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Expropriation and the "Fair and Equitable" Standard

The Developing Role of Investors' "Expectations" in International Investment Arbitration

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International arbitral tribunals presiding over recent investment claims brought under bilateral investment treaties and the North American Free Trade Agreement (NAFTA) have made frequent references to the "expectations" of the investor claimant in deciding the cases before them. Some tribunals have referred to the investor's expectations as a core factor in deciding that an investment has been indirectly expropriated by the state respondent; others, particularly in some of the most recent awards, have referred to the investor's expectations as being a core indicator as to whether there has been a failure to accord "fair and equitable treatment" to the investor, often in circumstances where there was no accompanying finding of expropriation. In other cases where the supposed expectations of the investor were disappointed as a result of state conduct, tribunals have nevertheless found that there has been no breach of the expropriation or "fair and equitable" provisions of the applicable treaty.

It is now well-established that disappointed expectations can, in some circumstances, establish a basis of claim under international investment treaties. However, the guiding principles that have been applied by tribunals in deciding whether or not a breach of the claimant's expectations should be sufficient to establish state liability under the "expropriation" head or the "fair and equitable" one, or both together, or indeed neither of them, remain somewhat unclear. This article, with reference to the recent arbitral case law, attempts to identify: (i) in what circumstances an investor's expectations should be relevant to a tribunal's determination as to whether an investment has been expropriated; and (ii) in what circumstances such expectations should be relevant to an analysis of the "fair and equitable" standard. It then examines three of the most recent cases where investors' expectations were at issue: *Methanex*, *Thunderbird*, and *Saluka*. Each of these cases illustrates, in different ways, the continuing failure of some of the most pre-eminent arbitral tribunals to address, in a clear, consistent, and analytical manner, the precise content of, and interrelationship between, the "expropriation" and "fair and equitable" heads of claim in the context of investor's expectations. The article then concludes by attempting

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to clarify that interrelationship, against the broader context of an apparent tendency for recent tribunals to move away from findings of indirect expropriation in circumstances where there has been no "neutralisation" of the investment, in favour of reliance upon the more flexible and self-standing fair and equitable standard as a source of state responsibility.

I. The Domestic Law Origins of the Attachment of Legal Rights to Claimants' Expectations

As a first step, however, it is constructive to identify the roles played by claimants' expectations in forming the basis for certain related causes of action in systems of domestic law. The apparent similarities between the analysis of claimants' expectations by domestic courts and the approach taken by international tribunals in recent cases is illustrative of the expanding influence of domestic legal concepts, particularly those of a public law nature, on the field of international investment law.

The first domestic public law principle that has clear parallels in international investment law is the principle of "legitimate expectation." In exercising their powers of administration over private individuals and corporations, many domestic legal systems require public authorities to respect the "legitimate expectations" of the individuals and corporations concerned. Thus, Schwarze comments in the European context that:

> The connected concepts of legal certainty and legitimate expectations are to be found in all the legal systems of the Member States which make up the [European] Community, although their precise legal content may vary from one system to another.[1]

Pursuant to basic principles of English public law, for example, government entities are expected to honour their statements of policy or intention, particularly when these have been directed at particular individuals, or groups of individuals, as part of their general duty of fairness. Such statements can create "legitimate expectations," the disappointment of which can form the basis for a cause of action against the government entities concerned. These legitimate expectations can be either of a procedural or a substantive nature. Wade and Forsyth, two leading scholars in English public law, describe the distinction between procedural and substantive expectations in the following terms:

> An expectation may, first of all, be a procedural expectation where a particular procedure not otherwise required has been promised. Thus where the government of Hong Kong announced that certain illegal immigrants would be interviewed before deportation a procedural expectation was established. Secondly, what is expected may be a particular or favourable decision by the authority. Thus where the Home Secretary had specified the criteria applicable to a decision to allow a child to enter the UK with a view to adoption there was a substantive expectation that those criteria (which were satisfied by the applicant) and not others would be used when the decision was taken.[2]

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[1] *See generally* J. Schwarze, European Administrative Law ch. 6 (1992).

[2] H.W.R. Wade & C.F. Forsyth, Administrative Law 498 (8th ed. 2000). *See also* the general discussion of procedural and substantive expectations in P. P. Craig, *Substantive Legitimate Expectations in Domestic and Community Law*, 55 Cambridge L.J. 289, 290–97 (No. 2, 1996) (footnotes omitted).

In the context of procedural expectations as a cause of action under English public law, it has been commented that:

> A legitimate expectation will arise in the mind of the complainant wherever he or she has been led to understand—by the words or actions of the decision maker—that certain procedures will be followed in reaching a decision.... Where such expectations have been created, the decision maker is not free simply to ignore the procedures which have been indicated.[3]

In the context of substantive expectations, Wade and Forsyth consider that such expectations may be protected more readily when the expectation is given individually to a small group than where a general announcement of policy is made to a large group, since in the former class of case the governmental decision-maker's freedom of action is being restricted only in exceptional cases.[4]

The concept of "legitimate expectations" is also central to European Union law. Indeed, it forms a "general principle of law" pursuant to which the European Court of Justice can strike down national measures.[5] That court has had no difficulty in accepting claims for breach of legitimate expectations where the benefit sought is substantive in nature.[6]

The concept of "legitimate expectation" under English and other domestic public law systems has not grown up in connection with deprivations of property rights as such, but rather in the context of the standard of treatment that private individuals or corporations are entitled generally to expect from state authorities in the exercise of their powers. It is thus in connection with the fair and equitable standard that the concept has played the most significant role in the recent decisions of investment tribunals described *infra*. This is perhaps unsurprising given the clear parallel that exists between the objectives of the fair and equitable standard (as part of the "international minimum standard") at international investment law and the duty of fairness imposed upon public bodies in many domestic legal systems.

Francisco Orrego Vicuña is one leading public international lawyer to have observed this parallel in a recent article. Having referred to some of the leading authorities in the English courts on the legitimate expectations principle, he states that:

> The situation is not altogether different under international law. Governments and international organizations may undertake changes of policy in their continuing need to search for the best choices in the discharge of their functions. However, to the extent that policies in force earlier might have created legitimate expectations both of a procedural and substantive nature, for citizens, investors, traders or other persons, these may not be abandoned if the result will be so unfair as to amount to an abuse of power.[7]

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[3] HILAIRE BARNETT, CONSTITUTIONAL & ADMINISTRATIVE LAW 767 (5th ed. 2004).

[4] *Id*. at 499–500. For a leading case on the English public law of substantive legitimate expectations, *see* R. v. North and East Devon Health Authority ex p. Coughlan, [2000] 2 W.L.R. 622.

[5] *See*, *e.g.*, DE SMITH, WOOLF & JOWELL, JUDICIAL REVIEW OF ADMINISTRATIVE ACTION 867 (1995). *See also generally* ULF BERNITZ & JOAKIM NERGELIUS, GENERAL PRINCIPLES OF EUROPEAN COMMUNITY LAW ch. 4.1 (2000).

[6] *See*, *e.g.*, Cases C-104/89 & 307/90, Mulder v. Council and Commission, 1992 E.C.R. I-3061; Case C-152/88, Sofrimport Sour v. Commission, 1990 E.C.R. I-2477; and Case 74/74, CNTA S.A. v. Commission, 1975 E.C.R. 533.

[7] Francisco Orrego Vicuña, *Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society*, *in* 5 INTERNATIONAL LAW FORUM DU DROIT INTERNATIONAL, 188, 194 (2003).

