzer and M Stevens, *Bilateral Investment Treaties* (1995) 112.

[11] Dolzer and Stevens, n 11.

[12] But see *Funnekotter v Zimbabwe*, Award, 22 April 2009.

[13] See Y Fortier and S L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor' (2004) 19 *ICSID Review-FILJ* 293.

[14] See pp 117 et seq.

a regulation that amounted (by virtue of its scope and effect) to a taking, would need to be 'for a public purpose' (in the sense of a general, rather than for a private, interest). And just compensation would be due.[24]

It has been argued elsewhere that the international law of expropriation has essentially grown out of, and mirrored, parallel domestic laws.[25] As a consequence of this linkage, it appears plausible that measures that are, under the rules of key domestic laws, normally considered regulatory without requiring compensation, will not require compensation under international law either.

The importance of the effect of a measure for the question of whether an expropriation has occurred was highlighted by Reisman and Sloane:

> tribunals have increasingly accepted that expropriation must be analyzed in consequential rather than in formal terms. What matters is the effect of governmental conduct—whether malfeasance, misfeasance, or nonfeasance, or some combination of the three—on foreign property rights or control over an investment, not whether the state promulgates a formal decree or otherwise expressly proclaims its intent to expropriate. For purposes of state responsibility and the obligation to make adequate reparation, international law does not distinguish indirect from direct expropriations.[26] [Footnotes omitted]

In recent jurisprudence, the formula most often found is that an expropriation will be assumed in the event of a 'substantial deprivation' of an investment.[27]

The oscillating understanding of this approach may be illustrated in light of relevant jurisprudence.

(b) Judicial and arbitral practice: some illustrative cases

Cases decided by tribunals demonstrate the variety of scenarios in which the question of indirect expropriation may arise. Tribunals have had to adapt their focus of inquiry to these different circumstances; consequently, an emphasis on different aspects of the law should not necessarily be construed as an expression of inconsistency. Often, the facts of a case simply highlight only one specific factor and neglect of other possible factors does not result from oversight but from irrelevance to the specific circumstances. A short survey of cases may serve to demonstrate the diversity of factual bases and of the reasoning of tribunals.

The *Oscar Chinn* case[28] concerned the interests of a British shipping company in the Congo. In the aftermath of the economic crisis of 1929, the Belgian Government intervened in the shipping trade on the Congo River by reducing the prices charged by Mr Chinn's only competitor, the partly state-owned company

[24] R Higgins, 'The Taking of Property by the State: Recent Developments in International Law' (1982-III) 176 *Recueil des Cours* 259, 331.

[25] R Dolzer, 'Indirect Expropriation of Alien Property' (1986) 1 *ICSID Review-FILJ* 41.

[26] W M Reisman and R D Sloane, 'Indirect Expropriation and its Valuation in the BIT Generation' (2003) 74 *BYBIL* 115, 121.

[27] See eg *Société Générale v Dominican Republic*, Award, 19 September 2008, para 64; *Alpha Projectholding v Ukraine*, Award, 8 November 2010, para 408.

[28] *Oscar Chinn Case* (*UK v Belgium*), 12 December 1934, PCIJ, Series A/B, No 63, 4.

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The arbitration in *Revere Copper v OPI*
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[29] At 27. [30] *Revere Cop*
[31] On investment insurance an
[32] *Revere Copper v OPIC*, 291-
[33] At 292.

and purpose of a measure, in reference to the role of the intent of a government consideration of the issue of legitimate expectations of the investor, control over the investment, the need for regulatory measures, and the duration of a measure. These issues are discussed explicitly in some decisions, although they are not necessarily the key to a fully homogeneous theory that does justice to all existing arbitral decisions. But they will assist in a better understanding of individual decisions and general trends.

Not surprisingly, significant lacunae and open issues remain in the law governing indirect expropriation. Domestic courts have grappled with the same issues for far longer. Despite the benefit of constitutional texts and the homogeneity of the national legal systems, they have been unable to resolve all problems. Sometimes these courts have stated that broad formulae will not be helpful as guidelines for judicial reasoning.[79]

(c) Effect or intention?

