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Fair And Equitable Treatment And Evolving Standards Under Investment Treaty Arbitration

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Abstract:
The Fair and Equitable Treatment (FET) standards play an important place in International Investment Treaty Arbitration and International Investment Law. The host state is required to protect the alien territory, its investors, and investments from physical and legal encroachment. Hence, the FPS and FET clause of Bilateral Investment Treaty (BIT) should not be vague, absurd, arbitrary, or flawed. It is indispensable for sustainable business and investment growth that the host States provide physical and legal protection to the investor States and their investments. It is equally important to protect the investors from manifest arbitrariness, denial of justice and discrimination. The investors and investments should be protected from the actions of third parties and organs of the state and its officials. They, therefore, must be protected from every kind of illegitimate, unreasonable, arbitrary, irrational, and objectionable action of the state.

Key Words: BIT, FET, FPS, Manifest Arbitrariness, Investment Treaty Arbitration,

Introduction

The concept of fair and equitable treatment now plays an important role in investment relations between States. Along with other standards which have significantly grown in recent years, the fair and equitable treatment standard undoubtedly gives a useful yardstick for the purpose of assessment of relations amongst foreign direct investors and Governments of capital-importing countries. Generally, the standard also works as a signal from capital-importing countries with the intention that a host country guarantees fair and equitable treatment. It presumably demonstrates that the international investment within the ambit of its jurisdiction will be an inseparable part of treatment compatible with some of the main expectations of foreign investors.

In fact, the concern of the investors related to investment could be noticed in case of security and stability of the host state and its environment. Indian Finance Minister made an announcement of the roadmap of an ambitious Rs. 6 lakh crores in terms of national monetization pipeline. In my opinion, its success and prosperity will rely upon the participation of foreign investors in general and abiding by the standards of fair and equitable treatment. It is pertinent to mention that the unanimous decision against India at the Permanent Court of Arbitration in Vodafone and Cairn Energy cases demonstrate the significance of the Fair and Equitable Treatment (FET) clause in bilateral investment treaties (BIT). In both these cases, interestingly, countries ensured to maintain fair and equitable treatment, and arbitration in case of disputes. Furthermore, the policy change of Government of India will bring stability and it will help in avoiding future disputes. Nonetheless, there are still some possibilities for reforming the provisions of the old BITs. It goes without saying that the fair and equitable standard has been an important aspect of international investment law since the Second World War. The term “equitable treatment” was used for the first time in the 1948 Havana Charter for an international trade organization. Article 11(2) prescribed that it is necessary for the host state that foreign investors should be treated “justly and equitably”. It is humbly submitted that the ITO could make proposals for encouraging bilateral or multilateral agreements on such initiatives deriving from trade and to guarantee fair and equal treatment pertaining to business, expertise, skills, capital, and technology.

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Being a part of international law, "Fair and equitable Treatment" consists of all sources which includes state practice and judicial precedents. There is not only the need to comply with International customary law but also to consider numerous principles of different treaties. According to the OECD, fair and equitable treatment established a substantial legal standard which talks about the general principles of international law. In addition to this, it also gives a general guideline for interpretation of agreement for the purpose of resolving disputes. The principles of international law are considered to offer a basic fair understanding of the just and equitable treatment provided to the nation. Further, the treatment is supposed to protect the security of the investors along with their investments.

Meaning of Fair and Equitable Treatment

For the protection of foreign investment, fair and equitable treatment (herein referred to as FET) standard has replaced expropriation. FET is undoubtedly a legal standard. There should not be any ambiguity as to its practical application. The tribunal has tried to give a broad definition of the FET in several cases. In other words, the tribunals are essentially dependent upon the investor's basic expectation, reliance, consistency, accountability, ever-handedness, non-discrimination, justice, fairness, arbitrariness, judicial propriety, and natural justice. The issue with this approach is that either it is too broad to practically apply or too narrow to work as a useful standard for cases. On the other hand, procedural propriety and due process are essentials of the rule of law which is indispensable for fair and equitable treatment. In addition to this, procedural shortcomings and denial of justice could be considered as a violation of FET. Good faith is another element of FET. For instance, deliberate conspiracy to defeat the investment could be deemed as an instance of good faith violation. The application of FET would take place even in case of coercion and harassment of the investigators. States have perceived that sufficient economic activity cannot be generated staying alone from other nations to encourage fast economic growth. Such statement is more suitable for developing nations. Before getting involved in such activities, States are extremely cautious for restoring the investment flows in their respective countries.

The Evolving Standard

It is important to mention that FET standards are evolving as per the march of time and development of international trade and investment. The tribunals, therefore, have been significantly moving away from the discourse of the relationship between the FET standard and the minimum standard of treatment of aliens. As an alternative, they have emphasized on discerning the substantive content of the standard in terms of identifying the specific elements that the standard is dependent upon, taking into consideration the myriad of different specific factual contexts. The modern FET claims includes all kinds of administrative and legislative decisions. Additionally, it includes the conduct of anybody or entity if this conduct is attributable to the State.