A second, but entirely separate, domestic public law concept with clear parallels in international investment law is the concept of "investment-backed expectations." In contrast to the legitimate expectations principle, the concept of "investment-backed expectations" is recognised in some systems of domestic law specifically in the context of deprivation of property rights. In the United States, for example, the Fifth Amendment offers claimants whose property has been "taken" without payment of "just compensation" a cause of action that is in many ways similar to an expropriation claim under international investment treaties. The U.S. courts have identified the "investment-backed expectations" of a claimant as being a "relevant consideration" in determining whether or not public entities have "taken" property in violation of the Fifth Amendment.[8] The concept of "investment-backed expectations" has similarly been introduced by arbitral tribunals, both in the NAFTA context and more recently in bilateral investment treaty (BIT) cases, in determining whether or not there has been an expropriation of an investment for the purposes of the applicable treaty provision.

One significant difference between the U.S. law concept of "investment-backed expectations" and the English law concept of "legitimate expectations" is that, while the former relates to the general expectations of, for example, an investor when entering into an investment, based upon all of the circumstances of the investment, the latter relates specifically to expectations that have been created by the acts, statements or omissions of the relevant public authorities. As such, the close parallels between the requirement to fulfil "legitimate expectations" and the requirement to accord "treatment" that is "fair and equitable" in nature are particularly evident.

With these preliminary observations made, it is useful to proceed with an analysis of the recent investment case law as it has touched upon the failed expectations of investor claimants. This will be done with reference to those circumstances where failed expectations have contributed to, first, a finding that the claimant's investment has been the subject of an indirect expropriation and, secondly, a finding that state respondents have failed to accord fair and equitable treatment to the claimant. Following such analysis, an attempt will be made to identify the distinctive features of the two overlapping bodies of case law, thus allowing investors whose expectations have been disappointed to determine which (if any) of their substantive rights under applicable investment treaties have been violated in the particular circumstances of any given case.

II. Investors' Expectations and the Concept of Indirect Expropriation

The past five years have witnessed a crystallization in the central role that is played by investors' expectations in the law of indirect expropriation. This has led one pair of distinguished commentators to suggest that:

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[8] *See, e.g.*, Penn Central Transportation Co. and others v. New York City and others, 438 U.S. 104; 98 S. Ct. 2646.

> The prohibition against indirect expropriation should protect legitimate expectations of the investor based on specific undertakings or representations by the host state upon which the investor has reasonably relied. This is by no means an exclusive test to be applied to all types of alleged indirect expropriations in isolation of other relevant factors. It is, nonetheless, a useful guiding principle that appears to cover many of the situations that have come before modern investment treaty tribunals.[9]

But what have been the specific characteristics of those recent cases where the expectations of an investor have contributed towards a finding of expropriation? And have the investors' expectations in those cases always been based upon "specific" undertakings or representations by the host state? Six cases decided between 2000 and 2005, of which three were brought under the NAFTA and three were brought under applicable BITs, are particularly illustrative and will be addressed in turn.

In *Metalclad Corp. v. United Mexican States* ("*Metalclad*"),[10] the U.S. claimant alleged that Mexico, through the governments of the State of San Luis Potosi and the Municipality of Guadalcazar, had interfered with its development and operation of a hazardous waste landfill, contrary to the requirements of Articles 1105 and 1110 of NAFTA. Federal construction and operating permits for the landfill had been issued by the Mexican government prior to the claimant's investment and the state government had likewise issued a state operating permit. Federal officials assured the claimant that no further permits would be required to undertake the landfill project and, relying on these representations, the claimant started construction of the landfill and continued until it was made the subject of a "Stop Work Order" by the municipal government. The municipality subsequently denied a construction permit to the claimant, in direct contradiction to the federal government's previous assurances and on grounds that the tribunal found to be improper. The municipality's decision effectively prevented the claimant from operating the landfill.

In addressing the claimant's expropriation claim under NAFTA Article 1110, the tribunal, in a passage that has been cited frequently in subsequent cases by both counsel and investment tribunals, commented 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 favour 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.[11]

Applying this test to the facts of the case before it, the tribunal held that the municipality having denied issuance of a construction permit on grounds that were not open

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[9] Jan Paulsson & Zachary Douglas, *Indirect Expropriations in Investment Treaty Arbitration*, *in* ARBITRATING FOREIGN INVESTMENT DISPUTES 157 (N. Horn ed., 2004).

[10] Metalclad Corp. v. United Mexican States, ICSID Case No. ARB(AF)/97/1, August 30, 2000, *available at* <www.investmentclaims.com>.

[11] *Id.* para. 103 (emphasis added).

to it, taken together with the representations of the federal government upon which the claimant had relied, amounted to an indirect expropriation.[12]

The following year, an UNCITRAL tribunal in the case of *CME Czech Republic B.V. (The Netherlands) v. Czech Republic* ("*CME*"),[13] brought under the Netherlands-Czech Republic BIT, reached a similar finding of indirect expropriation. The purpose of the claimant's investment in that case had been to develop and operate a television station in the Czech Republic, for which a broadcasting licence had been granted by the Czech Media Council. The structure of the investment had been determined in conjunction with the Media Council in 1993 in order to attract the claimant's participation. However, in 1996 the Media Council reversed its position as to the legality of the claimant's investment structure and, as a result of the commencement of administrative proceedings and other coercion by the Media Council including threatened withdrawal of the broadcasting licence, the claimant was forced to restructure the investment. This had the result of forcing the investor to give up substantial accrued legal rights and of leaving the investment exposed to further state and regulatory interference. Some thirty months later, in 1999, the Media Council actively supported the destruction of the claimant's investment.

The tribunal held that the investor had been entitled to rely on the original investment structure as developed with the Media Council's approval. The coerced amendment of the investment structure in 1996, combined with the subsequent events in 1999, had the effect of neutralizing the claimant's investment and thus violating the expropriation provision of the Netherlands-Czech Republic BIT.[14]

A key feature of each of the *Metalclad* and *CME* cases was that, as a result of the breaches of assurances that had been given by the responsible state authorities, which had been relied on by the claimants when making their investment decisions, the claimants' investments were effectively neutralised. In a case decided the following year by an ICSID tribunal under NAFTA, *Marvin Feldman v. Mexico* ("*Feldman*"),[15] this feature was absent, with the result that the tribunal refused the claimant's expropriation claim in that case.

In the *Feldman* case, a U.S. investor claimed that Mexico's refusal to recognise his investment's right to a tax rebate constituted a breach of, inter alia, Article 1110 of NAFTA. The claimant made reference to certain assurances that had allegedly been given by Mexican tax officials to the effect that rebates would be paid. Indeed, the rebates were paid for a time, but following a change in Mexican tax laws the Mexican authorities demanded repayment of those rebates. The tribunal found that there was little persuasive evidence as to the scope of any assurances that had been given, nor was there any contemporaneous written record of an alleged agreement that the claimant's investment

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[12] *Id.* para. 107. In reaching this conclusion, the tribunal paid particular regard to the similarities between the case before it and the earlier case of Biloune and others v. Ghana Investment Centre and others, 95 I.L.R. 183, 207–10 (1993).

[13] CME Czech Republic B.V. (The Netherlands) v. Czech Republic, Partial Award, September 13, 2001, *available at* <www.investmentclaims.com>.

[14] *See id.* para. 601.