The effect of the measure upon the economic benefit and value as well as upon the control over the investment is the key question when it comes to deciding whether an indirect expropriation has taken place. Whenever this effect is substantial and lasts for a significant period of time, it will be assumed prima facie that a taking of the property has occurred.[80]

Tribunals have accordingly based their decisions on economic considerations. Indirect expropriation was seen to exist if the measure constituted a deprivation of the economic use and enjoyment, 'as if the rights related thereto—such as the income or benefits... had ceased to exist',[81] or when 'the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent'.[82] Other formulae and phrases have also been used.[83]

[79] See eg *Andrus v Allard*, 444 US 51, 65; 100 S Ct 318 (1979):

> There is no abstract or fixed point at which judicial intervention under the Takings Clause becomes appropriate. Formulas and factors have been developed in a variety of settings. See *Penn Central*, above, at 123–8.
>
> Resolution of each case, however, ultimately calls as much for the exercise of judgment as for the application of logic.

[80] See eg *Norwegian Shipowners' Claims*, I RIAA 307 (1922); *Goetz v Burundi*, Award, 10 February 1999; *Middle East Cement v Egypt*, Award, 12 April 2002; *Metalclad Corp v Mexico*, Award, 30 August 2000; *CME v Czech Republic*, Partial Award, 13 September 2001.

[81] *TECMED v Mexico*, Award, 29 May 2003, para 115.

[82] At para 116.

[83] See Y Fortier and S L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or *Caveat Investor*' (2004) 19 *ICSID Review-FILJ* 293, 305:

> the required level of interference with such rights—has been variously described as: (1) *unreasonable*; (2) an interference that renders rights so *useless that they must be deemed to have been expropriated*; (3) an interference that deprives the investor of *fundamental rights of ownership*; (4) an interference that makes rights *practically useless*; (5) an interference *sufficiently restrictive* to warrant a conclusion that the property has been 'taken'; (6) an interference that deprives, in whole or in significant part, the *use or reasonably-to-be-expected economic benefit* of the property; (7) an interference that *radically deprives* the economical use and enjoyment of an investment, as if the rights related thereto had ceased to exist; (8) an

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In *RFCC v Morocco*,[84] the Tribunal stated that an indirect expropriation exists in cases where the measures have 'substantial effects of an intensity that reduces and/or removes the legitimate benefits related with the use of the rights targeted by the measure to an extent that they render their further possession useless'.[85]

Other decisions have in various wording and degrees also emphasized the effect of the measure.[86] The Tribunal in *CMS v Argentina*[87] found that no indirect expropriation had occurred when Argentina unilaterally suspended a previously agreed tariff adjustment scheme for the gas transport sector in the context of its economic and financial crisis. The US company CMS had argued, inter alia, that the suspension of the tariff adjustment formula amounted to an indirect expropriation of its investment in the Argentine gas transport sector. The Tribunal rejected this argument even though it admitted that the measures had an important effect on the claimant's business:

> The essential question is therefore to establish whether the enjoyment of the property has been effectively neutralized. The standard that a number of tribunals have applied in recent cases where indirect expropriation has been contended is that of substantial deprivation.... The investor is in control of the investment; the Government does not manage the day-to-day operations of the company; and the investor has full ownership and control of the investment.[88]

In *Telenor v Hungary*,[89] the investor held a telecom concession which was affected by a special levy on all telecommunications service providers. The Tribunal held that in order to constitute an expropriation, the conduct complained of must have a major adverse impact on the economic value of the investment.[90] The Tribunal said:

> the interference with the investor's rights must be such as substantially to deprive the investor of the economic value, use or enjoyment of its investment.[91]... In considering whether measures taken by government constitute expropriation the determinative factors are the intensity and duration of the economic deprivation suffered by the investor as the result of them.[92]

interference that makes *any form of exploitation of the property disappear*...; (9) an interference such that the property can no longer be put to *reasonable use*.

RFCC v Morocco, Award, 22 December 2003.

At para 69 (original in French: 'avoir des effets substantiels d'une intensité certaine qui réduisent ou font disparaître les bénéfices légitimement attendus de l'exploitation des droits objets de ladite mesure à un point tel qu'ils rendent la détention de ces droits inutile'). See also *LESI v Algeria*, Award, November 2008, para 132; *Bayindir v Pakistan*, Award, 27 August 2009, para 459.

Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Eng'rs of Iran; *Biloune v Ghana*, Award on Jurisdiction, 27 October 1989; *Metalclad Corp v Mexico*, Award, 30 August 2000; *Wena v Egypt*, Award on Merits, 8 December 2000; *Santa Elena v Costa Rica*, Award, 17 February 2000; *CME v Czech Republic*, Partial Award, 13 September 2001; *Middle East Cement v Egypt*, Award, 12 April 2002; *Goetz v Burundi*, Award, 10 February 1999.

CMS v Argentina, Award, 12 May 2005.

At paras 262, 263. See also *Revere Copper v OPIC*, 56 ILR (1980) 258 and the cases discussed by G H Aldrich, 'What Constitutes a Compensable Taking of Property? The Decisions of the Iran–United States Claims Tribunal' (1994) 88 *AJIL* 585.

Telenor v Hungary, Award, 13 September 2006.

At para 64. [91] At para 65.

At para 70. Footnote omitted.

In the event, the Tribunal found that the special levy amounted to a very limited sum and fell below the threshold of the standard defining an indirect expropriation.[93]

In a number of cases tribunals have pointed out that what mattered for an indirect expropriation was only the effect of the measure and that any intention to expropriate was not decisive.[94] In *Tecmed v Mexico*,[95] the Tribunal found that there had been an indirect expropriation. After explaining the concept of indirect or de facto expropriation, the Tribunal stated: 'The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects.'[96]

In *Siemens v Argentina*,[97] the Tribunal found support in the applicable BIT for its finding that what mattered for the existence of an expropriation was the effect of the measures and not the government's intention. The Argentina-Germany BIT, like many other BITs, refers to indirect expropriation in terms of a 'measure the effects of which would be tantamount to expropriation'. The Tribunal said: 'The Treaty refers to measures that have the effect of an expropriation; it does not refer to the intent of the State to expropriate.'[98]

Authority for the 'sole effect doctrine' also comes from the practice of the Iran–US Claims Tribunal. In *Starrett Housing v Iran*,[99] the Tribunal said:

> it is recognized in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.[100]

Other decisions display a more differentiated approach. They take into account the context of the measure, including the purpose pursued by the host state. *Sea-Land Service Inc v Iran*[101] seems to fall into this category. Upon review of the case law, Fortier[102] has concluded that an approach balancing different factors seems to be dominant. This is certainly true for the jurisprudence of the ECtHR.[103] Also, the 2004 and 2012 US Model BITs, in their description of indirect expropriation, refer

[93] At para 79.

[94] See also *Azurix v Argentina*, Award, 14 July 2006, para 309.

[95] *Tecmed v Mexico*, Award, 29 May 2003, cited in *Plama v Bulgaria*, Award, 27 August 2008, para 192.

[96] At para 116 citing the decisions of the Iran–US Claims Tribunal in *Tippetts* and *Phelps Dodge*. Footnote omitted.

[97] *Siemens v Argentina*, Award, 6 February 2007.

[98] At para 270.

[99] *Starrett Housing Corp v Iran*, Iran–US Claims Tribunal, 19 December 1983, cited in *Plama v Bulgaria*, Award, 27 August 2008, para 191.

[100] At 154. See also *Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran*, Iran–US Claims Tribunal, 22 June 1984, 225–6; *Phillips Petroleum Co v Iran*, Iran–US Claims Tribunal, 29 June 1989, para 97.

[101] *Sea-Land Service Inc v Iran*, 6 Iran–US CTR 149, 166 (1984).

[102] Y Fortier and S L Drymer, 'Indirect Expropriation in the Law of International Investment: I Know It When I See It, or *Caveat Investor*' (2004) 19 *ICSID Review-FILJ* 293.

[103] See ECtHR, *Sporrong & Lönnroth v Sweden*, 23 September 1982.