Legitimate expectation

Protection of investors' legitimate expectations has been considered as an essential element of the FET standard which was repeatedly identified by arbitral tribunals. Claims pertaining to breach of legitimate expectations appear in situations when an investor is suffering losses because of the alterations brought about by State measures. To put it simply, when an adverse effect to an investment is caused by the very conduct of host state, it, consequently, reduces its economic value; an investor alleges that the State infringes legitimate expectations that the investor was entitled at the time of making the investment. Therefore, the obvious question is to what degree, the FET standard incorporates protection of such legitimate expectations. The focus should be on the stable legal and business framework. The unprecedented statement of the permissive position could be found in the tribunal's award in Tecmed v. Mexico the tribunal upheld that the Mexican authorities had acted in an absurd, irresponsible, and uncertain way in their actions in relation to the replacement of the license which consequently leads to infringing the legitimate expectations of the claimant. In the case of Duke Energy v. Ecuador, the assessment of the reasonableness or legitimacy must be taken into consideration all circumstances which include not only the facts related to the investment but also the political, socioeconomic, cultural, and historical conditions prevalent in the host State. There will be the presumption of awareness of general regulatory environment as a stipulation for the purpose of application of the legitimate expectations doctrine as it was held Methanex v. United States.

In the recent case of BayWa r.e. Renewable Energy GmbH and BayWa r.e. Asset Holding GmbH and Kingdom of Spain it was held that an investor has the legitimate expectation at the time when the regulation is modified by the state under which

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the investor made the investment, such medication of regulation shall not be unreasonably contrary to the public interest, and it shall not be in a disproportionate manner. In addition to this, the Arbitration Tribunal observed that the proportionality requirement is deemed to be fulfilled if the modifications are not unnecessary, unreasonable, and arbitrary. Additionally, they do not eliminate the essential features of the regulatory framework in place. Saluka v. Czech Republic it was categorically propounded by the tribunal that legitimate expectations, for the purpose of its protection, must appear to the level of legitimacy and reasonableness in terms of Balancing investors' expectations against legitimate regulatory action.

Manifest arbitrariness

The analysis of arbitrariness in the earlier arbitral awards has usually been interpreted in the context of a separate BIT obligation that explicitly prohibits arbitrary measures. Nonetheless, several tribunals have propounded that that prohibition of arbitrariness is an inseparable part of the FET standard. Arbitral conduct was explained as "based on prejudice or preference rather than on reason or fact" Another form of arbitrariness refers to a conduct which constitutes a "willful disregard of due process of law". For instance, a blatant non-observance of applicable tender rules, misinterpreting fair competition among tender participants, was held to be arbitrary. The violation must undoubtedly be blatant or manifest. It is crystal clear that due to prohibition of arbitrary conduct States cannot be prevented from regulating in public interest.

However, in the recent case of Odyssey Marine Exploration, Inc on their own behalf and on behalf of Exploraciones Oceanicas S. De R.L. De C.V. United Mexican States the tribunal said that manifest arbitrariness is the violation of NAFTA Article 1105(1) (Minimum Standard of Treatment). In this regard, the refusal by SEMARNAT to observe evidence and scientific analysis in its decision making and technically unreasonable conclusions, together with Secretary Pacchiano's avowal to prohibit project approval under any situations, all are the reflection of deliberate State treatment of the investment that is manifestly arbitrary, and which does not even comply of international minimum standards.

Denial of justice and due process

It is pertinent to mention that abiding by the most basic due process requirements is essential to avoid a denial of justice. Denial of justice can appear in the form of gross misadministration of justice by domestic courts. As a consequence of this, it leads to ill-functioning of the State's judicial system. It is usually considered that only gross or manifest instances of injustice are recognized as denial of justice. Following up this principle, it could be concluded that a simple error, misinterpretation, or misapplication of domestic law cannot be considered per se a denial of justice. The well-known examples of the denial of justice are refusal of courts to decide or unreasonable delay in proceedings. Even the lack of a court's independence from the legislative and the executive branches of the State are considered as denial of justice. Furthermore, the failure to execute final judgments, arbitral awards, or corruption of a judge along with discrimination against the foreign litigant is the instances of denial of justice. It was observed by the tribunal in the case of Lion Mexico Consolidated L.P.A V. United Mexican States denial of justice may arise in such a situation when the final act of a state's judiciary establishes a notoriously unjust or egregious administration of justice which leads to offend a sense of judicial propriety. In other words, a denial of justice exists where there is obstruction as to accessibility to courts. Moreover, there is the instances of failure to provide those guarantees which are usually considered indispensable for the purpose of effective administration of justice.

Discrimination

Several times tribunals have held that the FET standard prohibits discriminatory treatment of foreign investors and their investments. To be very specific, discriminatory treatment may target a foreign investor on other manifestly wrongful grounds such as gender, race or religious belief even other kinds of conduct which amount to a deliberate conspiracy for the purpose of destroying or frustrating the investment.