[15] NAFTA, Marvin Feldman v. Mexico, ICSID Case No. ARB(AF)/99/1, December 16, 2002, *available at* <www.investmentclaims.com>.

would be entitled to the rebates.[16] The written and oral communications referred to by the claimant were "at best ambiguous and misleading."[17] Indeed, in addition to noting these evidential weaknesses, the tribunal observed that the claimant's investment had failed to meet the specific conditions for a rebate under Mexican tax laws.[18]

The *Feldman* tribunal explicitly distinguished the facts of the case before it from those of the *Metalclad* case, where the assurances received by the investor had been "definitive, unambiguous and repeated" and had not been inconsistent with Mexican law.[19] Ultimately, however, the actions forming the basis of the claimant's case had not deprived him of control of his investment, interfered directly with his company's internal operations or displaced him as controlling shareholder. There had thus been no "taking," with the result that the claimant's investment could not be said to have been expropriated.[20]

In *Tecnicas Medioambientales Tecmed v. United Mexican States* ("*TECMED*"),[21] which was decided by an ICSID tribunal the following year under the Spain-Mexico BIT, the circumstances were very different. In that case, the Spanish claimant purchased a hazardous industrial waste landfill following a public auction. The Mexican authorities refused, by way of an administrative resolution, an application for renewal of the required operating licence two years later. The claimant argued that the refusal frustrated its "justified expectation of the continuity and duration of the investment made and would impair recovery of the invested amounts and the expected rate of return."[22] The tribunal allowed the claimant's expropriation claim, finding that the refusal had "fully and irrevocably destroyed" the investment's economic and commercial operations in the landfill. Indeed, the landfill could not be used for different purposes due to hazardous waste that had accumulated on the site. The tribunal considered that, in deciding whether or not there had been an expropriatory act, it was appropriate to determine whether the state's measures were:

> reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of those who suffered such deprivation. There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory act.[23]

The tribunal concluded that there was no such relationship of proportionality on the facts of the *TECMED* case. The claimant's investment had violated certain regulatory conditions, but these did not pose a present or imminent risk to the legitimate interests

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[16] *Id.* paras. 126–27.
[17] *Id.* para. 132.
[18] *Id.* para. 128.
[19] *Id.* para. 148.
[20] *Id.* para. 152.
[21] Tecnicas Medioambientales Tecmed v. United Mexican States, ICSID Case No. ARB(AF)/00/2, May 29, 2003, *available at* <www.investmentclaims.com>.
[22] *Id.* para. 41.
[23] *Id.* para. 122. In doing so, the tribunal made reference to the jurisprudence of the European Court of Human Rights under art. 1 of Protocol No. 1 to the European Convention on Human Rights.

of ecological balance or public health. The tribunal commented that "[T]he Claimant's expectation was that of a long-term investment relying on the recovery of its investment and the estimated return through the operation of the Landfill during its entire useful life."[24] The claimant's expectations "should be considered as legitimate and should be evaluated in light of the [BIT] and of international law."[25]

It is worthy of particular note that the long-term expectations of the claimant, to which the tribunal made reference in determining the proportionality of the Mexican authorities' refusal of the essential operating licence, were not in this case dependent on any act or representation attributable to the Mexican state. Rather, they flowed from the objective investment characteristics that the claimant had taken into consideration when deciding whether to make the investment and on what terms. They were based on all of the circumstances of the investment and were led by commercial considerations, not governmental assurances. As such, the expectations contemplated by the tribunal were very similar to the "investment-backed expectations" that are considered relevant by U.S. courts when determining whether public entities have "taken" property in violation of the Fifth Amendment. It was a failure to meet those expectations that was central to the tribunal's conclusion that the claimant's investment had been the subject of an indirect expropriation.

The next case which raised the question of the claimant's expectations in the context of an expropriation claim was the NAFTA case of *Waste Management, Inc. v. United Mexican States* ("*Waste Management*"),[26] decided by an ICSID tribunal in April 2004. The case arose out of a concession for the provision of waste disposal and street cleaning services in the City of Acapulco, which was awarded to the claimant's wholly owned subsidiary. Under the terms of the concession, the City agreed not to grant any competing concessions to third parties and to take and enforce various measures to protect the concessionaire's exclusive rights. In return, the concessionaire undertook to build and operate a solid waste landfill. The City agreed to provide a site for the landfill as a "gratuitous loan" for the term of the concession. Pending construction of the new landfill, the concessionaire would be given free access to an existing landfill site. The concession soon encountered financial problems as a result, inter alia, of unauthorized competition and low take-up by customers. The claimant alleged that the City had violated various of its obligations under the concession and referred to the fact that the City had failed to pay eighty percent of the total amount invoiced to it by the concessionaire by the time of suspension of activities under the concession. The claimant argued that the totality of the treatment to which its investment had been subjected amounted to an expropriation in violation of NAFTA Article 1110.

The tribunal rejected the claimant's argument. Although the City's conduct had deprived the concessionaire of the expected economic benefit of the project so far as

[24] *Id.* para. 149.
[25] *Id.* para. 150.
[26] Waste Management, Inc. v. United Mexican States, ICSID Case No. ARB(AF)/00/3, April 30, 2004, *available at* <www.investmentclaims.com>.

monthly incomes were concerned, this could be true of any serious breach of contract. Specifically, the tribunal commented that "the loss of benefits or expectations is not a sufficient criterion for an expropriation, even if it is a necessary one."[27] Making a clear distinction between the expropriation of a right under a contract and a mere failure to comply with a contract, the tribunal stated that the concessionaire had entered into the concession on the basis of an over-optimistic assessment of the possibilities. It concluded that:

> it is not the function of the international law of expropriation as reflected in Article 1110 to eliminate the normal commercial risks of a foreign investor, or to place on Mexico the burden of compensating for the failure of a business plan which was, in the circumstances, founded on too narrow a client base and dependent for its success on unsustainable assumptions about customer uptake and contractual performance.[28]

The *Waste Management* case demonstrates that a claimant's "investment-backed expectations" will be irrelevant to a claim of indirect expropriation if they are in any respect over-optimistic or presumptuous in the face of the normal commercial risks associated with an investment. Unlike in the *TECMED* case, the expectations to which the claimant referred did not go to the very core of the investment decision and were not based on reliable and objective criteria. Furthermore, the case is illustrative of the strict requirement for the "neutralization" or "destruction" of an investment as a result of governmental acts or measures in order that an expropriation can be established. Mere breaches of contract by a governmental counterparty were insufficient to establish an expropriation, particularly in circumstances where the concessionaire "at all times had the control and use of its property."[29] In the absence of "neutralization" or "destruction" of the investment, or of its "reasonably-to-be-expected economic benefit" as per *Metalclad*, there could be no finding of indirect expropriation.

In May 2005, in the case of *CMS Gas Transmission Co. v. Argentine Republic*[30] ("*CMS*"), an ICSID tribunal reached a similar conclusion in relation to an investor's claim of expropriation under the Argentina-United States BIT. The claimant bought a minority shareholding in an Argentinean company (TGN) which operated a gas transmission network in northern Argentina. The claimant asserted that, at the time of its investment, both Argentine law and TGN's licence allowed tariffs to be calculated in dollars and then converted into pesos at the time of billing, with adjustment every six months in accordance with the U.S. Producer Price Index (PPI). However, in the face of the serious economic crisis that afflicted Argentina in the late 1990s, the government twice approached representatives of gas companies including TGN and secured their agreement to a temporary suspension of the U.S. PPI adjustment of tariffs. On each occasion, the agreement was on the basis that the suspension would not be permanent,

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[27] *Id.* para. 159.
[28] *Id.* para. 177.
[29] *Id.* para. 159.
[30] CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, May 12, 2005, *available at* <www.investmentclaims.com>.

would not set a precedent or affect the companies' rights under their licence agreements and would be compensated for by subsequent adjustments. However, shortly afterwards other organs of the Argentine state moved to obtain a court injunction freezing tariff adjustments indefinitely. Following a deepening of the country's financial crisis, the government passed an emergency law under which the peso was devalued and the right of licensees of public utilities to adjust tariffs according to the U.S. PPI was terminated, as was the calculation of tariffs in dollars. All tariffs were redenominated in pesos at the rate of one peso to one dollar.