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stor' (2004) 19 *ICSID Review-FILJ* 293.
ı v Sweden, 23 September 1982.

ot only to the economic impact of the government action but also to the objective
protecting legitimate public welfare objectives.[104] What is uncontroversial is that
e mere post-facto explanation by the host state of its intention will in itself carry
o decisive weight.[105]
Indeed, a number of tribunals have pointed out that a proper analysis of an
propriation claim must go beyond the technical consideration of the formalities
and look at the real interests involved and the purpose and effect of the government
easure'.[106]

(d) Legitimate expectations

An issue that is not novel as such but has more recently received increasing
attention, is the existence of legitimate expectations on the part of the investor.
This theme has also found expression in various forms in domestic laws. In fact, it is
arguable whether the concept of legitimate expectations is part of the general
principles of law. Legitimate expectations play a key role in the interpretation of
the fair and equitable treatment standard;[107] but they have also entered the law
governing indirect expropriations.
The general nature of the concept of legitimate expectations makes it difficult to
draw mechanical conclusions from it. But it may be employed usefully in a number
of settings. Legitimate expectations may be created not only by explicit undertak-
ings on the part of the host state in contracts but also by undertakings of a more
general nature. In particular, the legal framework provided by the host state will be
an important source of expectations on the part of the investor. What matters for
an investor's expectations is the state of the law of the host country at the time of
the investment. To the extent that the state of the law was transparent and did not
violate minimum standards, an investor will hardly be able to convince a tribunal
that the proper application of that law led to an expropriation. This position is
consistent with the power of the host state to accept and define the rights acquired
by the investor at the time of the investment.[108]
Not every change in the host state's legal system affecting foreign property will
violate legitimate expectations. No such violation will occur if the change remains
within the boundaries of normal adjustments customary in the host state and
accepted in other states. Such changes are predictable for a prudent investor at

Model BITs 2004 and 2012, Annex B, para 4.
Norwegian Shipowners' Claims, I RIAA 307 (1922); R Dolzer, 'Indirect Expropriations:
Assessments?' (2003) 11 *NYU Environmental LJ* 64, 91.
Feldman v Canada, First Partial Award, 13 November 2000, para 285.
146 et seq.
Oscar Chinn v Belgium, 12 December 1934, PCIJ, Series A/B, No 63, 84:
[a British subject, when, in 1929, he entered the river transport business, could
have been ignorant of the existence of the competition which he would encounter on the
Congo, which had been established since 1925, of the magnitude of the capital
invested in that Company, of the connection it had with the Colonial and Belgian
Governments, and of the predominant role reserved to the latter with regard to the fixing
and application of transport rates.

(h) Duration of a measure

The duration of a governmental measure affecting the interests of a foreign investo is important for the assessment of whether an expropriation has occurred.[173] Th Iran–US Claims Tribunal has ruled that the appointment of a temporary manage by the host state against the will of the foreign investor will constitute a taking if th consequential deprivation is not 'merely ephemeral'.[174]

Investment tribunals have also laid emphasis on the duration of the measure i question.[175] In *SD Myers v Canada*,[176] the Tribunal said:

> An expropriation usually amounts to a lasting removal of the ability of an owner to make us of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partia or temporary.[177]

In the event, the Tribunal found that the measure had lasted for 18 months onl and that this limited effect did not amount to an expropriation.[178]

In *Wena Hotels v Egypt*,[179] the Tribunal found that the seizure of the investor's hotel lasting for nearly a year was not 'ephemeral' but amounted to an expropri ation.[180] In its subsequent Decision on Interpretation[181] the *Wena* Tribunal said

> It is true that the Original Tribunal did not explicitly state that such expropriation totall and permanently deprived Wena of its fundamental rights of ownership. However, i assessing the weight of the actions described above, there was no doubt in the Tribunal' mind that the deprivation of Wena's fundamental rights of ownership was so profound tha the expropriation was indeed a total and permanent one.[182]

LG&E v Argentina also ruled that the duration of the measure had to be taken into account.[183] The Tribunal found that, as a rule, only an interference that is permanent will lead to an expropriation:

> Similarly, one must consider the duration of the measure as it relates to the degree of interference with the investor's ownership rights. Generally, the expropriation must be

[173] See G C Christie, 'What Constitutes a Taking of Property under International Law?' (1962) *BYBIL* 307; J Wagner, 'International Investment, Expropriation and Environmental Protection' (1999) 29 *Golden Gate University L Rev* 465; W M Reisman and R D Sloane, 'Indirect Expropriation and its Valuation in the BIT Generation' (2003) 74 *BYBIL* 115.

[174] See *Tippetts, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Eng'rs of Iran*, 6 Iran–US CTR 219, 225 (1984); *Phelps Dodge Corp v Iran*, 10 Iran–US CTR 121 (1986); *James M Saghi, Michael R Saghi, and Allan J Saghi v Iran*, 14 Iran–US CTR 3 (1988).