The role of investor conduct

It is interesting to note that investor's conduct has evolved as a relevant factor in the analysis and evaluation of FET claims by arbitral tribunals. The relevancy of such concept may be presented in two ways. First, the measure taken against the investor could be justified by the respondent country. Furthermore, the investor may think of the failure of an investment onto itself by bad management like in Noble Ventures Inc v. Romania, the tribunal concluded that the claimant could not constitute that Romania had violated the FET standard or the expropriation provision under the wider ambit of the Romania-United States

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BIT. In this regard, it would not be unreasonable to state that many tribunals have opined that a violation by the host State of an investment contract or of its own domestic law does not give rise to a breach of the FET standard.

Apart from this, the obligation to exercise due diligence for the purpose of protection of foreign investors proves to be an important element of the fair and equitable clause. On general terms, to understand the due diligence the fair and equitable treatment is evaluated with the full protection and security clause. However, the full protection and security clause is prescribed in treaties as a separate obligation, but it helps in the interpretation and explanation of the Fair and equitable treatment laws. The main issue is that the FET principle itself does not contain any fixed meaning. It, therefore, was developed by arbitral tribunals. Another issue is the lack of adherence and compliance of some tribunals to basic principles of international law. The contemporary arbitral interpretative practices and the lack of a rule of precedent increase the problems of the FET principle.

The relationship between the FET and the FPS Standards

It is difficult to distinguish between them. It has been observed whether a particular action has breached both the FET and the FPS standards, it will be assessed on the valuation of both the standards. To put it simply, the FPS standards can be applied where the state has failed in following the due diligence in taking the required measures for the protection of investors and investments including sufficient legal mechanisms. The FET standards deal with actions of the state related to an investment as to whether the state is acting in good faith, rationally, honestly, and responsibly. Hence, it would not be unreasonable to state that in some cases the Tribunals have applied in a similar manner for unjust actions while in some cases the Tribunals have applied both the standards quite differently.

Due Diligence, Strict Liability, and the Capacity of the State

The application of due diligence is not as simple as it appears. The issue is whether the capacity of the state could be considered for determining obligations in terms of due diligence standards. The tribunals have taken views while resolving this issue. Hence, such a decision summarizes that the stability, capacity, resources, availability, and stability of the state are quite indispensable for resolving the issue of obligation of the host state for abiding by the FPS clause. For instance, in Pantechniki v. Albania the host state failed to protect the investors for their construction project. The tribunal found that there was no such liability of the State to provide protection and maintain the due diligence clause since the host state was not capable of having sufficient resources. In short, the tribunal should decide each case with great caution and precision since there is no straight-jacket formula for determining the case. Another question is whether due diligence or strict liability should be followed? First and foremost, one must understand that the protection of the investors and investment is not absolute. In case of the absence of any treaty standards, the state is supposed to follow the due diligence norms. In one of the cases namely AAPL v. Sri Lanka, the issue of strict liability was raised within the ambit of FPS. The tribunal rejected the proposition by saying that the due diligence standard should be followed. It can be concluded that there is no watertight compartmentalization for determining the liability. Whether the capacity of the State or due diligence would be considered, will vary as per the circumstances of the case.

Suggestions & Conclusion

An inevitable conclusion that the author would derive from the abovementioned argument is that the FPS and FET standards are full of inherent contradictions. The approaches of the Tribunals have been so varied. Some of them are standing by the physical harm while applying the FPS standards whereas others are more interested in applying the legal and regulatory harm as well. One of the methods of maintaining the fine balance between both is that the concluded BIT must contain a specific clause for the protection of the FPS and FET. A strict penalty should be imposed in case of a violation of the FET and FPS standards. The BIT should not be vague or flawed. For instance, the paramount purpose of the entire model BIT is to limit or restrict the liability for the host state and raise the bar which is necessary to bring a claim under the BIT. It unnecessarily narrows down the definition of "investment," thereby creating a high threshold of breaches, and removing much of the protections that investors are largely dependent upon. There should be a separate regulatory mechanism that will regulate the criteria of FET and FPS standards. The regulatory institution will be entrusted with maintaining the proper check and balance of the BITs and general principles of international law. The host States must play the role of a shield to protect them from the unruly swords, as they are supposed to protect the foreign investors and their investments. Consequently, it leads to inclusive development of the economy and society of the State. The joint efforts and mutual consensus of the state could identify the

factors indispensable for giving protection to foreign investors and their investments. The capacity of the state while applying the due diligence standard should be considered. The tribunal should also use the foreseeability and proportionality test while resolving the FPS and FET standards.

An investment-friendly business environment is the need of hour as it would increase economic activity and help raise more revenue over time for the Government of India. Additionally, it is expected that tax officials' desire to decline their defeat and to try and hang on to legally untenable revenue finds an unsympathetic burden from politicians in the finance ministry. It is equally important to note that India needs to craft constructive, unambiguous, and clear dispute resolution mechanisms in cross-border transactions for the purpose of preventing the disputes from going to international courts, and additionally save the cost and time expenditure of the State. Improving the very arbitration ecosystem will have a significant impact on the ease of doing business as well.

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