The claimant, with reference to the *Metalclad* award, argued that the totality of the measures implemented by the Argentine state constituted an indirect expropriation of acquired rights associated with its investment in TGN. In rejecting the claimant's argument under this head, the tribunal did not comment on either of the parties' arguments as regards the various commitments and assurances that had allegedly been given by the Argentine authorities. Rather, it identified the essential question as being whether the claimant's enjoyment of its property had effectively been "neutralized" by the measures on which its claim was based.[31] The tribunal observed that the claimant retained ownership and control of its investment and TGN's management remained independent of the government.[32] As a result, there had been no expropriation of the investment.

The *CMS* case, like the *Waste Management* case, illustrates that breaches of the expectations of an investor may mean little in the context of an indirect expropriation claim in the absence of some form of accompanying "destruction" or "neutralization" of the investment. This is particularly the case where the expectations concerned relate to specific assurances or commitments made by state authorities whose breach has not led to any wholesale deprivation of the "reasonably-to-be-expected economic benefit" of the investment, such that the claimant remains vested with ownership or control over an investment of some lasting value and potential.

There is little doubt that state action leading to deprivation of the "reasonably-to-be-expected economic benefit" of an investment can constitute an indirect expropriation in modern international investment law. In particular, such deprivation, or other substantial interference with the claimant's "investment-backed expectations," will indicate that there has effectively been a "taking" of the investment, or that its essential features have been "destroyed" or "neutralized." Thus, for example, reference is made in various U.S. Free Trade Agreements to "the extent to which the government action interferes with distinct, reasonable investment-backed expectations" as a relevant factor in determining whether there has been an indirect expropriation.[33] Indeed, it is not a necessary characteristic of such "investment-backed expectations" that they are based on "specific undertakings or representations" of the host state upon which the investor has reasonably relied. Rather, they can be based on the fundamental features or assumptions of a claimant's

[31] *Id.* para. 262.
[32] *Id.* para. 263.
[33] *See e.g.*, United States-Chile Free Trade Agreement, June 6, 2003, Annex 10-D; United States-Morocco Free Trade Agreement, June 15, 2004, Annex 10-B.

realistic economic projections when entering into the investment. Thus, in *TECMED*, the expectations of the investor which contributed to the tribunal's finding of expropriation related to the anticipated recovery of the investment over the long term, which had formed the basis of the investor's decision to invest. But as *Waste Management* shows, unfulfilled business models cannot form the basis for an indirect expropriation claim if they are in any sense over-optimistic or fail to take into account the inherent commercial risks associated with an investment.

In the absence of a substantial interference with the investment, governmental assurances upon which the claimant has relied in the context of its investment will therefore carry little or no weight in the expropriation equation. However, much as a failure to realize the "legitimate expectations" created by governmental assurances can give rise to a cause of action in certain domestic public law systems, so such failures can provide the basis for a claim under international investment law that there has been a violation of the fair and equitable standard of treatment. The following section of this article attempts to identify the circumstances in which this will be the case, with reference to the extensive (but not altogether consistent) case law on the fair and equitable standard.

III. Investors' Expectations and the "Fair and Equitable" Standard

The six cases identified *supra* have confirmed the role to be played by claimants' expectations in the formulation of an argument of indirect expropriation in cases where there has been a substantial interference with the investment so as to constitute a "neutralization" or "destruction" of the investment. However, many of those same cases have also demonstrated an increasing role for claimants' expectations in the context of the fair and equitable standard. Indeed, in the *CMS* case and the very recent case of *Saluka* (discussed *infra*), the tribunals established a failure to accord fair and equitable treatment even in the absence of any finding of expropriation. The question thus arises whether such recent decisions indicate a growing tendency of investment arbitration tribunals to rely upon claimants' expectation-based arguments as giving rise to a self-standing violation of the fair and equitable standard in preference to a violation of the more fundamental and demanding expropriation standard.

One of the key recent developments in the evolutionary standard of "fair and equitable treatment" has been an increased focus on the role that claimants' expectations play in connection with their investments. Thus, for example, Thomas Wälde has stated in connection with the standard:

> it is perhaps useful to highlight what so far has been the core component of the standard in recent application and argument: the concept—widespread in constitutional, EU and administrative law of most if not all developed countries—of the protection of "legitimate, investment-backed expectations" created by proper government assurances.[34]

[34] Thomas W. Wälde, *Investment Arbitration under the Energy Charter Treaty: An Overview of Selected Key Issues based on Recent Litigation Experience*, *in* Arbitrating Foreign Investment Disputes 209 (N. Horn ed., 2004).

An examination of some of the cases, including those discussed above, demonstrates the development of this recent trend.

Thus, in the *Metalclad* case, the U.S. claimant argued that, in addition to constituting an expropriation, Mexico's conduct constituted a failure to accord fair and equitable treatment to its investment, in violation of Article 1105 of NAFTA. The tribunal agreed with the claimant, citing in this regard the various representations of the federal authorities to the effect that the claimant had all of the necessary permits to undertake the landfill project. The claimant had relied on those representations in embarking on construction of the landfill, and subsequently relied on further federal assurances that, if it submitted an application for a municipal construction permit, the permit would be issued as a matter of course. The tribunal was of the view that the claimant had been entitled to place reliance on those representations. With reference also to the lack of any "transparent and predictable framework" for the claimant's business planning and investment, the tribunal thus concluded that Mexico had failed to comply with the requirements of Article 1105.[35]

The precedent value of the *Metalclad* award in relation to Article 1105 has clearly been diminished by the subsequent finding of the Supreme Court of British Columbia that that aspect of the award was beyond the tribunal's jurisdiction under the NAFTA.[36] However, the *Metalclad* case did nevertheless highlight the fact that failures by state authorities to live up to the specific assurances given to international investors could constitute a failure to accord fair and equitable treatment. This position has been confirmed in subsequent cases under both NAFTA and applicable BITs although, the approaches taken have not always been consistent and it is only in the most recent cases that this has been done with widespread reference to the domestic public law concept of "legitimate expectations."

The following year, in the *CME* case, the tribunal concluded that the Czech Media Council's "intentional undermining" of the claimant's investment (described *supra* in the context of the finding that the claimant's investment had been expropriated) also constituted a breach of the requirement to accord fair and equitable treatment under the Netherlands-Czech Republic BIT. This breach was based upon the Media Council's "evisceration of the arrangements in reliance upon [which] the foreign investor was induced to invest."[37]

In the *TECMED* case, the tribunal similarly found a failure to accord fair and equitable treatment alongside its decision that the claimant's investment had been expropriated. In that case, the expectations contemplated by the tribunal in connection with its finding of indirect expropriation were based upon all of the circumstances of the investment and were led by the investor's commercial expectations, not governmental assurances or regulatory measures. As such, they were very similar to the "investment-backed expectations" that are considered relevant by U.S. courts when determining whether

[35] *Id.* paras. 74–100.
[36] United Mexican States v. Metalclad Corp., May 2, 2001, [2001] B.C.S.C. 664, 5 ICSID Rep. 236 (2002).
[37] *Id.* para. 611.

public entities have "taken" property in violation of the Fifth Amendment. By contrast, when it moved on to consider whether there had been a separate violation by Mexico of the "fair and equitable" provision of the treaty, the tribunal observed as follows:

> The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host state to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments…. The foreign investor also expects the host state to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the state to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments.[38]

This passage illustrates that the types of expectation that were considered by the tribunal as being central to its examination under the "fair and equitable" head (namely, the investor's expectations as regards the conduct of the host state and the proper application by the responsible state authorities of the domestic rules and regulations relevant to its investment) were quite different to those that it had considered in connection with the claimant's expropriation argument. In many respects, they came far closer to the "legitimate expectations" which can form the basis of an independent basis of claim under many systems of domestic public law.