[175] *TECMED v Mexico*, Award, 29 May 2003, para 116; *Generation Ukraine v Ukraine*, Award, 16 September 2003, para 20.32; *Azurix v Argentina*, Award, 14 July 2006, para 313: 'How much time is needed must be judged by the specific circumstances of each case.'

[176] *S D Myers v Canada*, First Partial Award, 13 November 2000.

[177] At para 283.

[178] At para 287.

[179] *Wena Hotels v Egypt*, Award, 8 December 2000.

[180] At para 99.

[181] *Wena Hotels v Egypt*, Decision on Interpretation, 31 October 2005.

[182] At para 120.

[183] *LG&E v Argentina*, Decision on Liability, 3 October 2006.

reement (NAFTA) of 1992 contains the
aph 1.[13] This provision is discussed in

) of 1994 contains elaborate language a
e 10(1):

rdance with the provisions of this Treaty, en
and transparent conditions for Investors o
nts in its area. Such conditions shall in
vestments of Investors of other Contracting

guage

d of fair and equitable treatment sho
er standard clauses in investment trea
the variations in this area are quite signi
erpreted in accordance with Article 3
Treaties (VCLT), duly taking into acc
story. The discussion on the different
example of these variations.[16]
and reasonable' rather than 'fair and eq
reflect a difference in meaning.[17]

use as used in BIT practice is to fill ga
tandards, in order to obtain the level o
s.[18] The operation of FET clauses in
civil law countries which set forth a
hese with a general clause of good
gaps and informs the understanding
of the standard of fair and equitable
d faith in its broader setting, including
oprium and estoppel. In practice the FE
do not support a claim for expropria

ilateral *Investment Treaties* (1995) 58; G Sacc
on Investment Protection' (1997) 269 *Recueil*

1 September 2007, paras 271–8.
eptember 2007, para 297.
ary 2007, para 238; *Continental Casualty v Ar*

Does FET contain two standards, namely 'fair' and 'equitable', with independ-
meanings for each concept? While it would not be impossible to argue along
lines, no evidence of practice seems to point in that direction. The general
sumption appears to be that 'fair and equitable' must be considered to represent a
single, unified standard.

At times it has been suggested that the FET standard is merely an overarching
principle that embraces the other standards of treatment typically found in invest-
ment treaties.[20] While it is undeniable that there is a certain degree of interaction
and overlap with other standards, it is widely accepted that FET is an autonomous
standard.[21] In the majority of cases tribunals have distinguished FET from other
standards and have examined separately whether there has been a violation of the
respective standards.[22] There is no doubt that the FET standard is meant as a rule
of international law and is not determined by the laws of the host state. Tribunals
have repeatedly emphasized the independence of the FET standard from the
national treatment standard.[23] The FET standard may be violated even if the
foreign investor receives the same treatment as investors of the host state's nation-
als. For the same reason, an investor may have been treated unfairly and inequit-
ably even if it is unable to benefit from a most-favoured-nation (MFN) clause
because it cannot show that investors of other nationalities have received better
treatment.[24]

Some tribunals have pointed to the vagueness and lack of definition of the FET
standard[25] and the European Parliament has deplored the use of vague language in
this context.[26] In fact, the lack of precision may be a virtue rather than a shortcom-
ing. In actual practice it is impossible to anticipate in the abstract the range
of possible types of infringements upon the investor's legal position. The principle
itself allows for independent and objective third party determination of this type

Ventures Inc v Romania, Award, 12 October 2005, para 182; *Lemire v Ukraine*, Decision
diction and Liability, 14 January 2010, paras 259, 385; *Impregilo v Argentina*, Award, 21 June
ras 333–4.
Tudor, *The Fair and Equitable Treatment Standard in International Law of Foreign Investment*
, 199–202; C Schreuer, 'Fair and Equitable Treatment (FET): Interactions with Other Stand-
in C Coop and C Ribeiro (eds), *Investment Protection and the Energy Charter Treaty* (2008) 63.
v Argentina, Award, 14 July 2006, paras 407–8; *LG&E v Argentina*, Decision on Liability,
2006, paras 162, 163; *PSEG v Turkey*, Award, 19 January 2007, paras 258–9; *Plama v*
Award, 27 August 2008, paras 161–3, 183–4; *El Paso v Argentina*, Award, 31 October 2011,
s 358.
v Estonia, Award, 25 June 2001, para 367; *SD Myers v Canada*, First Partial Award,
ember 2000, para 259; *CME v Czech Republic*, Partial Award, 13 September 2001, para 611;
Canada, Decision on Jurisdiction, 22 November 2002, para 80; *El Paso v Argentina*, Award,
2011, para 337.
Yannaca-Small, 'Fair and Equitable Treatment Standard' in K Yannaca-Small (ed), *Arbitration*
International Investment Agreements (2010) 385.
v Argentina, Award, 12 May 2005, para 273; *Sempra v Argentina*, Award, 28 September
ra 296; *Rumeli v Kazakhstan*, Award, 29 July 2008, para 610; *Suez v Argentina*, Decision on
29 July 2010, paras 196, 202; *Total v Argentina*, Decision on Liability, 27 December 2010,
See also P Juillard, 'L'évolution des sources du droit des investissements' (1994) 250
Court 9, 133.
European Parliament Resolution of 6 April 2011 on the Future European International Invest-
preamble, para G.

of behaviour on the basis of a flexible standard.[27] Therefore, it is not devoid of independent legal content. Like other broad principles of law, it is susceptible to specification through judicial practice. As Prosper Weil wrote in 2000:

> The standard of 'fair and equitable treatment' is certainly no less operative than was the standard of 'due process of law', and it will be for future practice, jurisprudence and commentary to impart specific content to it.[28]

Stephan Schill has pointed out that 'fair and equitable treatment can be understood as embodying the rule of law as a standard that the legal systems of host states have to embrace in their treatment of foreign investors'.[29]

Although 'fair and equitable' may be reminiscent of the extralegal concepts of fairness and equity, it should not be confused with decisions *ex aequo et bono*.[30] The Tribunal in *ADF Group* pointed out that the requirement to accord fair and equitable treatment does not allow a tribunal to adopt its own idiosyncratic standard but 'must be disciplined by being based upon state practice and judicial or arbitral case law or other sources of customary or general international law'.[31]

(d) Fair and equitable treatment and customary international law

Considerable debate has surrounded the question of whether the FET standard merely reflects the international minimum standard, as contained in customary international law, or offers an autonomous standard that is additional to general international law. As a matter of textual interpretation it seems implausible that a treaty would refer to a well-known concept such as the 'minimum standard of treatment in customary international law' by using the expression 'fair and equitable treatment'. If the parties to a treaty want to refer to customary international law, one would assume that they would refer to it as such rather than using a different expression.[32]

A number of commentators have expressed the view that FET constitutes an independent treaty standard that goes beyond a mere restatement of customary international law.[33] Prominent among the supporters of an independent concept of

[27] S Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) 70 *BYBIL* 99, 100, 104, 145.

[28] P Weil, 'The State, the Foreign Investor, and International Law: The No Longer Stormy Relationship of a *Ménage À Trois*' (2000) 15 *ICSID Review-FILJ* 401, 415.

[29] S W Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law' in S W Schill (ed), *International Investment Law and Comparative Public Law* (2010) 151.

[30] See C Schreuer, 'Decisions Ex Aequo et Bono under the ICSID Convention' (1996) 11 *ICSID Review-FILJ* 37.

[31] *ADF v United States*, Award, 9 January 2003, para 184. See also *Mondev v United States*, Award, 11 October 2002, para 119; *Saluka v Czech Republic*, Partial Award, 17 March 2006, paras 282–4; *Enron v Argentina*, Award, 22 May 2007, paras 256–7; *MCI v Ecuador*, Award, 31 July 2007, para 370; *Total v Argentina*, Decision on Liability, 27 December 2010, paras 108–9.

[32] *Biwater Gauff v Tanzania*, Award, 24 July 2008, para 591.