The tribunal went on to observe that the claimant's investment vehicle (Cytrar) may have reasonably trusted that its operating permit for the industrial waste landfill would continue in force until the landfill had been relocated.[39] The responsible state agency had not expressed the existence of any irregularity or default that might jeopardise the permit's renewal or its limited extension so as to allow for relocation to take place. As a result, Cytrar was unable to make effective representations before the permit was revoked. The revocation of Cytrar's permit, and the closure of the landfill that inevitably followed, had been allowed to take place "in spite of the expectations created, and without considering ways enabling [the claimant] to neutralize or mitigate the negative economic effect of such closing by continuing with its economic and business activities at another place."[40] These factors, alongside the connected absence of any "transparency" in the responsible state agency's relations with Cytrar, led the tribunal to conclude that Mexico had failed to accord fair and equitable treatment to the claimant's investment.

In the *Waste Management* case, the claimant again accompanied its arguments of expropriation with a claim that the respondent state had failed to accord fair and equitable treatment to its investment. On the facts of the case, the tribunal rejected this claim,

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[38] *Id.* para. 154. *See also* para. 157 for a similar statement.
[39] *Id.* para. 160.
[40] *Id.* para. 164.

just as it rejected the expropriation claim. In particular, the tribunal found that the evidence before it did not support the conclusion that the City of Acapulco had acted in a wholly arbitrary manner or in a way that was grossly unfair, nor that there had been any "denial of justice" by the federal courts.[41] However, in describing in broad terms the scope of the fair and equitable standard under NAFTA Article 1105, the tribunal stated that:

> the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the state and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. *In applying this standard it is relevant that the treatment is in breach of representations made by the host state which were reasonably relied on by the claimant*. (emphasis added)[42]

Again, there is resonance here with the "legitimate expectations" which can form the basis of an independent head of claim under many systems of domestic public law. The types of expectation that were identified by the tribunal as being relevant to its analysis under the fair and equitable head were those that had been created by representations of the host state. By contrast, when dismissing the claimant's expropriation claim, the tribunal had made reference to the investor's over-optimistic commercial expectations generally when entering into the investment.

The *CMS* case confirmed this trend as regards the expectations of the investor which were considered central to the question of whether there had been a failure to accord fair and equitable treatment. Indeed, in that case the tribunal concluded that there had been such a failure notwithstanding its finding that there had been no indirect expropriation of the claimant's investment. The claimant's argument under this head was based on the allegation that Argentina's measures had "profoundly altered the stability and predictability of the investment environment."[43] Citing *TECMED*, the claimant referred to the "basic expectations" that it had taken into account when making its investment in Argentina. The tribunal held that "there can be no doubt … that a stable legal and business environment is an essential element of fair and equitable treatment."[44] Referring to *Metalclad* and *TECMED* in support of its conclusion that there had been a failure to accord fair and equitable treatment, the tribunal commented that:

> It is not 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.[45]

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[41] *Id.* paras. 115, 130.
[42] *Id.* para. 98.
[43] *Id.* para. 267.
[44] *Id.* para. 274.
[45] *Id.* para. 277 (emphasis added).

The *CMS* case is therefore further authority for the proposition that breach of expectations that have been specifically created by state acts, decisions or assurances can form the basis for a self-standing claim for failure to accord fair and equitable treatment in circumstances where the breach of expectations does not itself justify any finding of expropriation. As *TECMED* and *CMS* show, such claims are often made against the background of a particular legal or regulatory regime that the investor reasonably expects to be applied to its investment in light of communications with the host state. As such, the central role that might be played by the investor's "legitimate expectations" in a claim of failure to accord fair and equitable treatment is closely related to the separate requirement of a transparent legal environment for the investment.

One important consequence of this feature of the fair and equitable standard is that the precise level of treatment that it requires from state authorities will inevitably differ from state to state, depending upon the facts of each case. In particular, the question of whether or not there has been a violation of the standard will turn on what legitimate expectations the investor had in light of the specific assurances given by the relevant state authorities against the background of the domestic legal framework that was to govern the investment. In this respect, it might be questionable whether the fair and equitable standard now represents more than the "minimum standard of treatment" to which all international investments are entitled as a matter of customary international law. If it does, then all that can be said is that the "minimum standard" in this context prohibits all states from violating the legitimate expectations of international investors, whatever they may be in the individual circumstances of any given case. That standard cannot, by the very nature of legitimate expectations, define what those expectations might require in any given case. Thus, for example, State A might have given the investor certain specific assurances as an inducement to its investment, which State B did not give and which quite reasonably influenced the investor's decision to invest in State A. Such assurances may (or may not) have been given with explicit reference to attractive provisions of the domestic law of State A that have no equivalent under State B's domestic law. In such a scenario, the investor may have a legitimate expectation of better substantive treatment in State A than if it had invested in State B, as part of the requirement that State A accord "fair and equitable" treatment to its investment.

A more recent case where a breach of the investor's "basic expectations" was cited in support of a finding of failure to accord fair and equitable treatment was *Eureko B.V. v. Republic of Poland* ("*Eureko*"),[46] decided by an ad hoc tribunal constituted pursuant to the Netherlands-Poland BIT. The claimant argued that Poland had interfered with its investment in a minority stake in that country's leading insurance group, PZU, in violation of, inter alia, the fair and equitable treatment provisions of the treaty. That investment had been made as part of Poland's privatisation of PZU in 1999 and was effected by means of a Share Purchase Agreement (SPA) (and subsequent addenda) between the claimant and

[46] Eureko B.V. v. Republic of Poland, Partial Award, August 19, 2005, *available at* <www.investment-claims.com>.

the Polish Minister of the State Treasury. The claimant maintained that a core element of its decision to invest had been its expectation that the State Treasury would subsequently sell off the remainder of its shares in PZU by way of an Initial Public Offering (IPO), whereupon the claimant anticipated becoming majority shareholder in the group. This expectation had been reflected in the addenda to the SPA. The IPO never took place, leaving the State Treasury as the majority shareholder and in full control of PZU.

In addressing the question of whether there had thus been a failure to accord fair and equitable treatment to the claimant's investment under the treaty, the tribunal stated as follows:

> Eureko's investments, its contractual rights to an IPO, which would have led it to acquire majority control of PZU, have been, in the opinion of the Tribunal, unfairly and inequitably treated by the Council of Ministers and Minister of the State Treasury. Those organs of [Poland], consciously and overtly, *breached the basic expectations of Eureko that are at the basis of its investment in PZU and were enshrined in the SPA, and, particularly, the First Addendum*.[47]

It is unclear from this passage whether the fact that the claimant's basic expectations when making its investment were enshrined in contractual commitments was decisive to the tribunal finding that there had been a failure to accord fair and equitable treatment. It is submitted that, consistent with the approach taken in the previous cases addressed *supra*, this cannot have been the case. The violation of the fair and equitable standard in the *Eureko* case could have been based exclusively on the fact that Poland's conduct manifestly breached the claimant's basic expectations at the time of making its investment. Those expectations had been created, at least initially, by the stated objectives of the Polish authorities when they first decided to privatize PZU. The fact that they had subsequently been enshrined in the contractual instruments was important in the *Eureko* case rather because this gave rise to a completely separate violation of the "umbrella clause" of the treaty, an aspect of the partial award that is beyond the scope of this article.[48]

The *Eureko* case provided further confirmation of the relevance of investors' expectations to the fair and equitable test. However, the relative brevity and ambiguity in the tribunal's legal analysis is in many respects typical of recent awards touching upon the role of investors' expectations in investment treaty claims generally. The tribunal's analysis of the claimants' expropriation claim was also brief and certainly adds nothing to the analysis in the previous section of this article.[49]

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[47] *Id.* para. 232 (emphasis added).

[48] *See id.* paras. 244–60 for the *Eureko* tribunal's analysis of the "umbrella clause" issues.

[49] The tribunal concluded that the various culpable acts and omissions of Poland constituted "measures depriving Eureko of its investments," for the purposes of the treaty, notwithstanding the fact that the claimant continued to hold, and to receive dividends on, its minority shareholding in PZU. The tribunal commented that these measures had been "clearly discriminatory" and that such discriminatory conduct constituted a "blunt violation of the expectations of the Parties in concluding the SPA and the First Addendum." But, the tribunal's conclusion properly hinged on the fact that the claimant's contractual rights in connection with its investment had been "neutralized." The "investment-backed expectations" of the claimant were not critical to this conclusion, even if one of those expectations could properly have been described as an expectation that the claimant would, subsequent to its initial investment, have an opportunity to consolidate its control over PZU by purchasing a majority interest.

IV. Ongoing Ambiguity over the Precise Role to be Played by Investors' Expectations: *Methanex*, *Thunderbird*, and *Saluka*

Three very recent cases also purport to address the role of claimants' expectations in determining the merits of claims of expropriation and/or failure to accord fair and equitable treatment. However, despite the pre-eminence of each of the tribunals concerned and the strength of their findings on the facts before them, the legal analysis contained in those three decisions does not settle conclusively the debate over when claimants' disappointed expectations might be determinative under each head of claim. This is because the comments made by the three tribunals are in some respects unclear and, in other respects, display a marked lack of consistency of legal analysis. Each will be addressed in turn.

Methanex Corp. v. United States ("*Methanex*")[50] concerned a claim by a Canadian investor in California that Californian regulations banning the gasoline additive MTBE, of which it was an industrial producer, violated the United States' obligations under NAFTA Articles 1102 (national treatment), 1105 and 1110. On the evidence before it, the tribunal concluded that the claimant had received no specific commitments from the relevant U.S. authorities as to future regulatory action of this nature when making its investment, nor had any other "special representations" been made to the claimant. However, the present article would not be complete without a brief review of the tribunal's analysis of the legal tests that would have been applicable to the claimant's expectations-based arguments under Articles 1105 and 1110, had the claimant made out its allegations of fact.

In connection with its complaint that the Californian regulations constituted measures "tantamount to expropriation" under Article 1110, the claimant relied in part on the test applied in the *Metalclad* case. It placed particular emphasis upon an allegation that the regulations concerned had discriminated against it and in favour of the U.S. domestic ethanol industry. The tribunal commented as follows:

> In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation. But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, *inter alios*, a foreign investor or investment *is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation*.[51]

Such language, focusing as it does upon the question of whether "specific commitments" had been given to the claimant by the responsible authorities, and ignoring the question of the level of interference with the investment, is reminiscent more of a "fair and equitable" analysis than an "expropriation" one. Indeed, for reasons that it did not explain, the tribunal emphasised as part of its Article 1110 analysis the reference that had

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[50] Methanex Corp. v. United States, August 3, 2005, *available at* <www.investmentclaims.com>.
[51] *Id*. Part IV, ch. D, para. 7 (emphasis added).

been made in the *Waste Management* case to the importance of host state representations in the context of the fair and equitable standard under Article 1105. Consistent with the various other recent authorities cited in this article, it is submitted that this aspect of the *Methanex* tribunal's analysis would have been far more relevant to its analysis of the Article 1105 claim than to questions of expropriation under Article 1110.[52]

Indeed, the other authority relied upon by the tribunal in this part of its analysis of Article 1110, *Revere Copper & Brass, Inc. v. OPIC*,[53] was little more apposite to the question before the tribunal than the Article 1105 passages taken from the *Waste Management* case. After all, the *Revere* case is almost thirty years old, and related to an entirely different context, namely the meaning of "expropriation" at that time under the OPIC contract. It is true that reference was made in that case to the applicability of public international law principles to a concession contract where "actions taken by a government … are in conflict with undertakings and assurances given in good faith to [such] aliens as an inducement to their making the investment." Ultimately, however, the decision that there had been an expropriation contrary to the specific provisions of the OPIC contract in the *Revere* case did not turn upon the nature of any undertakings or assurances that had been given by the state authorities concerned. Rather, that decision turned upon the fact that the investor claimant had been "directly prevented … from exercising effective control over the use or disposition of its property." In this sense, the decision in the *Revere* case is not inconsistent with the hypothesis advanced in this article. But more importantly, the relevance of that case to the question at issue is extremely limited given the historical and legal context of the decision and, indeed, the fact that the fair and equitable standard was not even at issue in that case.

The *Methanex* tribunal's discussion of the relevance of specific governmental representations to the expropriation issue should thus be treated with extreme caution. The core of the tribunal's finding that there had been no violation of Article 1110 was its conclusion that "the California ban was made for a public purpose, was non-discriminatory and was accomplished with due process." As a result, "from the standpoint of international law, the California ban was a lawful regulation and not an expropriation."[54] Methanex had failed to show that the California ban "manifested any of the features associated with expropriation."[55] The tribunal's examination of the role to be played by allegations of specific governmental representations was *obiter dicta* and, to the extent that it was relevant, should have been addressed as part of its analysis of the "fair and equitable" complaint under Article 1105.

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[52] That this is the case was confirmed by the recent award in EnCana Corp. v. Republic of Ecuador, February 3, 2006, *available at* <www.investmentclaims.com>, where the tribunal commented (albeit *obiter dicta*) that, even if the host government had given any "specific commitment" to freeze the taxes applicable to the investment, "this would not convert a breach of contract or the denial of a legitimate expectation into expropriation." The tribunal went on to observe that, although such denial of a legitimate expectation might violate other provisions of a BIT, this was not possible in the case before it since the provisions concerned did not apply to taxation measures.

[53] Revere Copper & Brass, Inc. v. OPIC, 56 I.L.R. 258 (1980); 17 I.L.M. 1321 (1978).

[54] Methanex v. United States, August 3, 2005, Part IV, ch. D, para. 15.

[55] *Id*. Part IV, ch. D, para. 16.

However, in addressing the Article 1105 issue, none of these matters were addressed by the tribunal. This is perhaps explained by the fact that the claimant's Article 1105 complaint, although "commendably succinct,"[56] focused not on legitimate expectations-based arguments, but rather on the argument that the U.S. measures concerned "were intended to discriminate against foreign investors and their investments and that intentional discrimination is, by definition, inequitable."[57] In dismissing this argument, the tribunal concentrated its mind on the question of whether discrimination in the terms alleged (and ultimately unproven) could give rise to a violation of Article 1105. The detail of the tribunal's conclusions thus centred around the wording of Article 1105 itself (and, in particular, of Article 1105(2)) and the relevance of the NAFTA Free Trade Commission's July 2001 Note of Interpretation on Article 1105(1).