[33] R Dolzer and M Stevens, *Bilateral Investment Treaties* (1995) 60; P T Muchlinski, *Multinational Enterprises and the Law* (1999) 626; UNCTAD Series on issues in international investment agreements, 'Fair and Equitable Treatment' (1999) 13, 17, 37–40, 53, 61; S Vasciannie, 'The Fair and

8. National treatment

(a) General meaning

Clauses on national treatment belong to the core and the standard repertoire of BITs. They are meant to provide a level playing field between the foreign investor and the local competitor. In their typical version in European BITs, the clauses state that the foreign investor and its investments are 'accorded treatment no less favourable than that which the host state accords to its own investors'.[501] Hence, the purpose of the clause is to oblige a host state to make no negative differentiation between foreign and national investors when enacting and applying its rules and regulations and thus to promote the position of the foreign investor to the level accorded to nationals. The application of the clause presupposes some type of 'treatment' by the host state; the relevant determination will look at the substance of the issue and not to the formal side.[502]

This purpose differs fundamentally from the concept of 'national treatment' as it became known a few decades ago, especially as part of the proposed 'New International Economic Order'.[503] That concept was intended to limit, as far as possible, any rights a foreign investor could derive from international law. The possibility that national law could actually be less protective for the foreign investor than the general rules of international law is anticipated in the current BITs by the words 'no less favourable', thus recognizing that other rules may be more favourable. Hence, a positive differentiation remains possible and will even be obligatory where the general standards of international law are higher than the ones applying to nationals.[504]

In BITs concluded by European states, the wording of the clause has essentially remained the same in past decades. US treaties traditionally specify that the clause will apply when 'like situations'[505] exist. In recent years there was a change in US practice from the term 'in like situations' to 'in like circumstances'.[506] This may indicate that for the US Government there are nuances between these two versions that deserve attention.[507]

[501] For a review of different national treatment clauses in BITs, see R Dolzer and M Stevens, *Bilateral Investment Treaties* (1995) 63–5.

[502] A broad understanding of 'treatment' is also found in *Merrill & Ring v Canada*, Award, 31 March 2010 and in *SD Myers v Canada*, Award, 13 November 2000, para 254.

[503] See p 4.

[504] See R E Vinuesa, 'National Treatment, Principle' in R Wolfrum (ed), *Encyclopedia of Public International Law*, vol VII (2012) 486.

[505] See the 1994 US Model Treaty, Art II.1 reprinted in UNCTAD (ed), *International Investment Instruments: A Compendium*, vol III (1996) 195.

[506] See the 2004 and 2012 US Model BITs, Art 3.

[507] NAFTA, Art 1102 also refers to 'like circumstances'. Article 1102(1) reads:

> Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

All national treatment clauses apply on national treatment). This covers both regu investment treaties, especially those conclu also include provisions concerning a right o of national treatment (pre-entry national t

The relative homogeneity of the clauses been said that the standard may be easi assumption, however, seems misleading. while the basic clause is generally the same more or less wide-ranging exemptions of antly, even the basic guarantees contained clarified.

It is generally agreed that the application context of fair and equitable treatment, standard resists abstract definitions and t preting the clause will be found. The re major components of the rule are conside

(b) Application

Three steps of analysis will be necessary to respected. First, it has to be determine domestic investor are placed in a compa like situation' or in 'like circumstances'. S the treatment accorded to the foreign treatment accorded to domestic investo that is less favourable, it must be dete justified. Behind these seemingly simple p that are not answered completely by exis and legal context of the relevant issues w

aa. The basis of comparison: 'like'

The first step in an application of the rul foreign investor with the domestic inve investor who is in exactly the same busin

[508] *Bayindir v Pakistan*, Award, 27 August 20

[509] See p 89.

[510] The Appellate Body of the WTO has obs that evokes the image of an accordion': *Japan—T* R (4 October 1996) H.1.(a).

[511] See pp 133–4, 139.

[512] *UPS v Canada*, Award, 24 May 2007, pa of a national treatment claim under Art 1102 of 1102, (b) like circumstances with local investors

All national treatment clauses apply once a business is established (post-entry national treatment). This covers both regulatory and contractual matters.[508] Some investment treaties, especially those concluded by the United States and Canada, also include provisions concerning a right of access to a national market on the basis of national treatment (pre-entry national treatment).[509]

The relative homogeneity of the clauses in BIT practice may explain why it has been said that the standard may be easier to apply than other standards. That assumption, however, seems misleading. As a matter of legal drafting technique, while the basic clause is generally the same, the practical implications differ due to more or less wide-ranging exemptions of certain business sectors. More importantly, even the basic guarantees contained in the standard itself have not yet been clarified.