All in all, the *Methanex* award, in large part due to the facts of the case and the nature of the arguments advanced by the claimant, cannot be treated as setting out an authoritative analysis of the role to be played by claimants' disappointed expectations in the context of arguments of expropriation or failure to accord fair and equitable treatment.

In some respects, the same can be said of the most recent NAFTA case to touch on those issues: *International Thunderbird Gaming Corp. v. United Mexican States* ("*Thunderbird*").[58] The claimant in that case was engaged in the business of operating gaming facilities. In July 2000, it decided to request an official opinion from the Mexican authorities as regards the legality under Mexican law of a planned investment in Mexico. The written request (or *solicitud*), which was submitted by its legal representative in Mexico to the *Secretaria de Gobernación* (SEGOB) on August 3, 2000, described Thunderbird's planned investment as concerning "the commercial exploitation of video game machines for games of skills and ability." It went on to explain that "[i]n these games, chance and wagering or betting is not involved."

In its formal response (or *oficio*), SEGOB referred to the Federal Law of Games and Sweepstakes, which prohibited "gambling and luck related games" on Mexican territory and made provision for the regulation and authorization of gambling establishments. The *oficio* stated that, if the machines used by Thunderbird operated in the form and on the conditions stated in the *solicitud*, SEGOB would be unable to prohibit their use pursuant to Mexican law.

Thunderbird's investment subsequently opened a number of gaming facilities in Mexico. However, following a change of government, SEGOB began closing down those facilities which had been opened and issued a resolution declaring that the machines used in the investment were prohibited.

Thunderbird based a significant part of its complaint on an argument that the *oficio* had created a "legitimate expectation" that it would be able to operate its machines

[56] *Id.* Part IV, ch. C, para. 3.
[57] *Id.* Part IV, ch. C, para. 2.
[58] International Thunderbird Gaming Corp. v. United Mexican States, January 26, 2006, *available at* <www.investmentclaims.com>.

without regulation by SEGOB. Without giving any reason for its approach, the tribunal addressed the "legitimate expectation" issue in general terms in its award prior to its examination of the detail of Thunderbird's complaints under Articles 1102, 1105, and 1110. Having considered much of the case law described above, it described in perhaps the most precise terms yet the nature of the "legitimate expectations" test in the NAFTA context. It commented that:

> the concept of "legitimate expectations" relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.[59]

The tribunal concluded that the *oficio* had not generated a legitimate expectation upon which Thunderbird could reasonably rely for the purposes of this test. In doing so, it pointed out that the information presented in the *solicitud* had been incomplete and inaccurate. Furthermore, the *oficio* had done no more than convey a message to the effect that, if the machines operated in accordance with the representations made in the *solicitud*, SEGOB would not have jurisdiction over them. The tribunal was therefore of the view that Thunderbird could not have reasonably relied to its detriment on the *oficio*. Indeed, Thunderbird had known when it chose to invest in Mexico that gambling was illegal under Mexican law. As a result, it was incumbent on Thunderbird to exercise "particular caution" in pursuing its business venture in Mexico.

It was only following this general analysis of the "legitimate expectations" question that the tribunal went on to analyse each of Thunderbird's specific heads of claim. Indeed, in addressing the Articles 1105 and 1110 complaints, the tribunal did not even refer to its previous discussion about the relevance of Thunderbird's expectation-based arguments. In particular, in connection with the Article 1105 complaint, the tribunal focused its attention on a somewhat restrictive application of the customary international law minimum standard of treatment. The tribunal commented that, in order to violate that standard, an act must amount to a "gross denial of justice or manifest arbitrariness falling below acceptable international standards." The tribunal concluded that there was insufficient evidence to establish that the SEGOB proceedings had been arbitrary or unfair, let alone so manifestly arbitrary or unfair as to violate the minimum standard of treatment.

The *Thunderbird* award provides a relatively concise description of the circumstances in which the principle of legitimate expectations will apply to investment arbitrations generally under NAFTA. It also shows that, where the host state conduct giving rise to an alleged legitimate expectation has been induced by an approach to the responsible state authorities by the investor claimant, that approach must include as complete and accurate a disclosure as possible of all of the pertinent facts, particularly those that are in the exclusive knowledge of the investor. It further demonstrates that broadly termed or conditional governmental assurances will, taken in isolation, rarely be sufficient for the

[59] *Id.* para. 147.

purposes of establishing a claim. But the *Thunderbird* award provides no guidance whatsoever on the question of to which investment treaty head of claim an investor should attach its expectation-related arguments and under what circumstances. In particular, the majority of the tribunal failed to make any association between the principle of legitimate expectations and the fair and equitable standard as contained in NAFTA Article 1105.

In this respect, the separate opinion of the partially dissenting arbitrator, Professor Thomas Wälde, is significantly clearer and more helpful than the award itself. He approached the legitimate expectations principle as forming a central part of the fair and equitable test under Article 1105. Neatly summarizing the development that can be traced through the case law described *supra*, he stated that:

> One can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the "fair and equitable standard" as under Art. 1105 of the NAFTA.[60]

The most recent investment award of all, *Saluka Investments B.V. v. Czech Republic* ("*Saluka*"),[61] takes yet another approach to the role of the legitimate expectations principle in applying the fair and equitable standard. The case arose out of the privatization of the Czech banking system following the end of communist rule in Czechoslovakia in 1990 and the subsequent establishment of the Czech Republic. The claimant's parent, Nomura, agreed terms with the Czech Republic for acquisition of a substantial shareholding in a large state-owned commercial bank (IPB). Nomura subsequently transferred its shares to the claimant, a special-purpose Dutch subsidiary. Shortly afterward, the Czech government passed a number of measures that were designed primarily to assist three banks (including CSOB) in which the state retained a major shareholding. IPB was not given any such assistance since it was by then regarded as a privatized institution "whose fate was a matter for its private shareholders."

By early 2000, IPB was in serious financial difficulties. There followed several months of negotiations between Nomura and the Czech authorities by which Nomura hoped to secure a rescue package for IPB. While these negotiations were ongoing, the Czech authorities conducted separate talks with CSOB about the possibility of CSOB taking control of IPB. As a result of the ongoing difficulties of IPB and failure to agree to any rescue package, the Czech Securities Commission suspended trading in IPB shares and the Czech government placed IPB into forced administration in June 2000. The Czech National Bank subsequently approved the sale of IPB's enterprise to CSOB, following which CSOB became the beneficiary of further Czech state assistance. In early 2004, IPB was declared bankrupt and CSOB was registered as the new owner of Saluka's IPB shares.

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[60] *Id*. para. 37 of the separate opinion.

[61] Saluka Investments B.V. v. Czech Republic, Partial Award, March 17, 2006, *available at* <www.pca-cpa.org>.

Saluka claimed violations of both the expropriation and "fair and equitable treatment" provisions of the Netherlands-Czech Republic BIT. Under the expropriation head, Saluka does not appear to have made any argument based on breach of its (or Nomura's) "investment-backed expectations." The tribunal concluded that there had been no expropriation on the facts of the case since the various measures at issue could be "justified as permissible regulatory actions."[62] In particular, the tribunal found that the Czech National Bank, as the responsible banking regulator, had exercised its powers in a way that was reasonable in the circumstances in pursuit of the general interests of the state.

The tribunal then proceeded to find that there had been a violation of the fair and equitable standard under the treaty. In so doing, the tribunal distinguished between the "customary minimum standard of treatment," in relation to which adverse treatment must attain a relatively high threshold in order for a violation to be established, and the "lower degree of inappropriateness" required under the "fair and equitable treatment standard under modern bilateral investment treaties."[63] It noted, in particular, the omission of any reference to the customary minimum standard in the fair and equitable provision of the treaty at issue (in contrast to NAFTA Article 1105).