It is generally agreed that the application of the clause is fact-specific.[510] As in the context of fair and equitable treatment,[511] such a statement cautions that the standard resists abstract definitions and that no hard-and-fast approach to interpreting the clause will be found. The reason will be seen immediately when the major components of the rule are considered.

(b) Application

Three steps of analysis will be necessary to determine whether the standard has been respected. First, it has to be determined whether the foreign investor and the domestic investor are placed in a comparable setting or, in US terminology, in 'a like situation' or in 'like circumstances'. Secondly, it has to be determined whether the treatment accorded to the foreign investor is at least as favourable as the treatment accorded to domestic investors.[512] Thirdly, in the case of treatment that is less favourable, it must be determined whether the differentiation was justified. Behind these seemingly simple parameters of the clause, lie complex issues that are not answered completely by existing case law. At all levels, the full factual and legal context of the relevant issues will have to be taken into account.

aa. The basis of comparison: 'like'

The first step in an application of the rule to a case concerns the comparison of the foreign investor with the domestic investor. Is it necessary to identify a domestic investor who is in exactly the same business, or is it sufficient to point to an investor

[508] *Bayindir v Pakistan*, Award, 27 August 2009, para 388.

[509] See p 89.

[510] The Appellate Body of the WTO has observed that the 'concept of "likeness" is a relative one that evokes the image of an accordion': *Japan—Taxes on Alcoholic Beverages II*, WT/DS8, -10, -11/AB/R (4 October 1996) H.1.(a).

[511] See pp 133–4, 139.

[512] *UPS v Canada*, Award, 24 May 2007, para 83 distinguishes three distinct elements of a review of a national treatment claim under Art 1102 of the NAFTA: (a) treatment in the areas listed in Art 1102, (b) like circumstances with local investors and investments, and (c) less favourable treatment.

assessing jurisdiction, the Tribunal considers, prima facie, that Pakistan is bound to treat investments of Turkish nationals 'fairly and equitably.'[582]

MFN clauses have also been invoked in the context of defining the standard of compensation in expropriation cases. In *CME v Czech Republic*,[583] the applicable BIT provided for 'just compensation' representing the 'genuine value of the investment affected'. In its award, the Tribunal also relied on the MFN clauses in order to rule that the compensation should represent the 'fair market value' of the investment:

> The determination of compensation under the Treaty between the Netherlands and the Czech Republic on basis of the 'fair market value' finds support in the 'most favored nation' provision of Art. 3(5) of the Treaty.... The bilateral investment treaties between the United States of America and the Czech Republic provides that compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken... The Czech Republic therefore is obligated to provide no less than 'fair market value' to Claimant in respect of its investment, should (in contrast to this Tribunal's opinion) 'just compensation' representing the 'genuine value' be interpreted to be less than 'fair market value.'[584]

(e) Current state of the law

While it is important to consider the reasoning of the tribunals and their methodological approach, it is equally or more significant to focus on the holdings of the decisions.[585] The weight of authority clearly supports the view that an MFN rule grants a claimant the right to benefit from substantive guarantees contained in third treaties. The cases so far decided do not address in detail the question whether and to what extent any limits exist for the application of the rule to such substantive guarantees.

The larger group of cases deals with the applicability of MFN clauses not to substantive guarantees but to dispute settlement. That issue is discussed in Chapter X on dispute settlement.[586] As can be seen there, practice in that field is less straightforward and to some extent divided.

On this basis, it is too early to conclude in broader terms in which direction the jurisprudence may evolve in regard to the effect of an MFN clause for the invocation of another treaty. One view would be that so far no tribunal has permitted the invocation of the clause in a manner that would have led to 'regime change' in regard to the basic treaty containing the clause. This would mean that an MFN clause will operate only to the extent that the provision in the other treaty is compatible in principle with the scheme negotiated by the parties in the basic treaty

[582] At paras 231–2. See also *Bayindir v Pakistan*, Award, 27 August 2009, paras 163–7.
[583] *CME v Czech Republic*, Final Award, 14 March 2003.
[584] At para 500.
[585] In *Bayindir v Pakistan*, Decision on Jurisdiction, 14 November 2005, paras 201 et seq, the Tribunal discussed de facto discrimination, but, in spite of the decision's wording, focused on the requirement of national treatment rather than the MFN rule.
[586] See pp 270–5.