The tribunal commented that:

> An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host state subsequent to the investment will be fair and equitable.
>
> The standard of "fair and equitable treatment" is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard. By virtue of the "fair and equitable treatment" standard included in [the treaty] the Czech Republic must therefore be regarded as having assumed an obligation to treat foreign investors so as to avoid the frustration of investors' legitimate and reasonable expectations.[64]

The tribunal commented further that:

> The Czech Republic, without undermining its legitimate right to take measures for the protection of the public interest, has therefore assumed an obligation to treat a foreign investor's investment in a way that does not frustrate the investor's underlying legitimate and reasonable expectations. A foreign investor whose interests are protected under the Treaty is entitled to expect that the Czech Republic will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (i.e., unrelated to some rational policy), or discriminatory (i.e., based upon unjustifiable distinctions).[65]

However, the tribunal's ultimate finding of violation of the fair and equitable standard was not based on any disappointment of specific representations or assurances that had been given by the Czech state. Rather, the violations were based on the Czech Republic's discriminatory treatment of Saluka's investment in IPB; unreasonable frustration of what were effectively the claimant's good faith efforts to resolve the IPB crisis;

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[62] *Id.* para. 265 et seq.
[63] *Id.* paras. 292, 293.
[64] *Id.* paras. 301, 302 (footnotes omitted).
[65] *Id.* para. 309.

failure to deal with the claimant's proposals in an unbiased, even-handed, transparent, and consistent way; and unreasonable refusal to communicate with IPB and Saluka/Nomura in an adequate manner. Summarizing its approach under the fair and equitable head, the tribunal emphasized that "the host state, in providing state aid, is clearly bound not to frustrate an investor's legitimate and reasonable expectation to be treated fairly and equitably."[66]

The *Saluka* award confirms the central role to be played by the principle of legitimate expectations in the context of claims based on the fair and equitable standard under modern BITs. However, the tribunal's analysis goes significantly further than the previous awards cited in this article in describing the legitimate expectations principle as the "dominant element" of the fair and equitable standard. This is a very different approach to that of viewing the principle as a self-standing subcategory and independent basis of claim under the fair and equitable standard, in the way described by Professor Wälde in the *Thunderbird* case.

In this sense, the *Saluka* award "puts the cart before the horse" in relation to the relevance of the legitimate expectations principle to the fair and equitable standard. To indicate that the principle will be of dominant importance even in the absence of any specific assurance or other representation by the host government is to go too far. Not only does such an approach extend far beyond any previous authority on the relevance of legitimate expectations to the fair and equitable standard, it also runs counter to the domestic public law origins of the legitimate expectations principle.

The issues that were central to the *Saluka* tribunal's finding of violation of the fair and equitable standard, such as discriminatory treatment, bias and lack of transparency, sit at the heart of that standard *alongside* the principle of legitimate expectations. But to say that the claimant had some kind of inherent legitimate expectation that it would not be treated in a discriminatory way, or that the Czech authorities would negotiate with it in good faith to resolve the bank crisis, is to over-extend the proper reach of the legitimate expectations principle. The proper role to be played by that principle is as an element of the requirement to act "fairly" as part of the fair and equitable standard.

What is more, the principle of legitimate expectations must be as relevant to the fair and equitable standard under Article 1105 of the NAFTA as it is to the fair and equitable standard under most BITs. In this sense, the majority in *Thunderbird* erred in failing to include their discussion of the principle as part of their Article 1105 analysis, instead relying upon a restrictive approach to the scope of the customary international law minimum standard of treatment as required under that provision. Similarly, the *Saluka* tribunal erred in highlighting the absence of any reference to the customary minimum standard in the treaty at issue in that case as a basis for its conclusion that the legitimate expectations principle was the "dominant element" of the fair and equitable standard as it applied under that treaty. As previous NAFTA cases like *Waste Management* demonstrate, host state representations that are reasonably relied upon by foreign investors can (and should) be as relevant to the fair and equitable standard under Article 1105 of the NAFTA as they

[66] *Id.* para. 446.

are to that standard as it is applied under other investment treaties. The alternative would be a widely divergent approach to the fair and equitable standard as it applies under each treaty regime such that, while legitimate expectations would play a central role in the fair and equitable analysis under the majority of modern BITs, it would play no role whatsoever under Article 1105 of the NAFTA. Just as the fair and equitable standard *simpliciter* has evolved over recent years so as to embrace a central role for the legitimate expectations principle, so that standard should be allowed to evolve in the NAFTA context, where it forms an important element of the evolutionary customary international law minimum standard.

V. Conclusion: Failure to Meet Investor Expectations as a Discrete Cause of Action in International Investment Law

The cases highlighted in this article demonstrate the differing analysis that most recent arbitral tribunals have employed as regards investors' expectations when determining investment treaty claims alleging expropriation and failure to accord fair and equitable treatment. In some respects, this analysis is reflective of a broader trend of many investment tribunals to resist findings of expropriation, whether direct or indirect, save in the most extreme circumstances where state action has caused a "neutralization" of the investment such that its economic value has effectively been destroyed. Over the same period, the concept of fair and equitable treatment appears to have taken on a life of its own such that it now encompasses a broad range of mistreatment, or failure to accord due process, without requiring the high threshold of interference that is attendant upon any expropriation claim. In many cases, therefore, it will be possible to establish a failure to accord fair and equitable treatment in circumstances where there has been no expropriation, or measure having equivalent effect.

One central feature of the broadening of the fair and equitable standard as applied by many modern investment tribunals has been the increased role played by investors' legitimate expectations, as induced by specific state acts, decisions or assurances that are fundamental to the investor's decision to invest. Associated with this development has been the now universally accepted inclusion of the requirement of "transparency" as part of the fair and equitable standard. These developments have, in the author's view, meant that the breadth of the fair and equitable standard today stands in sharp contrast with the "international minimum standard" as it stood in the early twentieth century. They demonstrate the continued evolutionary nature of the fair and equitable standard, and of the customary international law minimum standard of which it forms part, and the need that it should adapt to the international community's contemporary perceptions as to the level of treatment that should be accorded by host states to foreign investors.

None of this is to say that the fundamental expectations of an investor no longer play any role in the context of an expropriation claim. Indeed, the reasonable "investment-backed expectations" of an investor remain central to the expropriation equation and to the question of the proportionality of state measures that lead to the neutralization of an

investment. This is reflected also by the modern treaty practice of certain states. In any case where there has been a wholesale deprivation by a state of the "reasonably-to-be-expected economic benefit" of an investment, a finding of expropriation, or measures equivalent thereto, will most likely follow. But this is simply another way of determining whether the required threshold of interference has been met in order to establish a finding of expropriation. Where the required threshold has not been met, there can be no finding of expropriation purely on the basis of a violation of the investor's expectations, whether or not those expectations can be said to have been "legitimate." To suggest otherwise would be to confuse the circumstances in which claims will lie under the expropriation and fair and equitable provisions of modern investment treaties.

Thus, wherever an investor's reasonable expectations have been disappointed, but there is doubt as to whether the expropriation threshold has been met, the most sensible application of the recent case law indicates as follows: provided that the investor's expectations have been induced by a host government's specific assurances in relation to an investment, and the investor has suffered damage as a result of its reliance on such assurances, the investor will be best advised to construct its investment treaty complaint around a self-standing claim of violation of the fair and equitable standard.